

Consumer Packaged Goods



Designing a winning consumer goods organization

February 2012

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Designing a winning consumer goods organization

Introduction

Following several decades of successful global expansion, many consumer packaged goods (CPG) companies now manage a wide array of products, brands, categories, and channels, and serve diverse customer segments in multiple countries worldwide. It is no surprise, therefore, that their organizational structures tend to be more complex than those of companies in other industries, which leads CPG executives to invest considerable time and effort in improving their organizations' effectiveness and efficiency.

As their brand portfolios, product types, and geographic footprints have evolved, companies have tried to adjust their organizational design accordingly, grappling with questions such as: how can we set up our marketing and sales functions to best drive growth? Do we have the right global R&D footprint? How should we think about staffing in emerging markets? In addition, economic uncertainty and consumers' propensity to "trade down" have increased cost pressures on CPG companies, making organizational efficiency even more important and forcing CPG executives to ponder perennial questions with greater urgency: in what parts of our organization can we drive out costs without jeopardizing growth? What kinds of efficiencies can we expect to gain by increasing our scale?

Some companies have experimented with design choices by making small structural changes to their organizations; others have undertaken major restructuring programs. In our experience, these efforts often drive short-term improvements but fail to build capabilities to accelerate growth or sustain cost reductions in the long run. We

found, for example, that fewer than half of the top 30 CPG organizations managed to reduce SG&A by more than one percentage point over the ten-year period between 1997 and 2007. Certainly, organizational design decisions are not simple to make: there is no single blueprint that guarantees sustained success, and a company's organizational design should support its specific strategy. But are certain organizational design choices "right," regardless of a company's strategy?

To arrive at a fact-based answer, we analyzed the organizational design and performance of more than 40 of the world's largest CPG organizations (see sidebar, "Our research methodology," page 2). We found that there are indeed a set of organizational design choices that correlate with strong performance in top-line and market share growth as well as costs, regardless of a company's strategic goals, size, CPG subsector (for example, food versus nonfood), or logistical setup (direct-to-store delivery or warehouse). Furthermore, our analysis shows that in many cases the performance difference is substantial.

In this paper, we share the highlights of our research findings and elucidate them by drawing on our extensive experience working with CPG companies worldwide. Specifically, we call attention to six organizational design choices relating to scale; degrees of centralization and specialization in marketing, sales, and back-office functions; location of R&D resources; and investment in emerging markets. We believe these insights can help CPG companies evaluate their current organization design, examine how if at all it diverges from best practice, and determine whether their business strategies truly require different design choices.

Our research methodology

A team of McKinsey practitioners and researchers conducted a quantitative analysis of the organizational structure of more than 40 companies, including two-thirds of the world's 50 largest CPG companies (as measured by revenues)—specifically, how they allocate employees across their organizations. The companies we studied were from a diverse cross-section of the CPG industry including food and beverage (F&B), home and personal care (HPC), beauty, and over-the-counter drugs.

Our analysis covered only white-collar employees—office-based workers who perform managerial or support activities—and excluded direct labor (such as manufacturing line operators, delivery truck drivers, or warehouse workers) as well as employees in parts of the business that are not typical of a CPG company (such as retail activities). We took a three-step approach:

- a) We tabulated the number of full-time equivalents (FTEs) globally in each of the main business functions, using a standardized taxonomy of 12 functions: sales, marketing, supply chain, research and development (R&D), finance, IT, HR, corporate affairs, legal, strategy, general management, and administrative. We further mapped FTEs to approximately 60 subfunctions, which helped us understand the degree of specialization in each function. The subfunctions in marketing, for example, are brand/category management, promotions, consumer insights, marketing services, and new product commercialization. FTEs in brand/category management are generalists, while FTEs in the other four subfunctions are specialists. We mapped employees to functions and subfunctions based on the activities they perform, rather than the company's reporting structure.
- b) For each function, we then analyzed the degree of centralization by tabulating the number of FTEs at the company's headquarters, in each regional business unit, and in each country.
- c) Finally, we analyzed the number of FTEs in each function in developed markets (North America and Western Europe) as well as in emerging markets, with a focus on Brazil, Russia, India, and China (the "BRIC" countries).

