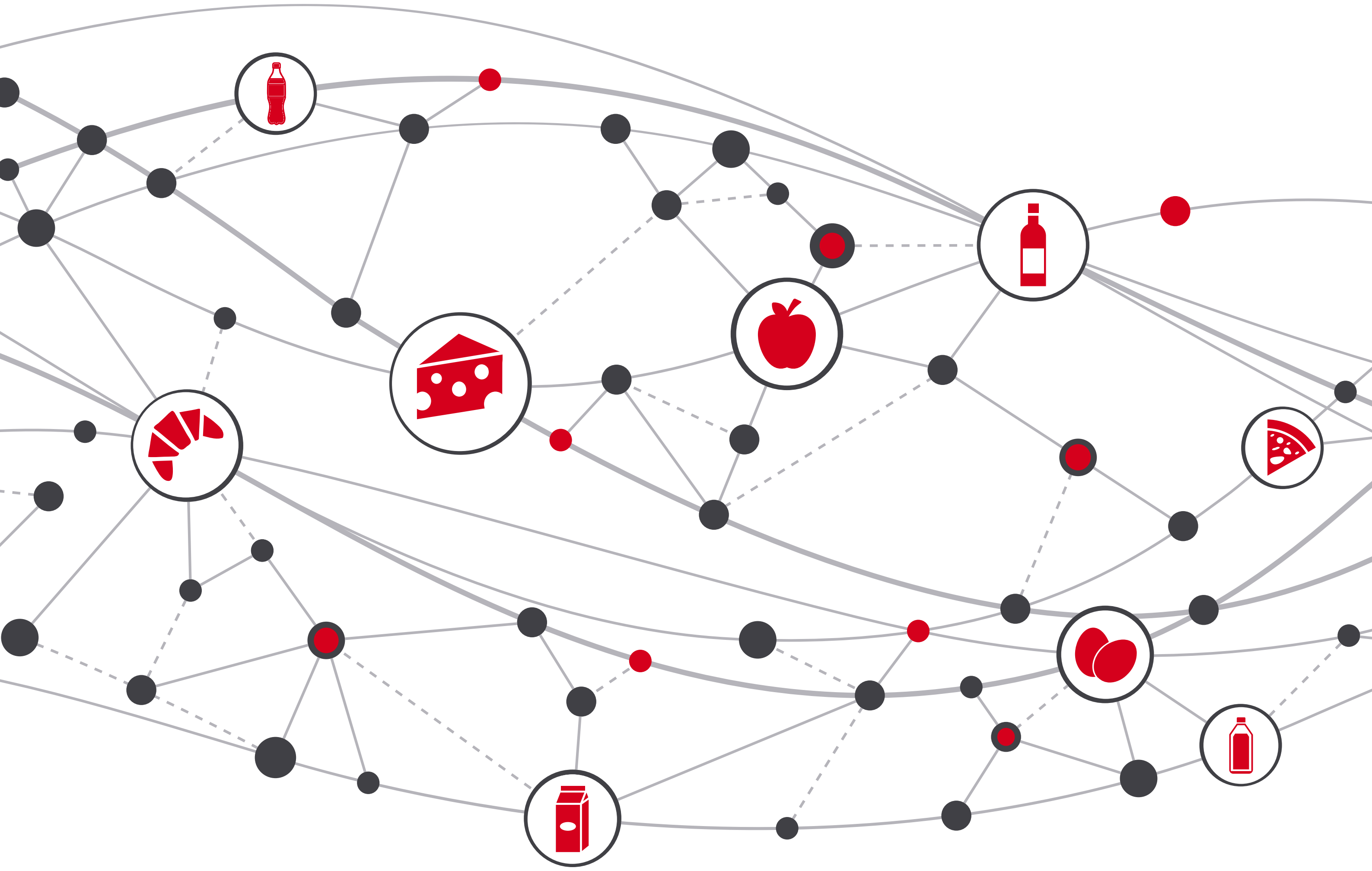
Consumer Goods



Creating Growth in Consumer Goods

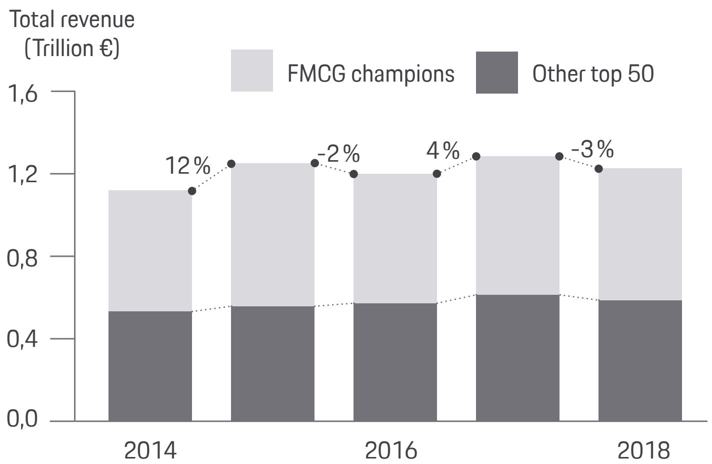
Five operating practices of successful fast-moving consumer goods companies

Porsche Consulting
Strategic Vision. Smart Implementation.

