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2018 consumer products industry outlook

Newer approaches and bolder moves

Contents

The drive toward differentiation in 2018

Today's business environment is in a constant state of change. The ability of consumer products (CP) companies to quickly adapt, innovate, and differentiate themselves in the marketplace, thus driving brand growth, is often essential to success. While many CP companies continue to pull traditional levers that enable differentiation such as global expansion, innovation, mergers and acquisitions (M&A), and increased digitization, they're developing newer and bolder strategies to execute these levers against a backdrop of a more stable US and worldwide economy.

Globalization continues to be an avenue of growth. In 2018, CP companies are apt to look for ways to strategically capitalize on the growth in emerging markets as well as for opportunities to acquire or partner with companies in these markets to enable access to their consumers, leverage their market solutions, and in some cases, access sources of raw material.

Innovation, which companies have traditionally looked to as a source of growth, is often being approached through newer and bolder strategies in addition to the classic approaches followed by many CP companies. Many of these newer strategies include: developing company sponsored venture capital-styled incubators, crowdsourcing, innovation through renovation, and continuing to focus on health and wellness/good-for-you products. To keep pace with today's dynamic marketplace, some companies are also adapting the principles borrowed from the software industry of "fail fast, learn quickly, move forward."[1] This involves an agile approach to developing, testing, and iterating innovative ideas compared to traditional, highly structured testing methods that are often time consuming and more costly. Under this approach, companies will quickly introduce a product in select markets and make a decision on its potential in a short time frame.

M&A activity continues to be pursued by many CP companies to achieve differentiation through globalization and innovation. In recent years, several leading CP companies have tirelessly driven market penetration in their home markets, but now are finding it hard to achieve significant new growth. Given this scenario, CP companies are often increasingly looking to expand across geographies and reach out to markets that can drive both sales and profitability. Through M&A activity, many CP companies are turning into global giants and finding new paths to innovation. With slowing growth, many CP companies are shedding "non-core" assets to focus on high margin and growth businesses.

Digitization is now a focal point of strategies in many CP companies as they align technology in creative and efficient ways to optimize customer engagement and influence the consumers' path to purchase while driving innovation and better managing internal operations.

US economy: A steady ship amidst nature's fury

The current economic environment helps set the stage for CP companies' ability to expand globally, innovate, consolidate, and continue their journey toward digitization. The US economy is likely to continue to grow at a moderate 2.0–2.5 percent rate into 2018. A key source of strength is consumers, who have benefitted from a strong labor market and rising incomes. Unemployment is at a record low of 4.2 percent (as of September 2017) with an average of about 148,000 jobs added every month. Real disposable personal income is up, albeit slowly, by 1.8 percent in 2017, and is likely to pick up momentum next year, rising by more than 2.0 percent.[2]

US consumers are also benefitting from low inflation, which is still below the Fed's target. Households are enjoying growing wealth as well, due to rising house prices and strong stock markets.[3] Consumer confidence remains elevated despite uncertainty in the political and economic policymaking areas: As of September 2017, the Conference Board Consumer Confidence Index was 15.8 percent higher than a year ago.[4] In October 2017, the University of Michigan Index of Consumer Sentiment was 16 percent higher than a year ago.[5] Natural disasters, especially hurricanes in Florida, Texas, and Puerto Rico, were in the news in the fall of 2017. While such events dent the local economy, eventually economic data will likely return to moderate baseline growth as the impact of the natural disasters lessens.

The global economy, overall, appears to be accelerating even though the US economy is only growing at a moderate pace and the UK economy is evidently slowing. Yet, the overall trend is positive. Indeed, the central banks of most of the major developed economies are either starting to normalize monetary policy or are thinking about it. Perhaps a significant threat to the health of the global economy is the adoption of protectionist policies—the trend to limit imports or promote exports.[6]

Achieving globalization to drive differentiation and growth

Expanding into global markets is one avenue US-based CP companies can pursue to drive growth and brand differentiation. CP companies could benefit from considering ways in which they can strategically capitalize on the growth in emerging markets and identify opportunities to partner or acquire successful businesses in these markets, thereby having access to their consumers.