Our next step was to define effectiveness and efficiency metrics for each function. The primary role of the marketing function, for example, is to drive revenues faster than the competition, and therefore the best measure of its effectiveness is revenue growth (adjusted for mergers, acquisitions, and divestitures) exceeding the growth of the categories in which the company plays. To gauge efficiency, we used a metric of revenue per marketing FTE. The role of the R&D function, on the other hand, is to drive growth through the introduction of new products—so our metric for R&D effectiveness was the percent of incremental growth generated by new products; we expressed R&D efficiency in terms of revenue per R&D FTE. (We normalized our efficiency metrics to take into account differences in company size and the degree of operational complexity among companies—for example, the number of countries in which a company has a presence or the number of plants it owns.)

By looking at the companies that scored highest on the effectiveness and efficiency metrics in each function, we identified certain organization design choices that correlate with high performance.

Six winning moves

Our research uncovered six key insights—some intuitive, others less so—about the organizational design choices of high-performing CPG companies. Of these six, four are linked by a similar idea: scale, centralization, and specialization are neither always beneficial nor always detrimental, and companies must make thoughtful decisions about each of these. Scale, for instance, is an advantage but only up to a certain point. Having locally deployed resources is a common trait among fast-growing and nimble marketing and sales organizations, but among most back-office functions the opposite is true. Getting to the right level of specialization—that is, the optimal proportion of staff in specialist roles as opposed to generalist roles—is challenging, because the right balance depends on the nature of the tasks that specialists perform in each function. In general, we found that centers of excellence, when established within subfunctions of sufficient scale, can help drive performance.

Organizational design is only one contributor to business performance, so making the following six choices will not guarantee strong growth and high efficiency. That said, the

data show that on average these represent the right moves for CPG companies.

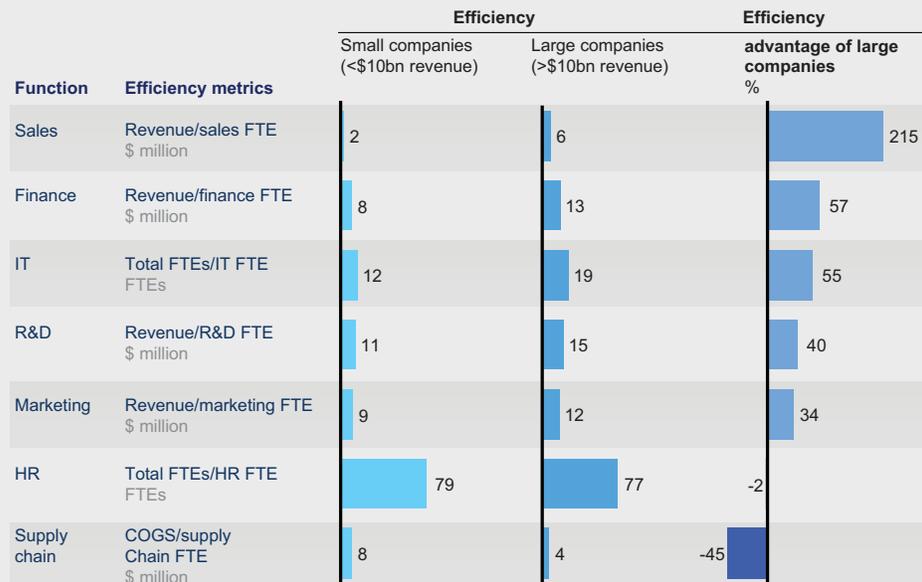
1. Build scale but manage complexity

Not surprisingly, we found that the bigger global companies—those with annual revenues of \$10 billion or more and operating in at least two regions of the world—enjoy significant economies of scale. In the sales, finance, IT, R&D, and marketing functions, large companies are at least 34 percent more efficient than their smaller competitors (Exhibit 1). What is more surprising is that there appears to be a tipping point—both in terms of revenues (\$20 billion) and number of countries (approximately 50)—at which the scale advantage tapers off, most likely offset by increasing complexity and greater need for interaction and coordination among the various parts of the organization.

