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Agility@Scale: Solving the growth challenge in consumer packaged goods

The magnitude and pace of change in the US market have undermined traditional growth models for many consumer-packaged-goods companies, especially larger ones. Companies need to combine greater agility with new types of scale advantage to compete more effectively.

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It has been a tough few years for large consumer-packaged-goods (CPG) manufacturers in the US market. Since 2011, the organic-growth rate for CPG companies has declined. Several CPG categories, including personal products, household products, beverages, and food products, have fallen several rungs in industry rankings of economic-profit contribution, and shareholder returns have lagged the S&P 500.

The sector's performance is attributable to changing conditions on several fronts. Consumers, channels, and competition are all different than they were a decade ago, stymieing CPG manufacturers that had grown accustomed to the fairly stable growth brought about by rising consumer demand. And the next five years will almost certainly bring more change than did the previous five years. Many CPG executives recognize that they can't continue to rely on historical growth models, but we have found that few have made sufficiently transformative moves—often, incremental change gets mistaken for transformation.

What will it take to jump-start and sustain profitable growth in the CPG sector? We believe CPG companies need a new Agility@Scale model to drive their businesses—one that combines aspects of scale advantage, defined in new ways, with greater agility on multiple fronts. Moving to this new model will require a combination of mutually reinforcing changes in organization, capabilities, and investments.

Fundamental changes in consumers, channels, and competition

The growth downturn has been a six-year slog, with 2017 being the worst year so far. CPG companies with material portions of their business in the United States have seen year-over-year organic-growth rates drop to the very low single digits on average. The length and depth of this decline isn't something that the sector has experienced over the past 20 years or more, and the drop contrasts with consumer confidence, which is back up at prerecession levels (Exhibit 1).

Total return to shareholders (TRS) has underperformed the S&P since 2011. Worse, the TRS that has occurred hasn't been grounded in performance but in multiple expansion and leverage. Growth has been a negative contributor and margin expansion only a minor positive contributor.

Furthermore, the factors stunting the CPG industry's growth are structural in some ways: consumers are changing, sales channels are fragmenting, and smaller, fast-moving competitors are on the rise. Competitive barriers for large CPG companies have eroded. Every large CPG company must have a strategy for tackling these trends head-on, because they are not about to go away.