Stagnation in the western fast-moving consumer goods market calls for action

The fast-moving consumer goods (FMCG) sector is undergoing fundamental transformation. Developed markets are widely saturated (in units), and consumer behavior is changing faster and more drastically than in the past. As a result, top 50 FMCG players have been faced with stalling or shrinking sales in recent years (see figure 1a). Traditional growth strategies have lost traction, and yet FMCG champions are thriving. These companies manage to increase their profit margins while margins of their less well-faring competitors are decreasing substantially (see figure 1b).

Successful FMCG companies employ five key practices in their operations processes to improve their topline, reduce costs, increase product availability, and ultimately expand their profit margins. This paper explores the five practices from an operations perspective. It can offer C-level executives orientation when designing, reviewing, or revising their operations strategies.



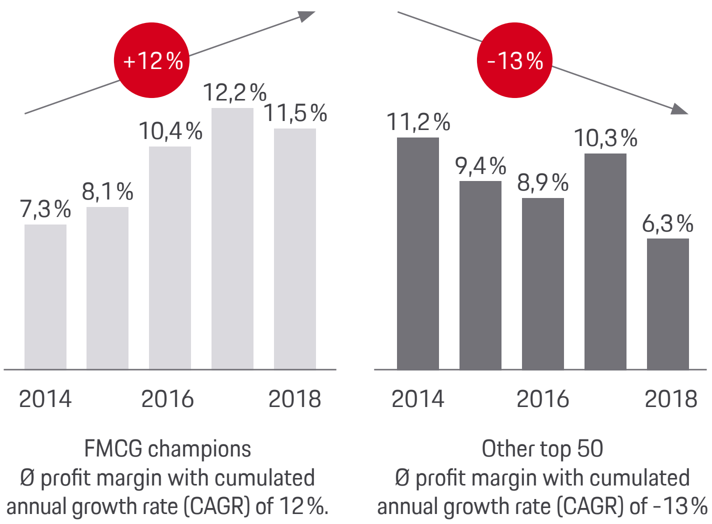


Figure 1. [a] Revenues of the 50 largest FMCG companies are stalling. [b] FMCG champions nurture their profitability while the rest of the competition loses ground.

Understanding developments in the FMCG world

Underlying the changes are global megatrends that alter consumer preferences and consumption habits on a global scale. The six megatrends shown in figure 2 have substantial growth potential for FMCG companies and will be focused on in the following.

Figure 2. These six global megatrends offer growth potential to FMCG companies.

THE PURSUIT OF BETTER HEALTH

Between 2000 and 2016, the average life expectancy at birth in Europe increased by 7 percent to 77.5 years of age. With every generation living longer than the previous one, maintaining good physical health and mental well-being during the aging process is becoming more and more important. Increased health awareness manifests itself in various consumer subtrends, which range from specialized diets, yoga, and mindfulness training to the use of tracking devices to monitor sleep, physical activity, nutritional intake, and other bodily KPIs. In the FMCG sector, this trend has particularly affected the foods and drinks industry. While the image of unhealthy ingredients, such as sugar or saturated fatty acids, continues to deteriorate, superfoods like chia seeds are projected to grow with a CAGR of 40 percent in coming years.[1]

However, this megatrend does not end with consumer lifestyle choices. Governments and NGOs increasingly focus on mitigating threats to the health of the general population. To achieve this, limits and recommendations have long been the preferred option for protecting societies while simultaneously minimizing interference with free markets. To foster transparency about unhealthy foods and to ease purchasing decisions for healthy foods, France recommended introducing the Nutri-score, a five-color nutrition label, to food products in 2017. Belgium adopted the model in 2019, and Germany and Spain have announced to introduce this system as well.