Our experience has shown that to manage complexity and avoid these diminishing returns, large CPG companies must be vigilant about not allowing bureaucracy and inefficiency to creep in. They must set forth clear ways of working, including defining how and when different groups should interact with one another and how to resolve conflict. They

Exhibit 1

Large global companies achieve economies of scale across nearly all functions.



must establish well-defined roles and responsibilities, explicitly identifying where handoffs should occur with regard to decision making. In analyzing the interactions involved in making certain critical decisions at large CPG companies, we typically find that only about 50 percent of the interactions are perceived to truly add value. Of the remaining interactions, about half are necessary for internal alignment, while the other half are wasted time. By redesigning the decision-making processes—cutting out unnecessary participants, eliminating unproductive steps, and clarifying the basis for making various decisions—companies are typically able to reduce by 20 to 30 percent the number of FTEs involved in making these decisions, thereby increasing overall organizational efficiency.

Another finding is that larger companies allocate a higher fraction of their head count (32 percent of total FTEs) to back-office functions—finance, HR, IT, legal, corporate affairs—than smaller companies do (23 percent). This supports our belief that large CPG companies still have substantial opportunities to reduce head count in back-office functions. We discuss back-office functions in greater detail later in this paper.

2. Deploy marketing resources close to consumers and complement with centers of excellence at scale

Our previous research showed that a high degree of centralized decision making can be the right option for a CPG marketing organization if four criteria are met: consumer preferences for its products are similar around the world (as is true for certain personal-care products), it plays in categories in which economies of scale create significant value, its brand portfolio is truly global, and it has a top-down decision-making culture.¹ In our recent research, we specifically studied the location of marketing resources and found that fast-growing companies have

more of their resources located closer to the consumer, with nearly 90 percent of their marketing personnel deployed at the local level (in country offices as opposed to regional offices or corporate headquarters). These companies on average outperform the market² by an additional 2.2 percentage points compared to companies with less locally oriented models (Exhibit 2).³ A locally oriented marketing organization, after all, can stay close to consumers and respond quickly to their changing needs and preferences. It is important to note that our research focused not on where decisions are made, but rather on the location of resources and its impact on performance. We have seen companies make decisions at regional or global levels while deploying most of their resources locally.

In our sample, marketing organizations with a high percentage of locally deployed resources are also more efficient: on average, they generate 34 percent more revenue per marketing FTE than companies in which marketing resources are more concentrated at regional or corporate levels, and can therefore keep head count lower. Head count buildup occurs when companies create centralized marketing roles without also removing duplicative resources at the local level. In effect, these companies are merely adding cost at the regional and corporate levels. The key is to strike the right balance between centers of excellence—which can be beneficial in subfunctions of a certain size—and locally deployed marketing resources.

Another attribute of high-performing marketing organizations in our sample is a heavier reliance on brand/category managers rather than specialists (for example, marketers with specialized expertise in promotions or consumer insights). On average, companies in which brand/category managers account for majority of the marketing staff are both more efficient and more effective than companies with a higher portion of specialists.