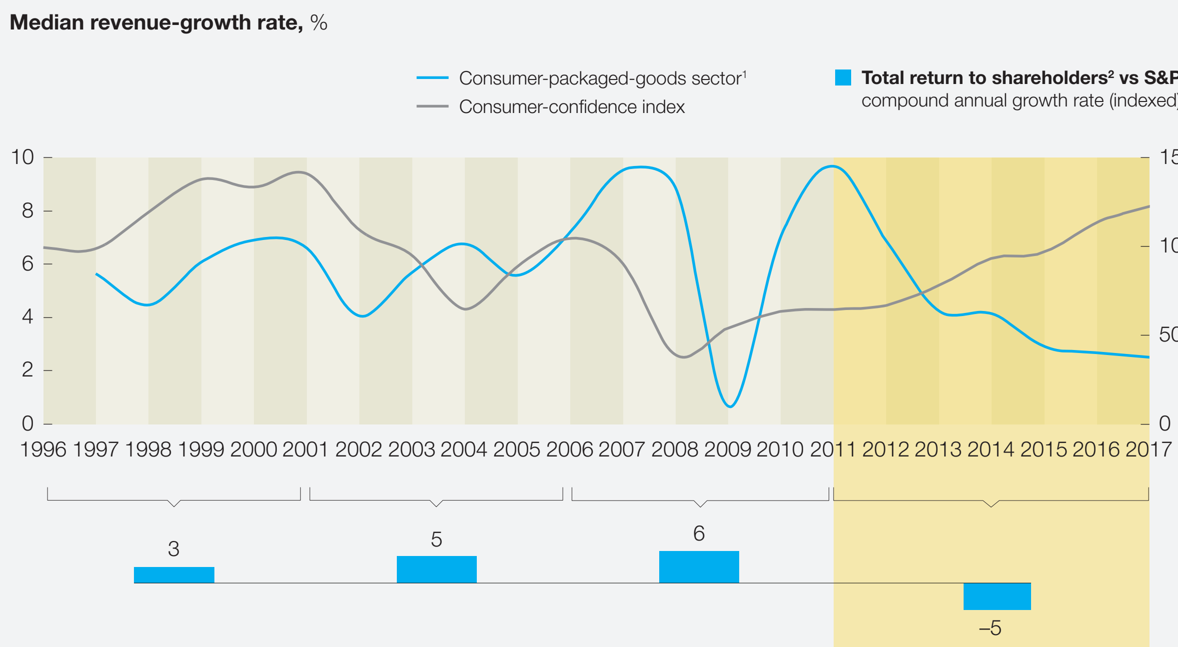
Consumers: The millennial effect

By 2025, most people in the US workforce will be millennials. McKinsey research suggests that millennials' buying and consumption habits substantially differ from those of other cohorts. They are less brand loyal, and their brand preferences are fragmented. They are very comfortable with buying online. Perhaps most alarmingly for large CPG manufacturers, American millennials are almost four times more likely than baby boomers to avoid buying products from "the big food companies." Size has become, to some extent, a liability.

In addition, millennials are drawn to deals and discounts, in part because they don't have that much money to begin with: millennials are poorer than previous cohorts. For example, when Gen Xers were 27 years old, their income level was 9 percent higher than that of today's 27-year-old millennials on a real basis.

In response to these trends, CPG manufacturers and retailers are offering millennials more choices—and lower prices—when it comes to brands and products. In effect, millennials have recaptured consumer

Exhibit 1 **Consumer-packaged-goods companies are facing an unprecedented growth challenge.**



[1] Revenues based on local currency for US-oriented consumer-packaged-goods companies with revenues ≥$100 million (n=195).
[2] Market-cap weighted index of US-oriented consumer-packaged-goods companies.

Source: Capital IQ by S&P Global; Datastream by Thomson Reuters; The Conference Board; Corporate Performance Analytics by McKinsey

surplus. That is one reason (of several) that the prices of food and CPG products have begun to lag the consumer price index in recent years.

Channels: Retail revolution

Retailers historically favored large CPG manufacturers, giving them prime shelf-space advantages. Those advantages have deteriorated. Retailers have made more room on their shelves for fast-growing small- and medium-size brands and have continued to emphasize perimeter-store development.

Furthermore, large retailers themselves are under pressure. Other channels and formats, both offline and online, are gaining share in many categories. If current patterns continue unabated, traditional grocers in the United States and Western Europe could lose 20 percent or more of their sales by 2026.

Some of those sales have shifted to e-commerce. Online penetration in many CPG categories remains low, but the shift will only accelerate as home delivery becomes less costly for retailers. Our analysis shows that the costs of home delivery, which are about 10 to 12 percent of sales on average today, could fall to 5 to 7 percent by 2025 thanks to greater warehouse automation, higher delivery density, low or no labor delivery, and relocation of distribution centers closer to residential areas.

Discounters, too, have the potential to disrupt the US market. Trader Joe's already has close to 500 stores; both ALDI and Lidl are pursuing aggressive US growth plans (albeit with some recent setbacks). Their limited assortments, high-quality private labels, and low prices are attracting low-income and affluent consumers alike. With only about a 5 percent share in the US market today (compared with more than 10 percent in several European countries and more than 40 percent in Germany), discounters still have lots of room for growth and are making a renewed push for it.

Competition: The explosion of small

Over recent years, about 70 percent of CPG-sector growth has come from small- and medium-size brands. Smaller brands are capitalizing on the preferences of millennials and opportunities from digital marketing. Smaller companies, in aggregate, are nimble and respond fast to market signals.

It is not necessarily that smaller companies are individually better at innovation. Brands launched by smaller companies don't appear to have higher survival rates than do launches from companies with over $1 billion in sales: survival rates for both are about 25 percent after four years. Rather, the issue is that there are so many small companies, and they are "outlaunching" the bigger companies in total. In aggregate, small competitors are going after every attractive niche in the market and are capturing most of growth. Indeed, the venture-capital community has responded to—and helped to fuel—this dynamic as investment levels have jumped up to about $1.8 billion a year (average 2014–2017) from about $500 million a year (average 2010–2013).

What it will take to reinvigorate growth: Agility@Scale

Given these headwinds, growth rates for large CPG companies will continue to be under pressure unless companies battle the inertia in their current growth models. And there is no single solution to the growth challenge; rather, changes along multiple dimensions are necessary.