When market mechanisms work too slowly or not in the desired direction, however, governments undertake more regulative measures with increasing frequency. One example of compulsory regulations was the tax imposed in April 2018 on sugary drinks in the UK, which was intended to combat obesity and type-II diabetes. The model puts a charge of up to 24 pence per liter on drinks containing sugar. Due to the high price sensitivity of the soft drinks market, the tax prompted over 50 percent of manufacturers, including Fanta and Dr Pepper, to reformulate their drinks by June 2018 in order to evade the levy.

THE DESIRE FOR INDIVIDUALITY

In 2019 social networks amassed 2.8 billion registered users, and this number is expected to rise to over three billion by 2021. As a result, there is a growing desire to distinguish oneself from the crowd in this hyper-connected global society. However, individualization is not only a matter of personal style or preference. Personalization also makes customers feel more appreciated, and personalized products are considered more valuable to buyers. Nevertheless, there is little willingness to pay a premium for individualized products, particularly in the FMCG space.

Personalization offers in the FMCG sector mainly encompass the option of adding custom texts or images to a product or its packaging. Mars Inc. pioneered this feature for the mass market during the 2004 holiday season, when it first offered consumers the option of personalizing

M&Ms with a custom design on the back of each chocolate [2]. This offer was so successful that it was soon made available year-round. Today, personalized M&Ms are a common gift option for various occasions from birthday presents to weddings. In recent years, the competition jumped the bandwagon with the same intention—to foster its relationship with the consumer and create brand loyalty. Customers can now order beverages with a chosen name, shower gels with a personalized message, and product packaging with customized images. In 2017 Ferrero launched its "Nutella Unica" campaign in Italy, a special edition of their product Nutella with seven million unique product designs [3]. In addition to the substantial effort of managing the complexities associated with personalization, the costs are completely absorbed by the company; consumers pay little to nothing for their custom-made products.

THE DEMAND FOR ENVIRONMENTAL RESPONSIBILITY

To maintain our current consumption for resources, we would need the equivalent of 1.7 Earths, according to Global Footprint Network. The global average temperature is rising, and the oceans are facing increasing plastic pollution, with 10 million metric tons added every year.

With such dramatic news increasing in frequency, a growing body of consumers prefers products manufactured in environmentally responsible ways. As a result, worldwide sales of organic food have more than doubled to US$97 billion in the decade from 2007 to 2017 [4]. Conventionally produced meat is viewed critically for its high resource consumption. Plantbased alternatives are on the rise. By 2030 the market for vegan meat alternatives and lab-grown meat is projected to reach almost US$400 billion, while conventional meat consumption declines gradually [5].

The FMCG industry must prepare for changes not only in consumer behavior but also in legislation. In 2012 electric bulbs were banned from sale in the EU. Taking effect in 2021 is the ban on single-use plastic utensils like straws, cups, plates, and q-tips. Recycling targets have been introduced for plastic bottles in an attempt to boost a circular economy at a time when Asian countries have stopped the decades-old practice of importing global waste.

Sustainable business models should view environmental responsibility as an opportunity rather than a threat. Many FMCG companies worldwide have already committed to ambitious sustainability targets. Unilever, for example, is aiming at halving its environmental impact by 2030 [6]. Henkel has committed to making all of its packaging material recyclable, reusable, or compostable by 2025. Additionally, the company wants to increase the share of recycled plastic used for its packaging to 35 percent overall by 2025 and foster its collaboration with the Plastic Bank [7].

THE PROGRESS OF GLOBALIZATION

Globalization started in the late nineteenth century with technological advancements in transportation and communication technology. As a result, manual production was outsourced on a large scale to countries with the lowest labor costs. The same process extended the sphere of influence of political and economic decision-making.

Today, globalization is characterized by the economic rise of former developing countries and regions. Local industry champions challenge global players with products and services better tailored to the needs and preferences of the customers in their region. Global players who want to prevail in such environments should not merely rely on the strength of a Western brand. Instead, custom solutions must be found, with all of the implications for supply chains, R&D expenditure, and marketing. An exemplary global champion succeeding in a highly specialized market is Nestlé's KitKat in the Japanese market. The Japanese product life cycle for packaged food products is exceptionally low, as consumers constantly demand novel products. This is a problem for most Western brands, who typically have only a handful of flagship products that might not change for decades. But Nestlé decided to adjust its strategy to the East-Asian market, launching over 300, often short-lived varieties of the chocolate-covered wafer bar since 2000 [8]. The efforts paid off in 2017 with a 3.8 percent share of Japan's 9.4 bn US$ chocolate market. This made Nestlé the largest Western company and fifth largest overall producer in the Japanese chocolate confectionery business [9]. This is an example for glocalization: a global product that is adjusted to match the needs of the consumer in a local market.