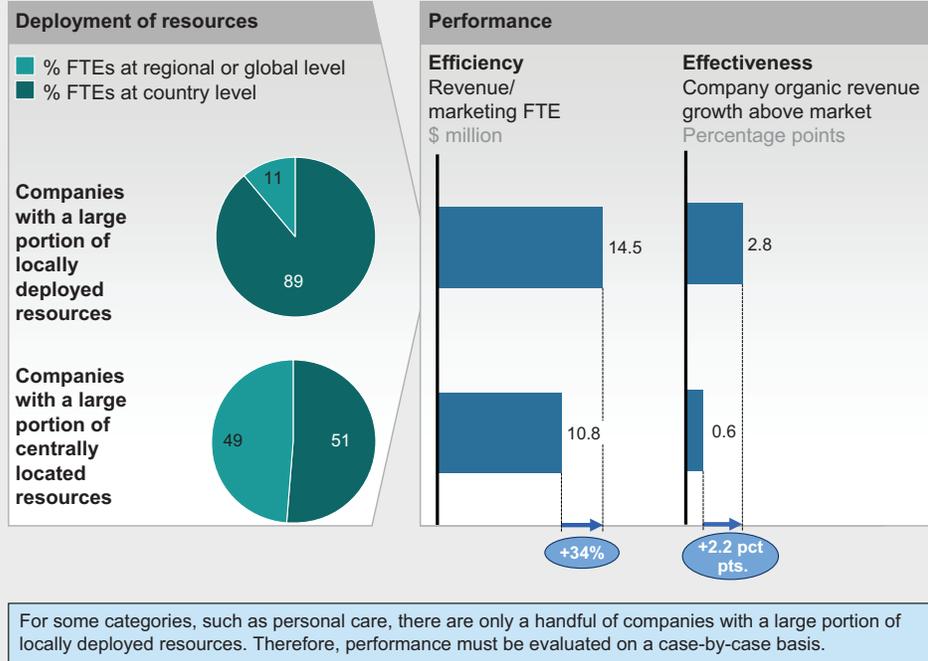
1 Stacey Haas, Carl-Martin Lindahl, Elizabeth Mihas, and Cédric Moret, “Organizing CPG Marketing for Growth: Beyond the Global v. Local Debate,” November 2008.

2 As noted in the sidebar explaining our research methodology, we measured the organic revenue growth (that is, excluding acquisitions) of the companies in our sample against their “market.” Our definition of “market” is the combination of categories that a company competes in, weighted based on each category’s contribution to company revenue.

3 This finding holds true for both food/beverage and home/personal-care companies, but our sample did not allow for analysis of companies that play exclusively in the personal-care category.

Exhibit 2

A marketing function with a large portion of locally deployed resources drives higher performance.



Specialization is an attractive proposition because it holds the promise of deep expertise that can be leveraged across brand and category teams. Moreover, hiring specialized marketing talent is often less expensive than hiring brand/category managers, and some companies seek to shift tasks from traditional brand- or category-management positions to lower-cost specialized support positions. But too high a degree of specialization in marketing can disperse expertise and, in turn, decision-making authority. Decision making becomes slow and complex, hindering the marketing function from being nimble and responsive, and ultimately limiting its ability to drive growth. Here again, balance is key: by selectively creating centers of excellence in marketing subfunctions with sufficient critical mass, companies can overcome the drawbacks of specialization.

3. Strengthen the local sales staff with specialized support

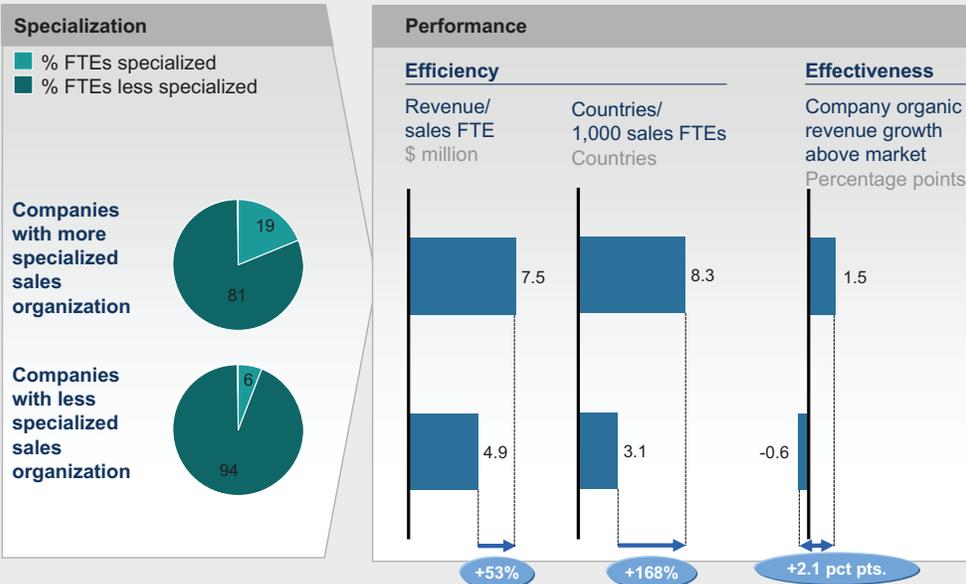
Like a successful marketing organization, a successful sales organization relies on skilled staff at the local level who are close to their customers and can execute quickly. Companies in our sample with locally oriented sales organizations (in