Traditional sources of scale advantage—such as advantaged customer relationships and distribution, investment levels for share of voice and marketing, iconic brands' targeting of mass audiences, owned asset bases—are still relevant in many cases but have eroded enough that smaller players can compete more effectively. Today, the agility of smaller rivals, in aggregate, is beating larger companies when it comes to organic growth. The challenges for bigger players are to connect the benefits of agility with new sources of scale advantage and to change concurrently how they answer the question of "where to play" (Exhibit 2).

A new model for growth involves embedding agility and recapturing scale advantages in the way a company operates, and we believe there are six key areas where CPG companies need to change that cut across the organization, capability, and resource-allocation dimensions. Winning in new areas based on a superior Agility@Scale operating model requires thinking both more broadly and more granularly about where to compete and moving beyond the idea of "near in adjacencies" (a concept based on traditional scale advantages) (Exhibit 3).

Each of the components of the model is an involved topic, and the relative importance of each puzzle

Traditional sources of scale advantage have eroded enough that smaller players can compete more effectively.

Exhibit 2 **The growth model for consumer packaged goods needs to change.**

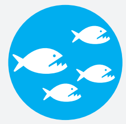
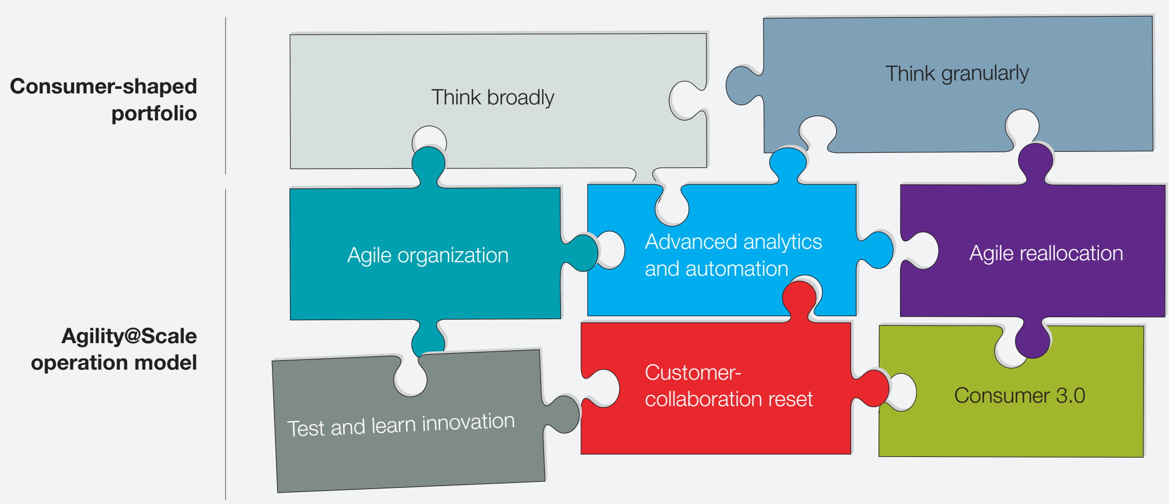
Historical	Current	Future
		
Big beats small	Fast beats slow	**How can CPG companies bring together the advantages of scale and agility** to win in the future?
• **Controlled message** to consumers and access to channels to reach them • **Controlled shelves** where consumers shopped • Controlled supply chain and manufacturing to make products • Invested efficiencies to build **mass-appeal brands**	• **Fragmented channels** with consumer-generated content • **Democratization of choice** through e-commerce and channel disrupters • Access to **supply-chain and manufacturing** partners • **Lower appeal of mass brands** with growing distrust of big institutions	

Exhibit 3 **There is an emerging model for consumer-packaged-goods sector growth.**



piece—and how they fit together—will vary by company. Here we will just scratch the surface by giving a short description and emphasizing how each component can create new forms of scale advantage and how they each reinforce other components.

Build an agile, streamlined organization

Agile organizations are characterized by their ability to combine talent in more fluid ways by bringing the right people together to meet objectives and then disbanding and recombining elsewhere. The principles and language of agile organizations (such as “squads” and “sprints”) are mostly foreign to CPG companies but are used in other sectors, such as software development.