THE EXPLOSION OF THE MIDDLE CLASS

The first decades of the twenty-first century have seen two major trends reshape global societies: a strong growth in the middle class and aging societies. In 2009 the global middle class was estimated to comprise about 1.8 billion people. It is expected to have grown to 3.2 billion by 2020 and become 4.9 billion in 2030 [10]. With the middle class defined as "neither rich nor poor by national standards," its growth infers an increase in spending power. But as a significant share of middle-class growth is taking place in rural Asia, leveraging this new potential could be challenging for currently established supply-chain networks.

The average age of societies, on the other hand, is increasing on all continents but Africa. In Europe the share of the population aged 65 years or older is expected to increase by 10 percent points to 28 percent in the period from 2015 to 2050. There is, however, a distinct shift in mind-set in this growing population group. The so-called "best agers" are more active than in the past thanks to long-lasting good health. They are tech-savvy, shop online, use social media, and in particular, do not want to be perceived as old or out of touch. More importantly, the spending power of the group over 60 is higher than that of most other age categories.

Both the growing middle class and the population's increasing longevity bear the potential to realize price premiums due to consumers' ability to pay them. The same applies to the millennial generation, whose purchasing decisions focus on higher quality regardless of cost. A common strategy to leverage potential is product premiumization. This strategy is particularly evident in the food and drink industry—from beer and spirits to coffee and chocolate, culminating in the premium private labels of grocery retail chains. However, there is more to premiumization than a strong brand name, an appealing marketing story, and a high price tag. Conveying a credible impression of exclusivity requires a holistic approach: a high-quality product reflected in the chosen ingredients, appealing packaging, and outstanding customer experience. The premium price the consumer pays is the result of all of the above, not an end in itself.

THE ASCENT OF DIGITAL TECHNOLOGIES

With increasingly intuitive software design, falling hardware prices, and the world's growing connectivity, there are virtually no societies or economic regions unaffected by this megatrend. There are, however, numerous companies that have not yet found their way forward in the digital age. Most companies have begun systematically collecting data on their operations and customers. However, on average, between 60 % and 80 % of all data within a company goes unused for analytics [11].

Despite the topic's perceived complexity, there are players in the FMCG arena who have mastered it and are using it to their competitive advantage. LVMH's personal care and beauty chain Sephora succeeded at creating an outstanding shopping experience by taking an omni-channel approach: They have a strong presence on several social media channels. Customers can purchase products online and pick them up in stores. A mobile app with augmented reality supports them in finding the right product. A rewards program develops customer loyalty, and more importantly, provides personalized offers based on a consumer's behavior profile [12].

Another possibility is the direct-to-consumer model. The Dollar Shave Club (DSC), a startup founded in 2012, leveraged this opportunity by offering their customers a monthly no-frills razor blade subscription, delivered by mail to their homes. The offer was so successful—capturing 16 percent of the US razor cartridge market—that Unilever acquired DSC in 2016 for a reported US$1 billion [13].

While client-facing front-end digitalization can benefit sales, marketing, and R&D, digitalizing back-end operations is equally important. Digitally enhanced operations processes are powerful tools to reduce costs and increase efficiency: production line stabilities can be improved, tasks automated, and processes scheduled and operated more flexibly. The ambition need not be the immediate upgrade to a "dark factory" in every case. Nevertheless, those unwilling to invest in this area will eventually fall behind the competition. Combining the different megatrends offers even greater growth potential.

Five practices to lead FMCG operations

With megatrends shaping the world faster and more drastic than before, new opportunities emerge. There are, however, requirements to be met and challenges to be overcome in order to access this potential.

Successful FMCG companies employ five practices in operations to master theses challenges. Digital technology can help further improve productivity and quality.

Figure 3. FMCG champions successfully employ five practices in their operations, leveraged by digitalization.

PRODUCT PORTFOLIO STRATEGY

With the growing demand for individualization and product life cycles shortening, FMCG companies are under more pressure than ever to manage their portfolio effectively. Complexity is costly. A company's aspiration should therefore be to balance external variety with internal complexity by using three key success factors (figure 4): appealing products, flexible operations, and agile portfolio governance.

Successful FMCG companies clearly position themselves on the market. They offer an appealing product portfolio that contributes to their product's strategic vision, distinguishes them from competitors, and satisfies their customers' needs. At the same time, FMCG champions take operational circumstances and boundaries into consideration. To minimize internal complexity, they leverage the benefits of modular product design, standardization, and late differentiation. Best-in-class companies have established rigorous portfolio governance to ensure consistent portfolio review along the entire product life cycle. This requires thorough cooperation between operations and sales/marketing with clear target setting, responsibilities, and management processes.