which more than 75 percent of sales personnel are local) outperform the categories they play in at a higher rate than companies with more centrally located sales resources—by an average of 0.2 percentage points. They are also more efficient, as their revenue per FTE is an eye-opening 61 percent higher than companies with more centrally located sales resources. These findings suggest that only minimal centralized sales staff is needed (for example, to coordinate global key accounts or define a global channel strategy); anything more is simply adding duplicative resources and increasing unnecessary complexity.

Whereas a high degree of specialization is a disadvantage in marketing, some degree of specialization appears to enhance the performance of a sales organization. On average, specialized sales personnel (typically employees responsible for sales analysis, planning, or support) comprise only 12 percent of a CPG company’s sales staff—a much lower percentage than in other functions. But companies in the sample with an above-average amount of specialist sales resources outperformed their categories by an average of 2.1 percentage points more than those with less specialized resources. These companies were

Exhibit 3

A higher degree of sales specialization is linked to higher performance.



also significantly more efficient, logging an impressive 53 percent advantage in revenue per sales FTE (Exhibit 3). This advantage is likely due to the fact that specialized sales roles are primarily administrative and analytical; their work affords the head of sales much higher visibility into the customer-facing activities of key account managers and field salespeople. The head of sales can use this information to optimize the productivity of the sales staff.

4. Shift R&D resources to low-cost countries

In the past few years, a number of leading CPG companies have chosen to open new R&D centers in low-cost countries with large talent pools, rather than locating them in North America or Western Europe. Our research shows that such moves can, on average, make a difference of 6 percent to 8 percent in total R&D labor costs (Exhibit 4). To date, the CPG industry has lagged behind other sectors in tapping R&D talent in low-cost countries. For instance, 18 of the 20 largest pharmaceutical companies worldwide have at least one R&D center in the Asia-Pacific region, compared with only 12 of the top 20 CPG companies.