Emerging markets represent opportunity for growth

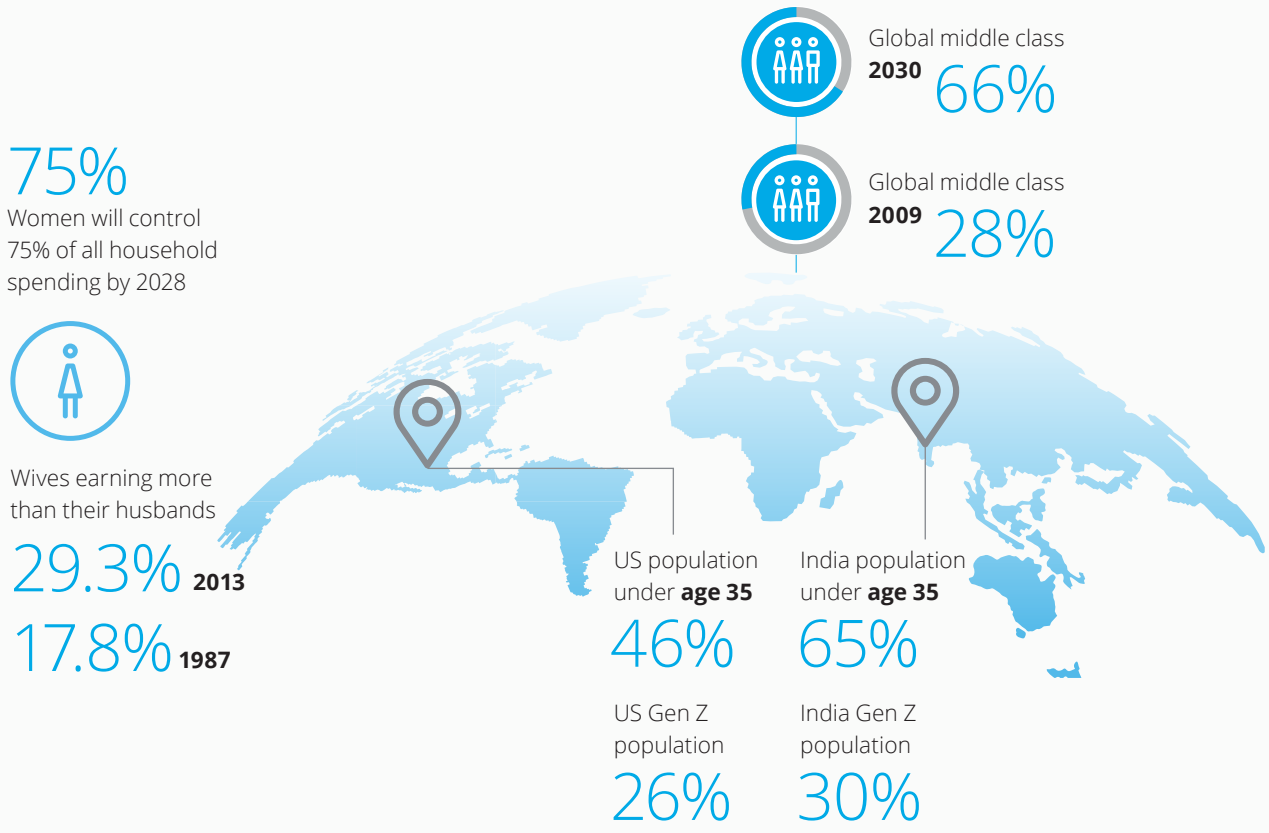
Facing similar issues of weak demand and increased competition in North America across CP categories, many US companies anticipate growth opportunities from outside the United States. Global retail sales of packaged foods is expected to rise to over $3 trillion by 2020 with emerging markets being the primary driver.[7]

CP majors Nestlé and Unilever continue to invest in emerging markets: Nestlé, the world's largest food company, notes that approximately 40 percent of their sales come from emerging markets. By 2020, Nestlé hopes to achieve 45 percent of sales from these regions.[8] Similarly, Unilever has its sights set on making emerging markets 75 percent of its revenue stream by 2020.

Demographic trends in emerging markets suggest there is vast potential in many different product categories, rendering these markets very attractive to many global CP companies. While the global population is estimated to expand to 9 to 9.7 billion people by 2050,[9] most of this growth is likely to come from emerging markets. Significant global trends that may specifically affect emerging markets include:

- The rise of the middle class which, according to the World Bank, will reach 3.2 billion people in 2030, and will constitute 66 percent of the global middle class in 2030 versus only 28 percent as recently as 2009.[10]
- The expanding influence of women shoppers. Women now represent the largest market opportunity in the world. According to Forbes, female consumer purchasing power exceeds the GDP of India and China combined. Women are fast becoming "prominent creators of wealth," and it is expected women will control 75 percent of all household spending by 2028.[11] Further, according to the US Bureau of Labor Statistics, the percentage of wives who earn more than their husbands has risen to 29.3 percent in 2013 as compared to 17.8 percent in 1987.[12]