The implementation of effective portfolio management is accelerated by powerful analytics tools. Widely automated real-time performance analysis on the stock keeping unit (SKU) level is possible today. These tools can project product life cycle trajectories with an accuracy, speed, and efficiency that has been hitherto unachievable.

In summary, the following practices are essential to effective portfolio management:

01 Understand customer preferences and offer appealing products that fulfill their desires.

02 Minimize operational complexity and keep operations flexible by using modular product design, standardization, and late differentiation (postponement strategy).

03 Actively and consistently manage the product portfolio (both in and out) and allocate resources to products according to their future growth potential.

Figure 4. Three key success factors in achieving an optimized product portfolio strategy.

INNOVATION

Over two-thirds of all product innovations in FMCG companies fail. How can this figure be reduced? The product innovation process must be perceived as solving problems for consumers. There are two different types of problems that need to be solved—those both known and unknown. An ideal system for good product innovation addresses both types of problems. Efficiency gains in linear innovation are required to keep up with the competition. At the same time, headspace is required for experimentation that prepares for potentially disruptive business opportunities of the future.

A good innovation strategy embodies the ambition to power innovation. It prioritizes innovation fields to focus on and strikes a balances between linear and disruptive products in the innovation portfolio. A comprehensive strategy and infrastructure are required to enhance and manage innovation, from idea generation to product development and testing to the market rollout. In today's world, innovation processes can be well supplemented by digital technology, particularly by integrating consumers into the process. Modern media allow direct access to the consumer base through such channels as external scouting platforms. As a result, their demands and preferences can be understood at lower cost and in shorter time frames than previously possible. Involving consumers in the product development journey increases the likelihood of releasing a product that will resonate with customers.

In summary, the following practices are essential to good product innovation:

01 Create transparency regarding resources that are linked to linear and disruptive innovation.

02 Increase the profitability in linear innovation by identifying redundant processes, standardizing knowledge, establishing rules as well as efficient processes, and monitoring discipline in the workforce.

03 Boost the hit rate by finding the right talent to solve the problem, establishing guiding principles, making room for individual projects, and allowing values to evolve naturally.

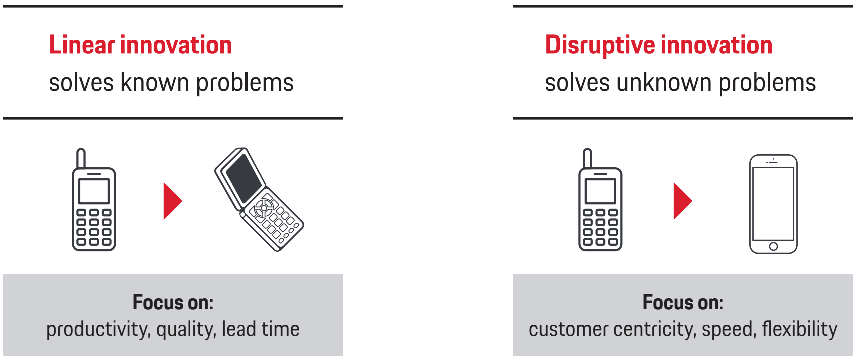


Figure 5. Two different ways to solve problems: linear and disruptive innovation (schematic)

SUPPLY-CHAIN MANAGEMENT

Responsive and reliable at a reasonable cost: this is the ideal of a well-designed supply chain. When setting up the supply chain for a product range or an entire company, both ends—supplier and customers—must be taken into account. The production footprint is in the center of the end-to-end supply chain, focusing on fulfilling customer needs. This holistic view prevents local optimizations, which often harm the overall performance.

An important factor is the level of integration along the supply chain, especially in regard to data consistency and availability; it should be among the criteria for supplier selection. Strategic collaboration between customers and logistics providers is also highly relevant. Data transparency is necessary to be ready for the future, including a willingness to exchange data openly with defined partners. A well-designed and integrated end-to-end supply chain has the potential to decrease logistics costs significantly while increasing the service level and reliability for all parties.

Digitalization solutions arise along the whole supply chain and facilitate optimizations in many cases. However, the most powerful options require a certain maturity and stability of the underlying processes to create value. A good example is the concept of the digital twin where all relevant production and distribution footprints are simulated and mirrored digitally. This allows determining the ideal course of action considering constraints regarding costs, delivery performance and responsiveness.

In summary, the following practices are essential to establish an agile and flexible supply chain:

01 Map the end-to-end supply chain to identify best practices and weak spots.

02 Pilot deeper integration of one selected partner (supplier or customer).

03 Integrate suppliers and customers throughout the entire supply chain, leveraging beneficial solutions—both digital and analog.