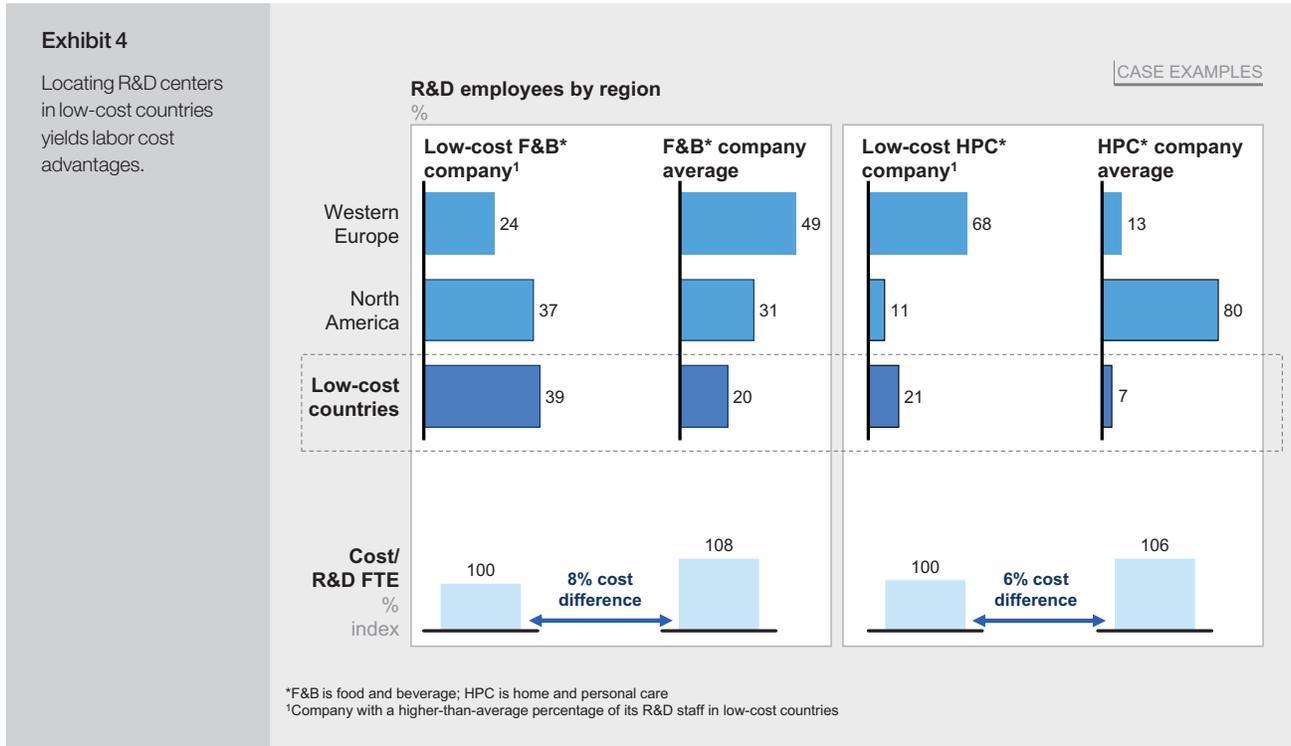
Some CPG executives are adamant that R&D resources should always be close to core markets, in particular for

categories such as food, in which consumer preferences differ substantially across geographies. But we have found that a more balanced approach—one that distributes R&D facilities across developed and emerging markets—can yield a significant cost difference without reducing effectiveness (measured as percent of incremental growth from new products). The cost savings can then be reinvested in additional R&D activities.

China, Russia, and India are high-potential locations given that they have huge numbers of college graduates with technical degrees. Some CPG companies have resisted establishing R&D centers in these countries because of skepticism about the type and quality of academic degrees awarded by the local universities. We have observed, however, that some companies have achieved success by matching the skills they need with the type of talent available in low-cost countries.

5. In emerging markets, focus on mix of skills—not staff size

Over the next 15 years, 55 percent of the world's GDP growth and 95 percent of global population growth are expected to come from emerging markets in Asia, Africa, Latin America,



and Eastern Europe. It is therefore critical that CPG companies develop optimal organizations in these regions. Looking at CPG companies over the past decade, we have found no link between the number of FTEs in an emerging market and a company's growth rate in that market. The same holds true when we look at the BRIC countries in particular. Some companies in our sample have managed to outperform the competition with very limited staff on the ground; conversely, others have set up large operations but failed to expand their market share.

In our experience, growth in emerging markets is primarily driven by the ability to understand consumers, capitalize on underdeveloped categories, and drive distribution. This dynamic is very different from developed markets, where growth is usually linked to the ability to continuously innovate to reach new consumers or customer segments and create new occasions or uses. Accordingly, to win in emerging markets, we believe CPG companies must tailor their mix of skills to the particular dynamics of those markets. We have too often seen US and European CPG companies set up organizations in emerging markets that mirror the mix of skills in their home markets, with disappointing growth as a result.