Figure 1: Demographic trends in emerging markets



- The continually growing influence of younger generations, particularly those in emerging markets. While Millennials account for 27 percent of the global population or about two billion people,[13] emerging markets have a greater percentage of Millennials and younger generations versus established markets: About 65 percent of the population of India is under the age of 35 vs. approximately only 46 percent in the United States.[14] Further, there's an expectation that Gen Z will become a global force as they grow older, enter the workforce, and develop their own preferences. Gen Z represents approximately 26 percent of the US population,[15] slightly more than Millennials and larger than any other segment. In India they account for approximately 30 percent of the population.[16]

Achieving globalization through partnerships

One approach to achieving globalization is through partnerships between US companies and local brands. Such partnerships potentially help US-based companies adapt their products to the needs of a specific market. For example, in a move to enter the $7 billion Chinese toy category, which has posted strong growth through average per-child spending on toys, Mattel recently entered an agreement with China-based online retailer Alibaba. This partnership lets Mattel aggressively sell its core brands to mobile-savvy Chinese parents, thus allowing them to target an audience of about 443 million active buyers via Alibaba's marketplace.[17] Such partnerships mitigate some of the risk in bringing US products to emerging markets and the danger of assuming that US products will be successful in every emerging market.

Realizing the potential of global markets by tapping into consumer insights

Another approach CP companies can pursue to help gain a foothold in the marketplace is to develop deep insights about consumers in the emerging markets they wish to enter. Unilever, for example, reports focusing on local products in response to the "return of nationalism" among consumers and an appetite for local products; they recently coined the term "multipolar" to reflect the trend of local tastes becoming increasingly important.[18] Another example is KFC in China where the dining experience is completely different from that in the United States. This is attributed to two important factors: the local menu that is constantly updated, and the manner in which KFC has customized its standard US business model to embrace local food tastes in China. This pliability is considered critical to its success in the region.[19]

Newer, bolder paths to innovation

While many CP companies have always looked to innovation as a source of growth, what's changing is how companies are pursuing innovation. In addition to following traditional new product development cycles, many CP companies are experimenting with new approaches such as developing their own venture capital-styled incubators, crowdsourcing, innovation through renovation, and continuing to focus on health and wellness/good-for-you products.

Innovation through venture capital-styled incubators

To engage with a wide range of innovative partners and hasten the innovation process, many CP companies are setting up their own units to invest in start-up companies and entrepreneurs who tend to be more closely and organically in tune with the consumers.

Coca-Cola's Venturing & Emerging Brands (VEB) unit operates as part venture capitalist, part brand incubator, and part industry forecaster. The team invests in and produces groundbreaking beverages that satisfy unmet consumer needs. VEB invests in startups that have reached an annual revenue of $10 million. Brands such as NOS and FUZE are recent success stories helping build Coke's portfolio of thirst-quenching brands[20] and is the third-fastest growing energy drink in the US market, quickly attaining about five percent market penetration[21] and has rapidly grown in the energy drinks space.[22] Similarly, Coca-Cola expects FUZE, a line of vitamin-enriched, non-carbonated fruit drinks, to be a significant contributor to their business in North America. FUZE Tea is the latest Coca-Cola brand to join the $1 billion club.[23]

Similarly, L'Oréal has invested in Founders Factory, a multi-sector digital accelerator and incubator, which allows L'Oréal to connect to a global ecosystem of world-class startups and entrepreneurs operating in the field of beauty. Based on this partnership, the company will become Founders Factory's exclusive partner for investments in beauty tech startups worldwide. L'Oréal has often been ahead of competition in its digital innovations, with products such as an augmented reality-based app called Makeup Genius and a skin sensor designed to monitor ultraviolet light exposure.[24]

Companies are also applying the venture-styled incubation model by working in collaboration with other entities. For example, Mars Inc. has collaborated with diverse parties including Thermo Fisher Scientific, the Partnership for Aflatoxin Control in Africa (PACA), the University of California, Davis, the University of Washington, and Northeastern University to launch an innovative food safety initiative. This effort aims to use crowdsourcing to call for solutions to prevent the spread of aflatoxin, a little known but dangerous foodborne toxin that can cause liver cancer and growth stunting. In October 2017, a series of aflatoxin puzzles went online on Foldit, a gaming platform chosen to increase awareness of this issue. All player designs will be available in the public domain, free of patents, in order to maximize the positive impact the project could have on global food safety. Through such innovation and collaboration methods, Mars' goal is to combat the causes of unsafe food and improve global food security as part of its Sustainable in a Generation plan.[25]

Innovation through crowdsourcing and partnering with consumers

While CP companies have been leaders in connecting with consumers through traditional market research methodologies, by implementing crowdsourcing approaches, many CP companies are now asking entrepreneurs and everyday consumers to submit innovation solutions through online communities such as NineSights.com, Indiegogo.com, and eYeka. These sites connect companies of all sizes with creative, entrepreneurial talent with the objective of tapping into their innovative ideas.