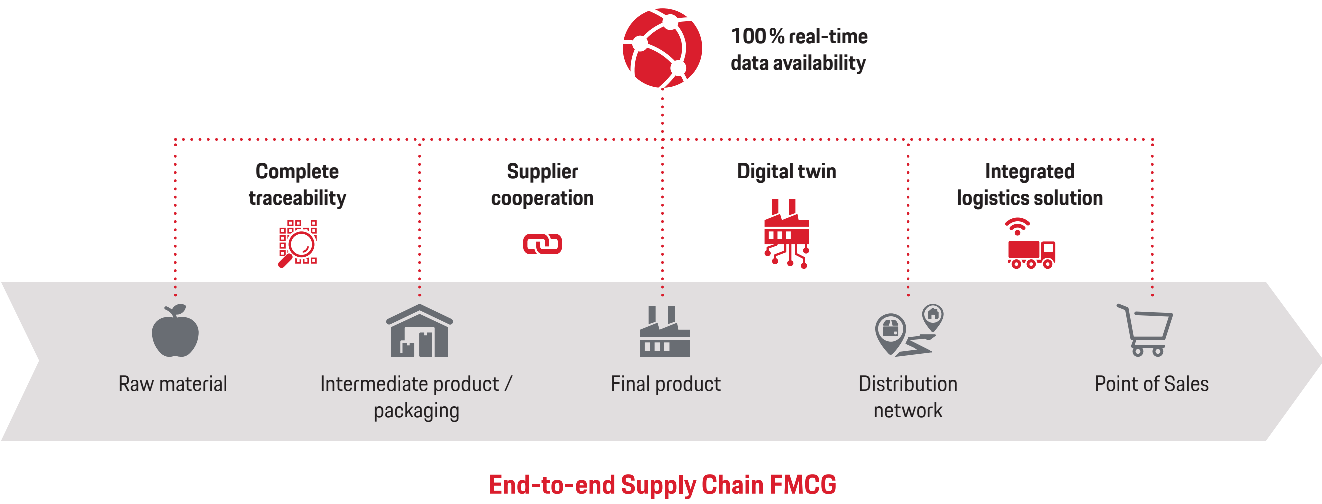


Figure 6. Action fields along the end-to-end supply chain.

SALES AND OPERATIONS PLANNING

Planning that lacks quality can reduce productivity by 5 percent, as measured in overall equipment effectiveness [14]. Or worse, lead to out-of-stock events in retail stores. Sales and operations often purse conflicting goals, a condition enhanced by poor communication between sales, production, and order management departments. An ideal sales and operations planning (S&OP) process is continuous and cross-functional, balancing supply and demand and evaluating its financial impact for mid- and long-term planning horizons. Sourcing and production processes often take longer than the production-planning horizon allows. Forecast accuracy for all planning horizons is therefore a key success factor, and a well-designed S&OP process significantly increases this accuracy.

Improve the demand forecast by drawing on historic demand figures, market insights, and acknowledged trends. Constraints on production limits, material availability, or inventory plans determine the available capacity. The periodic cycle of the S&OP process compares demand with capacity and provides a platform for decisions should conflicts arise. For example, the cost of a short-term capacity increase must be weighed against the inability to fulfill a customer's request. When data is available consistently along the entire supply chain, real-time information regarding stock levels, sales, and promotions can further improve planning capabilities. Due to the relative abundance of data and increasing processing power, the decrease in costs for artificial intelligence (AI) is rendering the introduction of AI to the S&OP process feasible and economically viable.

Align the planning process for all departments involved, including sales, purchasing, planning, and production. This is a key success factor in eliminating silos, unsynchronized planning, and short-term changes that result in high costs.

In summary, the following practices are essential in optimizing the planning process:

01 Assess the current planning processes to identify unsynchronized steps and weak points.

02 Design an S&OP process that is aligned with the departments involved (e.g., sales, planning, purchasing, and operations); consider limitations and possible conflicts of interest.

03 Employ AI and advanced software support to evolve toward an integrated business-planning solution that provides a strong decision base through financial impact forecasts for different scenarios.

Figure 7. The rolling S&OP process consists of five major elements.