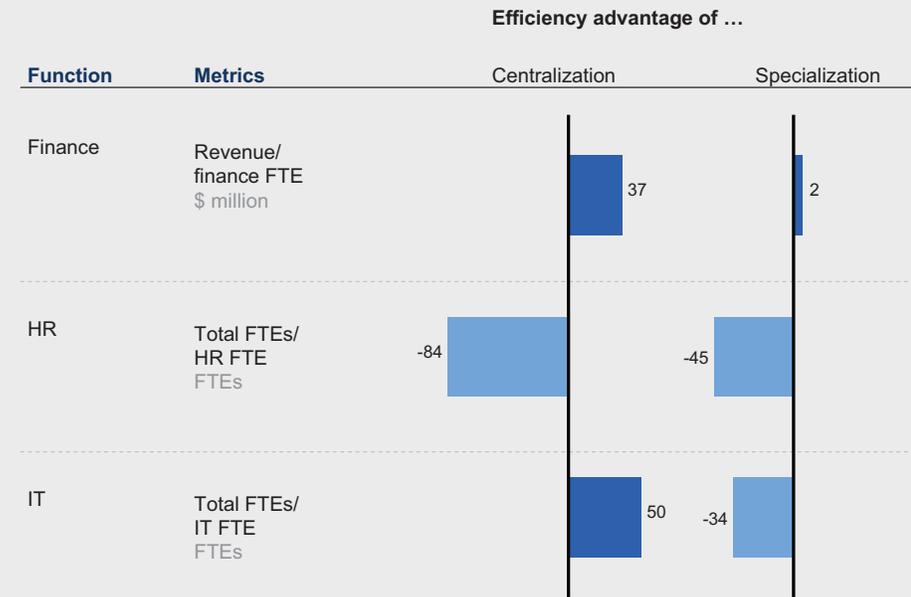
6. Relentlessly drive out back-office costs

We found large disparities in the degree of centralization in the back office, both across functions and across companies. We believe that in almost every CPG company, there is still potential to drive out back-office costs. The key to back-office efficiency from an organizational design standpoint, according to our research, seems to be centralization without overspecialization.

Companies that have centralized most of their back-office functions are the leanest. On average, centralized staff in global CPG companies account for 79 percent of total staff in IT, 64 percent in finance, and 44 percent in HR. Companies in our sample that have pushed back-office centralization even further, whether through establishing shared-services units or outsourcing certain activities, have an efficiency advantage of 37 percent in finance and 50 percent in IT (Exhibit 5). In HR, however, a higher degree of decentralization is advantageous, as many aspects of HR require face-to-face interaction, and local staff can be more responsive to the unique needs of current and prospective employees in each office or region. Furthermore, few companies have invested in a real-time global IT platform for HR, making it difficult for centralized HR staff to access

Exhibit 5

Back-office centralization is generally more efficient, but companies still need to find the right level of specialization.



local data. That said, centralization is the best option for some of the more transactional HR subfunctions and activities, such as payroll or employee benefits.

Similarly, there is a “sweet spot” of specialization within each function. For instance, companies with a more specialized HR function (in which, on average, 49 percent of HR staff are specialists) are less efficient—that is, they have a larger HR staff for the same number of total FTEs—than generalist-heavy HR functions (in which specialists account for 29 percent of HR staff on average). It appears that specialization in HR, just like specialization in marketing, disperses expertise, slows down decision making, and creates inefficiencies. The same is true in IT: the most highly specialized IT organizations, in which generalists make up only 4 percent of IT staff, are 34 percent less efficient than IT organizations with a higher proportion of generalists.

One way to arrive at the right balance between specialists and generalists is to take a structured approach to “leaning out” back-office processes—that is, eliminating activities and handoffs that add no value. If conducted correctly, such an exercise can help a company define the best mix of roles to support a given business. We have found that, at many

companies, back-office processes have become increasingly complex over time and have never been reevaluated.

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As we have seen firsthand in many diverse client situations, organizational design has a substantial impact on a CPG company’s ability to drive revenue growth, increase market share, and minimize costs. And our research has shown that companies need to take systematic, fact-based approaches when making decisions about scale, levels of centralization and specialization, and investment in emerging markets. Broad-brush approaches (for example, “centralize the entire back office” or “always keep R&D close to core markets”) will bring suboptimal results. Furthermore, our research revealed that even the best-performing companies do not consistently apply organizational best practices; each of the companies we studied has opportunities to organize more effectively and efficiently. As CPG players adjust to new consumer demands, navigate the evolving retail landscape, and identify new areas of growth, the organizational design principles we describe here will help them deliver results and develop a sustainable competitive advantage regardless of their strategy.

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