A recent example in the CP space is Reckitt & Benckiser who has teamed up with Indiegogo to launch its Healthier Tomorrow Challenge. The challenge was aimed at accelerating the pace of innovation for entrepreneurs within the health and well-being sectors, providing an opportunity to deliver their healthy ideas and products into homes worldwide.[26]

Innovation through renovation

This approach involves revisiting products that have been extremely successful in the past with the goal of transforming them to help ensure relevancy in today's marketplace. There are numerous potential benefits to this approach including less investment,

faster payback, ease of distribution, and instant brand name recognition.[27] Kraft Heinz has taken this approach by reinventing two of its iconic brands, Oscar Mayer and Kraft Mac & Cheese, with less or no artificial ingredients. Responding to the consumer trend of healthier foods with less additives, the recipes for Kraft Mac & Cheese were changed to take out artificial ingredients. The company shipped the revised product without telling consumers and saw no fluctuation in sales prior to announcing the change. The company anticipates balancing innovation and renovation over the next 18 to 24 months.[28]

Innovation through continued focus on health and wellness/good-for-you products

Worldwide, many consumers continue to be interested in more healthy and nutritious food offerings. Across the globe consumers are demanding more wholesome and nutritious products. Seventy-seven percent of global respondents in a Nielsen survey said that all natural ingredients were a very or moderately important factor in their snacking choices.[29] Further, Nielsen's Ingredient and Dining-Out Trends Around the World report shows that consumers are cutting back on certain foods that are typically high in fat, sugar, or sodium. Consumers are adopting a back-to-basics mind-set, focusing on simple ingredients and fewer processed foods. More than half of consumers say they're avoiding artificial ingredients, hormones or antibiotics, genetically modified organisms (GMOs), and bisphenol A (BPA).[30]

Responding to consumers' continued interest in health and wellness/good-for-you products, many CP companies continue to be proactive in developing and deploying advancements in R&D and technology. Reducing the amount of sugar, or providing no sugar options, is a goal being pursued by many CP companies.

For example:

- Cargill will launch its next generation zero calorie Stevia sweetener EverSweet in 2018. Cargill found that the leaves of Stevia had trace amounts of glycosides Reb M and Reb D that offered an increased sweetness similar to sugar. Further research by Cargill has revealed that controlled fermentation would increase the quantities of Reb M and Reb D molecules, further increasing sweet taste without adding calories.[31]
- Similarly, Nestlé has engineered a way to naturally restructure the sugar molecule, resulting in a reduction in the amount ingested. Nestlé plans to add the new sugar to its products in 2018, allowing the company to use up to 40 percent less sugar without compromising on sweetness of their products.[32]
- With regard to general, overall nutrition, Nestlé is focusing on R&D to identify and promote the therapeutic role nutrition plays in daily eating. This is being addressed through multiple research units focusing on innovating and developing new products in the nutrition space; these include: Nestlé Institute of Health Sciences, Nestlé Nutrition Institute, Corporate Nutrition, and Health and Wellness units.[33]

M&A is an organic path to globalization and innovation

When it comes to mega-mergers, motivations are multifaceted. Sometimes they're driven by the potential for expanding market access or the prospect of creating brand value through cost savings, while other times it's a combination of the two. Regardless of motivation, M&A activity enables CP companies to expand into global markets as well as pursue newer paths to innovation as discussed above.

The first half of 2017 witnessed an increase in iconic transactions (deal value of $1B+) among CP companies compared to 2016. Globally, 17 iconic deals were announced worth $95.3 billion, of which 7 (worth a combined $32.6 billion) involved US targets. This is an increase from 2016 where only two mega-deals totaling $70.2 billion were announced. In terms of volume, while the first half of 2016 saw 391 deals (747 in all), the same period in 2017 saw 492 deals.[34]

Due to its steadily growing economy, the United States remained an attractive investment destination among foreign buyers in the first half of 2017—led by the UK (at $19.2 billion), followed by France ($1.8 billion). In this period, US CP cross-border deal value grew 66.3 percent YoY to $22.6 billion; volume grew 20 percent to 84 deals compared to same period last year.[35]