OPERATIONAL EXCELLENCE

Over 20 years have passed since the principles of lean production first achieved widespread recognition in Europe. Many companies continue to show tremendous potential in their process optimization: FMCG companies experience 5 to 15 percent in direct areas and 15 to 25 percent in indirect areas [14]. Operational excellence is (still) one of the key success factors in determining the sweet spot between cost, quality, and deliverability. It must be achieved for all relevant processes, however, rather than for some at the expense of others. The definition of a clear target state is crucial to achieving operational excellence. The vision should then be realized in a pragmatic but rigorous implementation project, in tandem with a holistic change management approach, to ensure long term success.

Once process efficiency has reached a certain maturity in the classic (lean) sense, the field of smart, digital applications reveals further opportunities for improvement. With digital tool capabilities continuously evolving, the bar for truly excellent processes is being raised all the time. FMCG champions of today and tomorrow need a comprehensive digitalization strategy and implementation plan.

In summary, the following practices are essential to achieve operational excellence:

01 Develop clear process targets with precisely defined goals along the entire value chain and pursue this vision with a pragmatic approach to implementation.

02 Focus on operational excellence in the classical (lean-) sense before continuing the optimization journey with the implementation of smart and digital technologies.

03 Use well-considered governance and communication plans to alleviate any employee concerns and increase acceptance of the transformation endeavor.

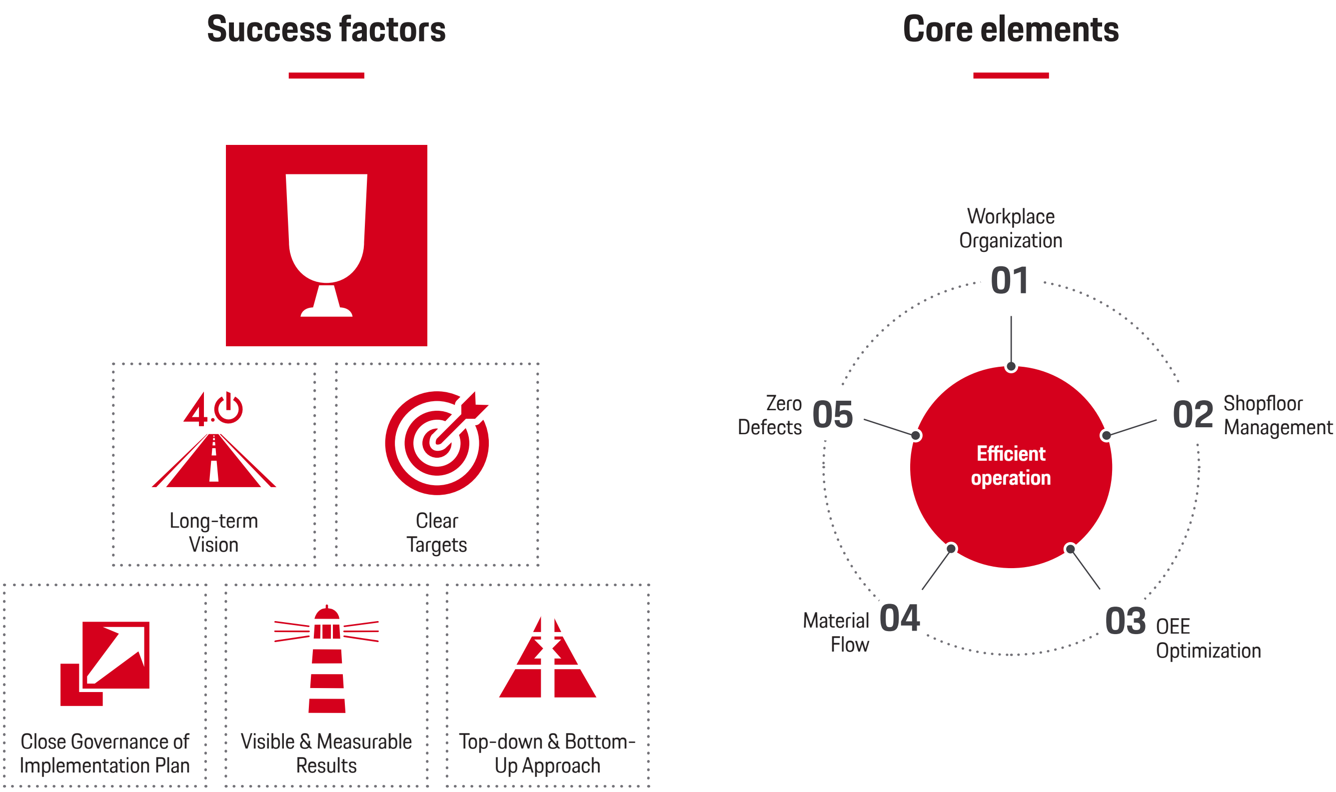


Figure 8. Success factors and core elements of operational excellence.