Consumer companies are not agile: in a 2016 McKinsey survey of 18 consumer companies, there were no companies that qualified as agile. At best, CPG companies create cross-functional teams for certain special projects, but these teams often spend considerable time trying to navigate the “real” organization with its many stakeholders. Agile organizations, in contrast, combine a stable backbone (clear structure, lean governance, and efficient core processes) with a dynamic front end consisting of small, cross-functional teams that are empowered to develop consumer-centric solutions quickly.

Large CPG companies should explore agile principles in depth and should consider dismantling complex matrix structures that diffuse ownership, undermine the owner’s mind-set, and slow decision making. Indeed, a few consumer companies are experimenting with agile principles in some pockets of their businesses: several companies, including Coca-Cola and Johnson & Johnson, emphasized agility at the 2018 CAGNY conference. Campbell Soup and Tyson Foods recently reorganized themselves, in part to increase agility.

Why is this important for recapturing scale advantage? Agile organizations create advantages for businesses that can attract the best—and most diverse—talent. Large CPG companies, which can attract broader and deeper talent and which have the ability to combine and recombine this talent to unleash its full potential, will be the ones to capture the advantage.

McKinsey’s latest research on agility shows that its advantages include 90 percent faster time to market, 30 percent higher productivity in frontline sales staff, and 130 percent more time spent on value-adding activities such as innovation, customer interaction, and problem solving. Agile business units are also 1.5 times more likely to outdo competitors on both financial and nonfinancial performance metrics (examples of the latter include time to market, productivity, and employee engagement). Furthermore, agility supports and benefits from other components of the new model, such as new innovation approaches and getting the most from advanced technology.

Develop triple-A capabilities: Advanced analytics and automation

Advanced analytics and automation are rapidly increasing in importance in the CPG sector. Regarding advanced analytics, some CPG companies are aggressively pursuing a wide range of use cases, including many aspects of digital marketing and marketing personalization, pricing and promotion optimization, sales-force effectiveness, and in-store–merchandising optimization. These use cases have already made the transition from theory to reality, especially in sectors with more commercial complexity (such as direct-store-delivered categories). And commercial use cases are only one dimension of many areas in which advanced analytics are starting to make a difference.

For automation, recent research by the McKinsey Global Institute indicates that about 35 percent of work in a typical CPG company—and not just work in the back office—can be automated using currently available technology. This clearly has important implications for cost structure, but it also improves speed and accuracy and is part of the capability backbone that supports an agile organization.

Right now, CPG companies are not at the forefront of advanced analytics and automation. Other sectors, like banking and even certain parts of retail, are far ahead. We also observe wide variability across CPG companies in how they prioritize these topics, from companies that are rapidly moving ahead in implementing use cases and building capabilities and analytic centers at scale to those that are only experimenting at the very margins of their businesses.

Why are advanced analytics and automation important for recapturing scale advantage? Advanced analytics and automation enable faster and better decisions at potentially a much lower cost structure. They also allow CPG companies to connect in more relevant and specific ways with each consumer. Large CPG companies, in particular, can benefit. These capabilities require investment—in data and systems infrastructure, in talent, in methodology development, and in the organizational and process changes implied by new ways of working—and large CPG companies can spread those investments across a broader revenue base for higher return on investment.

Fuel growth through agile resource reallocation

McKinsey research has shown that companies that are dynamic resource reallocators—meaning, they reallocate more of their capital among business units year over year (greater than 49 percent of capital reallocated over ten years)—have achieved much greater TRS growth over time than their less dynamic peers. Unfortunately, most CPG companies are not very dynamic.

In particular, CPG companies must get better at shifting resources away from unpromising areas and toward areas of strength with the highest growth potential. They need to develop a detailed understanding of the specific business cells (for example, subcategory and geography) that have the potential to yield profitable growth and to double down on those cells as opposed to maintaining or growing investment levels in legacy businesses that might be on the decline.

Of course, this process is easier said than done. It has challenges associated with strategic planning as well as with freeing up the capital to reallocate. Effective cost-reduction programs are part of the answer. They can provide the investable capital to invest and to shift a company's capital allocation over time. And our research suggests that there is no significant trade-off between operating-expense efficiency and growth performance in CPG. Indeed, over recent years, some CPG companies have set a new bar in terms of cost efficiency without a growth penalty relative their peers. So, framing cost reduction as a way to invest behind strength and coupling it with a fact-driven, enterprise-level strategic planning process that rethinks investment levels each year can be a way to capture the TRS benefits.

