

Agriculture Practice

What's ahead for the dairy industry

Three trends are shaping the dairy industry and will have near-term implications. To prepare, US dairy leaders should pursue a mix of company- and industry-level actions.

by Christina Adams, Isabella Maluf, Ludovic Meilhac, and Roberto Uchoa



© sara_winter/Getty Images

COVID-19 has had an impact on nearly every aspect of day-to-day life, and the dairy industry is no exception. Where and how consumers shop, eat, work, and live has shifted amid an acceleration of technology adoption among companies and consumers. For example, a 2020 McKinsey survey found that, compared with prepandemic levels, there was a 163 percent increase in US dairy consumers who report shopping for dairy “mostly online.”

The past year has challenged the dairy industry in several ways, including the rapid switch in demand from food service to retail. But the industry has proven its resilience and ability to meet consumer needs. Nonetheless, to succeed in the next three to five years, dairy executives must revisit their approaches to critical, evolving trends in consumer behavior, digital and analytics, and supply-chain management.

In this article, we will look more closely at these trends as well as what steps companies can take to prepare for the next three to five years at the industry and enterprise levels. We base our insights and recommendations on an October 2020 proprietary survey of US dairy consumers, market observations, and findings from a 2020 McKinsey dairy executive survey of more than 50 industry leaders, augmented by in-depth interviews.

The current state of dairy

As dairy leaders plan their strategic approach over the near term, they should keep in mind three critical market-shaping trends.

Changing consumer behavior and a need for better consumer insights

The pandemic has had a profound impact on consumer behavior. For example, 33 percent of consumers said they experimented with new brands more often during the pandemic, and 20 percent of consumers reported “trying new things” as a top priority. There has also been a greater focus on value, likely because of financial concerns among US consumers: 32 percent of consumers reported

purchasing dairy because of price promotions during the pandemic.

Pursuit of health and wellness continues to be on consumers’ minds; 42 percent of consumers that purchased more dairy alternatives during the pandemic than before did so based on perceived health benefits, a 14 percent increase from 37 percent in 2019. Similarly, an eye toward sustainability as a reason to purchase products increased significantly, with dairy consumers focused on both carbon emissions and packaging.

While e-commerce adoption, unsurprisingly, skews younger, many older consumers also readily adopted online shopping during COVID-19. Millennials and Generation Z account for about 60 percent of net new users, while Gen Xers and baby boomers account for 23 and 17 percent of growth, respectively. E-commerce adoption appears more popular among high earners (dairy consumers with incomes of more than \$100,000 a year), who report nearly double the tendency to purchase online compared with lower-income shoppers. Consumers with salaries of more than \$150,000 a year prefer buying dairy online over purchasing it in-store. The most common reasons for opting to buy online were saving time and safety and hygiene.

Even amid this growth in e-commerce, about 60 percent of consumers surveyed report that they continue to purchase dairy “mostly in-store.” While the online channel is certainly growing, in-store remains the most popular place for dairy purchases.¹

Executives’ overall confidence in the consumer insights their marketers are generating is declining, even as the industry attempts to address sustainability, convenience, and health trends. In 2020, about 28 percent of executives reported that their company had a high level of confidence in the level of insight into consumer trends and behavior, compared with 43 percent in 2019. This decline in executives’ confidence may be the result of the speed of shifting consumer preferences, likely conflated by the impacts of COVID-19.

¹ *America gets cooking: The impact of COVID-19 on Americans’ food habits—Food Study 2020*, Hunter, April 2020, hunterpr.com; Christina Adams, Ludovic Meilhac, Emmy Moore, and Roberto Uchoa, “Disruption in the dairy aisle,” March 26, 2020, McKinsey.com; Nielsen: YOY March–October fiscal years 2019/2020.

Investing in digital and analytics capabilities

Executives are looking to digital and analytics as tools to address consumer-facing and operational opportunities. Thirty percent of surveyed US dairy executives, for instance, say they are using predictive analytics for better forecasting and planning; one-third of those are using technologies that target an end-to-end value chain for better visibility, planning, and control; and two-thirds are using robotics and automation for plant efficiencies. In the next one to two years, 80 percent of executives report plans to deploy new digital and analytics.

While recognizing the importance of these tools, executives lack confidence in their digital and analytics capabilities today. Only 2 percent of surveyed executives report “very strong” digital and analytics capabilities, and only 16 percent say they have a large data collection and optimal use or insight generation. For most dairy executives, the challenge lies in extracting meaningful insights from the data collected. This problem is not unique to dairy; it persists across many industries, such as healthcare, where automation and digital engagement support the collection of large amounts of data without providing beneficial ways to integrate, interpret, and act on it.