Outlook: Act sooner (when you can) rather than later (when you must)

Staying on top of the FMCG operations game calls for numerous, manifold, and complex changes. Implementing the five practices demands resources and specialized expertise, both of which are scarce in many companies. But this should not deter any responsible decision-maker. Acting now to stay ahead of the competition not only ensures readiness for the future. Implementing these five practices early on also provides a competitive advantage over those who adopt them later. This offsets initial one-time implementation expenses—often many times over. Furthermore, external specialists are available to support the transformation end to end, if internal means prove insufficient. In the end, the question is not whether adaptation is necessary, but who will adapt first.

Appendix

(1) *https://www.mordorintelligence.com/industry-reports/chia-seeds-market*

(2) *https://www.businessinsider.com/nutella-unica-jars-in-italy-2017-6?IR=T*

(3) *https://www.mms.com/en-gb/history*

(4) *https://www.organic-world.net/yearbook/yearbook-2019/pdf.html*

(5) *https://de.statista.com/statistik/daten/studie/426592/umfrage/umsatz-mit-fleischersatzprodukten-in-deutschland/*

(6) *https://www.unilever.com/sustainable-living/*

(7) *https://www.henkel.de/presse-und-medien/presseinformationen-und-pressemappen/2019-04-29-henkel-setzt-social-plastic-in-verpackungen-fuer-kosmetikprodukte-und-wasch-und-reinigungsmittel-ein-936210*

(8) *http://edition.cnn.com/travel/article/japan-kitkats-chocolate/index.html*

(9) *http://www.agr.gc.ca/eng/industry-markets-and-trade/international-agri-food-market-intelligence/reports/sector-trend-analysis-confectionery-products-in-japan/?id=1532111027726*

(10) *http://oecdobserver.org/news/fullstory.php/aid/3681/An_emerging_middle_class.html*

(11) *Porsche Consulting project experience*

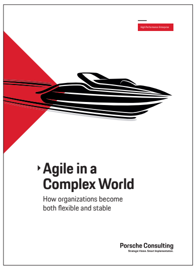
(12) *https://www.nytimes.com/2017/05/11/fashion/sephora-beauty-retail-technology.html*

(13) *https://www.ft.com/content/bd07237e-4e45-11e6-8172-e39ecd3b86fc*

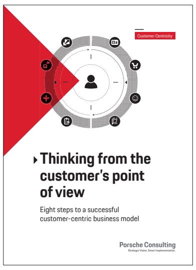
(14) *Porsche Consulting project experience*

Further reading

Spotlight on Corporate-Wide Efficiency Programs



Agile in a Complex World



Thinking from the Customer's Point of View

Five Practices to Accelerate Your Organization to High Performance

Planning in Disruptive Times

Authors

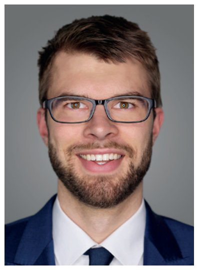
Michael
Tribus
Senior Partner

Contact
+49 170 911 3467

Adrian
Schöning
Associate Partner

Titus
Loss
Manager

Mark
Dreher
Senior Expert



Konstantin
Deichsel
Consultant

Porsche Consulting

Headquartered in Bietigheim-Bissingen, Porsche Consulting GmbH is a subsidiary of the Stuttgart-based sports car manufacturer Dr. Ing. h.c. F. Porsche AG. Founded in 1994, the company currently employs 600 people and is among the top 10 management consultancies in Germany (Lünendonk analysis). Active around the globe, it has offices in Stuttgart, Hamburg, Munich, and Berlin as well as in Milan, São Paulo, Atlanta, Belmont (Silicon Valley), and Shanghai. Following the principle of "Strategic Vision, Smart Implementation," its experts support companies worldwide primarily with their major transformations, the improvement of their performance, and enhancement of their innovative capacity. Their clients are large corporations and medium-sized companies in the automotive, aviation, and aerospace industries, as well as industrial goods. Other clients originate from the financial services, consumer goods, retail, and construction sectors.

Strategic Vision. Smart Implementation.

As a leading consultancy for putting strategies into practice, we have a clear mission: we generate competitive advantage on the basis of measurable results. We think strategically and act pragmatically. We always focus on people – out of principle. This is because success comes from working together with our clients and their employees. We can only reach our aim if we trigger enthusiasm for necessary changes in everyone involved.

Porsche Consulting

Stuttgart | Hamburg | Munich | Berlin | Milan | São Paulo | Atlanta | Belmont | Shanghai

www.porsche-consulting.com