Why is this important for recapturing scale advantage? Large CPG companies have more investment resources, and the efficient use of those resources can be a key advantage that many CPG companies are simply missing. Furthermore, large CPG companies have more diversity in investment options and greater breadth of view, which can be additional advantages if matched with enough investment flexibility.

Ditch the stage gate for "test and learn" innovation

For most larger CPG companies, innovation is not delivering sufficient growth. The challenge is that, with lower competitive barriers and less scale advantage, CPG companies are competing against the full innovative force of the market in faster cycle times than ever before. Large CPG companies need to transform their innovation approach and pursue multiple alternative models in parallel.

First, companies need to improve agility via new organization models and rapid launch approaches. The innovation function is a prime starting point for agile organization transformations, and our experience suggests that agile models can produce more and better ideas. With more ideas comes the need for more launches, requiring a "test-and-learn" approach, whereby innovations are rapidly market tested at smaller scale and with lower up-front investment (which saves the investment for scale up).

CPG companies must get better at shifting resources away from areas that lack promise toward areas of strength.

Second, CPG companies should embrace, rather than eschew, fast-follower models. Our research suggests that fast-follower models can be very effective and that the "second to market" often captures most of value in a new space (for example, Silk Almondmilk with a 34 percent share and Clif Bar with a 32 percent share).

Third, CPG companies should tap into broader market innovation via captive private equity, programmatic small-scale M&A, and perhaps entrepreneurial incubators. Admittedly, the record in CPG is unclear on these inorganic approaches, but we believe that, done well, they can create valuable options that CPG companies can call in when the propositions prove themselves in the market.

Why is this important for recapturing scale advantage? These alternative models create more propositions at greater speed and leverage capabilities of CPG companies (particularly large CPG companies). Such strengths include the ability to invest in and to commercialize quickly ideas gaining traction in the market as well as the possession of the resources to create a diversity of call options via small-scale investments, partnerships, and acquisitions.

Reset customer collaboration: E-commerce and small format

E-commerce penetration in many CPG categories remains low—for example, 2 to 3 percent in packaged food and beverage, 3 to 4 percent in home care, and 7 to 8 percent in personal care. However, the pieces for growth acceleration, including decreasing home-delivery costs, powerful new players entering the fray, and the rise of millennials and Gen Zers, are falling into place in the United States.

Why is e-commerce important for recapturing scale advantage? There will be winners and losers; e-commerce is not a "tide that will lift all boats" for two reasons. First, being a leader offline is no guarantee of being the leader online. There are a range of examples of online leaders being different from offline leaders in a variety of areas, such as pet food (with Blue Buffalo), coffee (with Nespresso), and home care (with Seventh Generation).

Second, e-commerce has the potential to consolidate share with online winners, contrary to the common notion of the "endless shelf" and therefore endless fragmentation. In some categories, there is more share consolidation online than there is offline—pet food and home care are, again, examples. Search algorithms as well as CPG online marketing and trade investments can reinforce this phenomenon.

Also, as consumers become more habituated to online purchases, the online potential for "stickiness" is higher than for offline models as consumer create and reorder their baskets. So, the potential to create and defend scale is there in e-commerce, and CPG companies should invest ahead of the growth curve to benefit.

Beyond the scale dynamics, e-commerce supports agility—the ability to sense consumer shifts rapidly, to respond quickly and specifically, and to use the test-and-learn method at a higher rate in a range of areas, such as pricing, promotion, personalized marketing, and innovation. Furthermore, it reinforces advanced analytics, both because it creates new avenues for impact for advanced-analytics–fueled insights and because it creates immense new sources of real-time data.

Of course, e-commerce is but one part of the omnichannel challenge that CPG companies face, and there are certainly other disruptions in retail. E-commerce is somewhat distinct, however, in its potential to rebalance winners and losers, to recapture scale advantages, and to provide a significant runway for growth over the medium and long terms.

Deliver next-generation consumer engagement: "Consumer 3.0"

In our experience, there is wide variability among CPG companies in how effectively they access and use the millions of "crumbs" of data available on consumers. In some data spaces, the CPG sector has fallen behind the retail sector and runs the risk of being at an information disadvantage in the value chain.

