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How do winning consumer-goods companies capture growth?

Consumer Packaged Goods April 2017

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How do winning consumer-goods companies capture growth?

Our detailed analysis of 53 companies reveals four major growth drivers.

For consumer-packaged-goods (CPG) companies, growth has become more elusive. The market segments that once represented the best bets are becoming increasingly competitive, with traditional companies and new players making aggressive moves. For example, retailers like Amazon are moving into private-label goods, logistics, and other areas of the value chain, and direct-to-consumer start-ups, such as Dollar Shave Club, are competing with established manufacturers by offering low prices and convenient services. In emerging markets, the landscape is even more tumultuous, with domestic players expanding locally and abroad. Faced with greater competition, some CPG companies have increased their M&A activity to capture market share.

In this challenging environment, what strategies have helped CPG companies drive growth? To find out, we analyzed data from 53 CPG companies over the past few years.[1] Using our proprietary approach for disaggregating revenue growth, we quantified the impact of three major sources of growth: portfolio momentum, execution, and M&A. We found several commonalities among winning players. First—and perhaps most significant—they make big bets on emerging markets, which are still driving most revenue growth despite the increased competition. Winning companies also focus their resources on the best opportunities, quickly respond to market changes, and engage in a combination of large and small M&A deals.

Don't underestimate the power of emerging markets

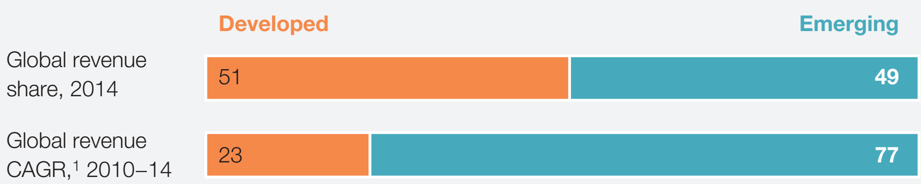
In our analysis, portfolio momentum—the growth achieved based on the product categories and geographic markets in which companies are active—accounted for 77 percent of total revenue growth. The remaining gains resulted from M&A and, to a lesser extent, execution (as indicated by an increase in organic market share).

Perhaps the most important portfolio choice involves the share of business in emerging markets. CPG companies have long recognized the potential of these regions, but they may underestimate their current role in driving growth. We continue to see strong growth in many product categories in these countries, such as baby food in Indonesia and facial moisturizers in India. Although developed countries accounted for 51 percent of CPG revenues in 2014, emerging markets drove 77 percent of growth from 2010 through 2014 (Exhibit 1). If this shift continues as expected, emerging markets will account for more than half of all CPG revenues by 2020.

In our analysis, companies that increased their share in emerging markets typically saw a commensurate rise in portfolio momentum. Companies with more than half their business

Exhibit 1 **Revenue pools are concentrated in developed markets, yet more than 75 percent of growth comes from emerging markets.**

Global revenue and growth among developed and emerging economies, %



Note: Covers categories such as food and beverage, consumer health, beauty and personal care, retail tissue and hygiene, and home care.

[1]Compound annual growth rate.

Source: Euromonitor; McKinsey analysis

in emerging markets had the strongest momentum. The best results came from the two businesses that generated more than 70 percent of their revenues in emerging markets.

Minimize complexity when possible

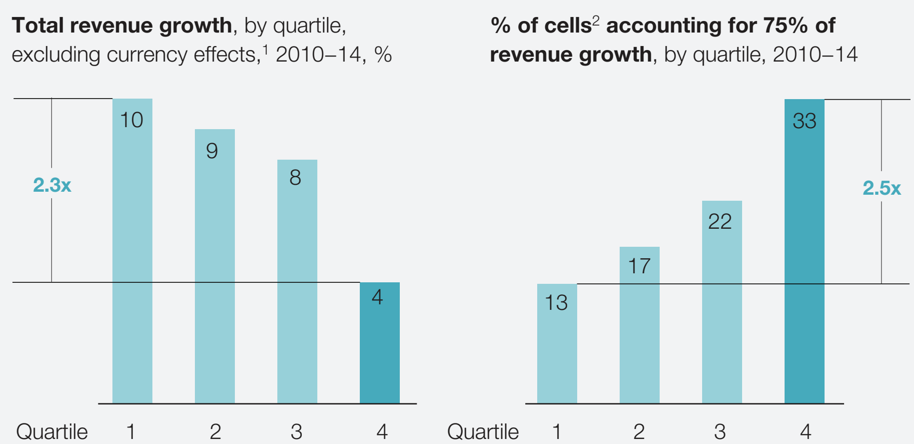
With economic uncertainty growing and competition rising, CPG executives may be tempted to pursue numerous opportunities. In our analysis, players typically managed hundreds or even thousands of business "cells"—defined as specific combinations of products and geographies, such as facial moisturizers in South Korea. But within these broad portfolios, most revenue growth came from the top 20 percent of cells. This lopsided distribution means that certain opportunities may not receive resources in proportion to their value unless companies closely monitor performance.