Improving response to supply-chain disruption

At the outset of the pandemic, one-third of dairy processors (who were mostly set up for food service) were operating at reduced capacity; about 40 percent rationalized their portfolios to meet demand for core dairy products such as milk and butter. While suppliers mobilized to address the sharp drop in food service and spike in retail demand, consumers faced empty shelves, including in the dairy aisle, due to supply-chain disruptions. A period of mismatch saw rising dairy sales (50 percent increase in March 2020) alongside dairy stockouts—in May, 14 percent of consumers reported not being able to find their dairy item.

Despite a rocky start, the dairy industry performed well during the pandemic. During the first three months of the pandemic, 73 percent of executives shifted their companies' manufacturing from food service to retail to some degree. This change also affected the margin performance of dairy companies. According to McKinsey's 2020 survey,

72 percent of respondents reported neutral to positive margin performance from March to November. This performance is attributed to three factors: retail sales surging amid stay-at-home orders; margins growing for those able to shift production from food service to retail, given retail's higher margins; and margins further benefiting from simplification and reduced SKUs.

In fact, most surveyed executives expect positive growth in the next three to five years, with about 40 percent expecting more than 5 percent growth per year. This optimism is likely rooted in dairy making a strong comeback in 2020 after several years of slow growth. Growth of fluid-milk sales, for example, had declined by an average of 1.7 percent per year from 2016 to 2019; in 2020, sales reached positive growth of 0.4 percent (exhibit).

Although dairy companies successfully shifted their channel mix and offerings in response to pandemic-related disruptions, there is still significant room to respond more quickly to market opportunities and uncertainty. Only 9 percent of executives described their company as very agile or fast in responding to consumer trends, seizing market opportunities, and responding to volatility and uncertainty.

How can the dairy industry prepare for the future?

Dairy companies can engage in a mix of approaches to address the trends described above and prepare for the next three to five years. Those actions will play out at different levels (company and industry) and different horizons (short and medium term).

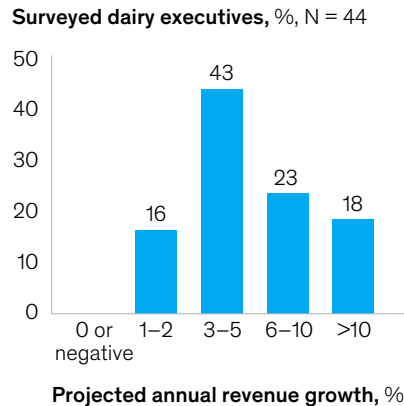
At the industry level, executives can take coordinated action to:

- reimagine how the industry defines sustainability performance to align with social and corporate incentives
- reimagine a new industry go-to-market, direct-to-consumer platform
- make dairy the career of choice for talented people to strengthen the industry

Exhibit

Dairy executives see an optimistic future after a strong performance in 2020.

What level of annual revenue growth are you expecting over the next 3 years?



Growth of sales, % per year

	Butter	Fluid milk	Yogurt	Ice cream	Cheese
Fiscal year 2016–19, average	1.8	–1.7	–1.7	–0.6	3.1
Fiscal year 2020	5.5	0.4	–0.4	–0.3	0.6
	↓	↓	↓	↓	↓
	+3.7	+2.1	+1.3	+0.3	–2.5
	percentage points				

Source: 2020 IDFA Member Survey; USDA estimated volume sales by product, YOY and YTD averages 2016–2020

- invest in research and consumer education that articulates the benefits of dairy

- strengthen corporate culture to attract and retain talent

At the company level, executives can:

- invest in technology and research to improve sustainability, health, and wellness attributes
- develop insight capabilities to enable consumer-focused innovation
- make significant international bets to find new avenues of growth
- embrace digital as a tool to solve problems and capitalize on opportunities
- use programmatic mergers, acquisitions, and divestitures to realign their portfolios
- improve operational agility and resilience

When determining which of these imperatives to pursue, it is important to consider alignment with a current strategy, compatibility with resources and capabilities, and scale within the value chain. Even a smaller company can play a vital role in a coordinated, industry-wide effort.

This past year was challenging for many reasons, yet the dairy industry showed its resilience. Leaders now will need to take focused, strategic actions to improve how they respond to consumer demand, use data and analytics, and respond to supply-chain disruption. Several of the strategic approaches are too big to handle single-handedly, but collaboration across the public, social, and private sectors can help dairy achieve its near-term goals and prepare for the future.

Christina Adams is a partner in McKinsey's New York office; **Isabella Maluf** is an associate partner in the New Jersey office; **Ludovic Meilhac** is a partner in the Stamford office; and **Roberto Uchoa** is a senior partner in the Chicago office.

The authors wish to thank Diane Guité, Melanie Lieberman, and Alina Malinauskaite for their contributions to this article.

Designed by McKinsey Global Publishing
Copyright © 2021 McKinsey & Company. All rights reserved.