The best CPG companies are stitching together disparate data, sometimes in real time, to understand microsegments of consumers and to build more intimate profiles of consumer behaviors, attitudes, and needs. These CPG companies are relying less on stated preferences and more on actual behavior. They are seeking to influence and engage consumers in a world where it is difficult to "own" the message fully with company-generated content. This "Consumer 3.0" approach stands in contrast to mass marketing to mass audiences ("Consumer 1.0") and to digital marketing ("Consumer 2.0"), which relies upon company content and essentially replicates offline marketing in a more targeted and efficient way.

Why is Consumer 3.0 important for recapturing scale advantage? The potential scale advantage for large CPG companies lies in combining 3.0 approaches with more traditional 1.0 and 2.0 approaches. They should be complementary, not mutually exclusive—"and," not "or." Indeed, high-cost TV remains the single most important medium for all age groups in the United States on the basis of minutes viewed, while the growth in minutes being devoted to the web (over a variety of devices) is largely additive to viewing, not substitutional for TV.

There is power in the ability to combine the brand awareness and presence associated with these high-reach (and high-cost) channels with the advanced-analytics– and data-fueled engagement of Consumer 3.0 approaches. CPG companies need a more expansive definition of "share of voice," one that encompasses both brand-owned content in traditional and digital channels, with the myriad other influence points for consumers. Larger players can potentially be more effective across this expanded share-of-voice landscape by using spend advantages in traditional channels with advanced analytics and data-advantage capabilities in new channels.

Use Agility@Scale to go broader and smaller

One of the advantages of using the Agility@Scale model is the potential to compete across a broader range of market spaces. The basis for competition becomes a superior organizational and operating model—one that can translate into new arenas beyond near in adjacencies. Indeed, "adjacency" thinking is, in some ways, a growth approach rooted in traditional notions of scale, such as capturing synergy because of manufacturing assets, distribution and customer advantages, and shared selling, general, and administrative functions.

With the growth challenge in CPG so pervasive across sectors, CPG companies need to think more broadly about where to get growth and to follow the example of others who compete in new ways. Amazon is an example through its devices, cloud services, marketing services, entertainment-content development, and omnichannel grocery, among others. Some CPG companies are pushing the boundaries of their footprints, although not necessarily on the basis of Agility@Scale. Examples include Mars' move into veterinary clinics, General Mills jumping into a high-growth space in pet food, and Nestlé moving further into the vitamins, minerals, and supplements space.

Regarding thinking "smaller," the underlying concept is that growth is granular. This notion is nothing new: finding pockets of growth within larger category and geographic definitions has been a key to growth for a long while. What is changing now is both the growing fragmentation of consumer preferences as well as the availability of data and technology to understand the market landscape at a micro level. These changes raise the bar on a CPG's ability to use data and technology to market to growth pockets as well as its ability to create the organizational agility to access them. In this way, "thinking smaller" is enabled by the Agility@Scale operating model, just as "thinking broader" is also enabled.

■ ■ ■

In summary, we believe tomorrow's winning CPG company will look different from that of today: streamlined and agile in organization, automated and deeply analytic across functions, dynamic in use of investment, fully omnichannel in go to market, able to respond more quickly and effectively to the market via innovation, and advanced in the ability to connect with individual consumers in many contexts. We also believe that new types of scale advantage can be captured across these elements. Therefore, we are bullish on the prospects of large CPG companies—at least those who recognize the need for far-reaching change—adapting and transforming to regain their growth footing.

For further reading, we recommend the following publications:

- Gregory Kelly, Udo Kopka, Jörn Küpper, and Jessica Moulton, "The new model for consumer goods," April 2018, McKinsey.com
- Rebecca Johnson, Lauren Ratner, and Kristi Weaver, "The organizational agenda in consumer packaged goods," March 2018, McKinsey.com
- Julie Lowrie, Max Magni, Ryan Murphy, and Sara Prince, "How some CPG companies grow 5 percentage points above market and expand margins: A data-driven perspective on achieving sustainable, profitable growth through commercial excellence," forthcoming on McKinsey.com
- Mark Dziersk, Stacey Haas, Jon McClain, Brian Quinn, and Jeff Salazar, "From lab to leader: How consumer companies can drive growth at scale with disruptive innovation," forthcoming on McKinsey.com ■

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