The drawbacks of complexity became increasingly clear when we divided companies into quartiles based on revenue growth. The top players obtained about 75 percent of their revenue growth from only 13 percent of their business cells. In the bottom quartile, it took 33 percent of cells to generate the same amount of revenue growth (Exhibit 2). These findings suggest that companies can win big by concentrating their efforts on a small number of promising cells, rather than dispersing their time and resources among many opportunities.

Dynamically re-allocate resources

Companies can't always reduce portfolio complexity, especially if cells with low revenue growth are critical to their branding, reputation, or future goals. They can, however, reduce the risks associated with large portfolios through dynamic resource reallocation. The

Exhibit 2 **Companies achieve more revenue growth when they focus on fewer cells.**



[1] The percentages shown for revenue growth were rounded to the nearest tenth.
[2] Combination of categories and geographies.

Source: Euromonitor; McKinsey analysis

highest-growth companies reallocate their resources constantly, rather than making a one-time decision or conducting cyclical reviews.

Our analysis provides evidence that agility wins, with top performers quickly moving resources, both by product category and geography, as opportunities shift. The speed of reallocation varied at each company based on several factors, including competitive dynamics, but they shared a commitment to moving rapidly. These top performers achieved average annual revenue growth of 5.9 percent between 2007 and 2014, compared with 4.9 percent growth for companies that made only geographic shifts and 3.9 percent growth for those that roughly maintained their traditional portfolio positions.

Companies that want to become more agile may need to adapt their operational and organizational models. For instance, they may want to create a decentralized decision-making structure in which individual country leaders have authority to reallocate resources or set growth targets. Our experience suggests that the most successful CPG players, whether in food, beauty, or consumer health, typically shift 10 to 20 percent of their resources to higher-growth business cells after each review, sustainably increasing organic growth by about 2 to 3 percent over a period of three to five years.

Mix up your M&A deal sizes

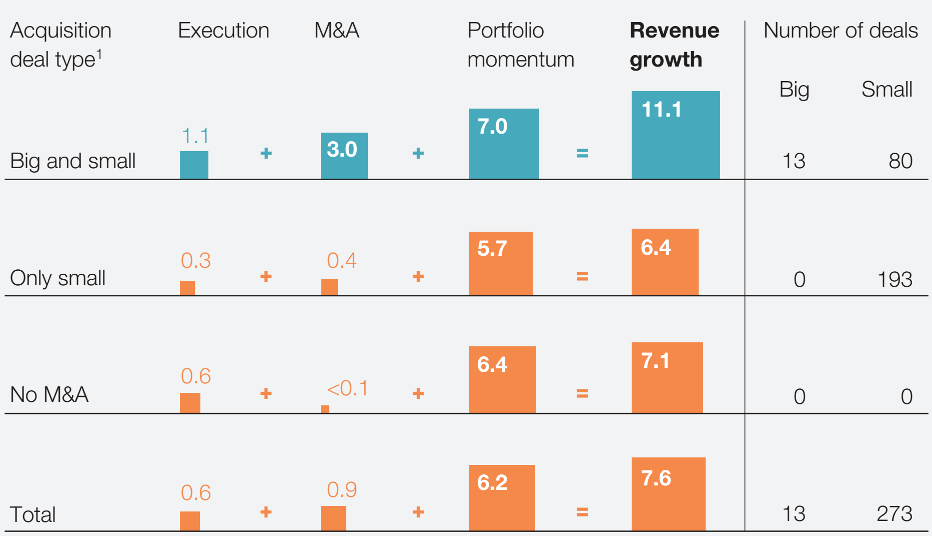
For M&A activity, companies in our analysis fell into three groups—they either refrained from deal making, conducted only small deals that accounted for less than 10 percent of sales in the year after closing, or took a balanced approach by pursuing a mix of large and small targets (Exhibit 3). Companies that focused only on small deals completed more M&A transactions—a total of 193 between 2007 and 2014, compared with 93 total in the balanced group. But the companies that focused on small deals didn't perform as well.

Deal-making strategy clearly affected company performance. Average annual revenue growth was 11.1 percent for the balanced group, compared with 6.4 percent for companies that concentrated on small targets. The balanced players also produced greater returns from portfolio momentum and execution. This pattern suggests that companies that pursue both large and small deals are also likely to be companies that rigorously reassess their portfolios and shift resources to high-growth areas.

Exhibit 3

Companies that engage in big and small deals report the greatest growth in revenue.

Average compound annual growth rate, 2007–14, %



[1]Deals are classified as big if they contribute more than 10% of the company sales in that year; remaining deals are considered small.

Source: Euromonitor; McKinsey analysis

With CPG growth slowing, companies need to become more focused and data driven, concentrating on the best opportunities. They need to be bold enough to adopt new M&A strategies or reallocate resources quickly if the market appears to be shifting, especially as emerging markets gain momentum. Such moves may require changes at every level of a company's organization, but the resulting revenue growth will be well worth the effort. ■

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[1] The analyses on emerging markets and portfolio complexity examine data for the years 2010 through 2014. The analyses related to agile shifts and M&A cover data for the years 2007 through 2014.

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April 2017
Designed by Global Editorial Services

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