Strategic buyers continue to drive activity in CP as the share of private equity firms is very low at 3 percent by value and 9 percent by volume. Food and Beverage (F&B) sub-sector topped the CP M&A activity with 51 percent and 63 percent deal share in volume and value, respectively, followed by Textiles and Apparels (19 percent and 16 percent, respectively).[36] Some noteworthy transactions in F&B space this year include:

- UK-based Reckitt Benckiser's $17.8 billion deal to acquire Mead Johnson Nutrition Co., which is expected to double Reckitt's business, while expanding its exposure to the US market.
- Tyson Foods' $4.1 billion acquisition of AdvancePierre Foods Holdings Inc. intended at expanding Tyson's portfolio of prepared foods and protein-packed brands. The demand for meat-based snacks has been growing as Americans increasingly turn to protein food, thereby driving acquisitions of meat snack makers.

Looking ahead, the uptick in CP M&A activity is likely to continue in 2018. The steady growth in the US economy is driving up the jobs rate and the rise in consumer spending, albeit gradual, can provide a conducive platform to consolidation. Activity will likely be driven by one of the two viewpoints: 1) acquisitions for growth and differentiation, and 2) divestitures to become leaner organizations focused on core brands and profitability. F&B will likely continue to constitute the major portion of this activity. M&A drivers in this space could include: innovative solutions to sustainable foods growth; consolidation of mature brands; continual changes in the retail; opportunities in emerging markets by virtue of their demography; and the digital way forward.[37]

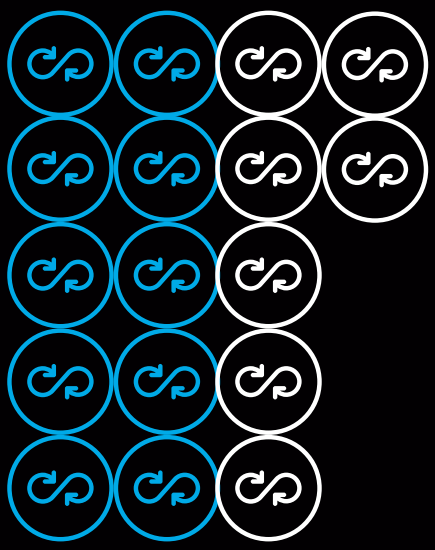
Iconic transactions among CP companies

17 iconic deals

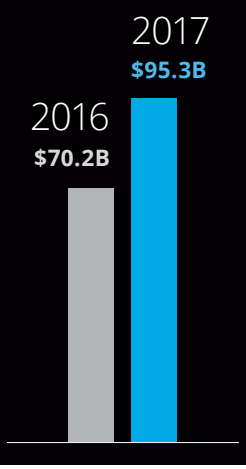
$95.3B

7 deals

$32.6B



Increase in mega-deals between 2016 and 2017



Digitization continues to drive differentiation through efficiency and creativity

Digital technologies and applications have a wide influence on many CP companies, from interacting with consumers to operations and procurement. In some organizations, the company's digital strategy is increasingly becoming part of its overall business strategy. There's a sense in which all companies now need to consider themselves in the technology business. Thus, CP companies could benefit from continually investing in digital technologies to deepen customer engagement and enhance the consumers' path to purchase. Investing in digital technologies could also benefit CP companies by driving efficiency in supply chain.

There has been real progress in the journey to digitization in recent years, but there's still room to grow. For example, CP companies are no longer standing on the sideline of the digital economy. As suggested in Deloitte's paper, *The Grocery Digital Divide: Digital's impact on the consumer path to purchase,* 2016 marked the year that digital arrived in grocery, with 51 percent of grocery sales influenced by digital somewhere along the path to purchase.[38] This represents an almost doubling in influence year over year and puts grocery on par with digital stalwart categories like electronics and home.[39] Digital now permeates the entire path to purchase. Many CP companies now have the means to reach consumers during all stages of their shopping experience. Eighty percent of shoppers have used a digital device to browse or research grocery products, and mobile usage among grocery shoppers is up nearly 10 percent from last year.[40]

Promoting real-time customer engagement

To engage directly with their consumers, many CP companies have created social listening programs that entail monitoring conversations on social media and responding to them in real time. Often referred to as "war rooms" or "newsrooms," these units are characterized by their ability to be extremely nimble and cut through the red tape previously involved in communicating directly with consumers.

For example, Adidas created digital newsrooms in 12 cities around the world. Marketers staffing the newsrooms are empowered to act on the trend by creating and deploying content in real time. For example, during the 2016 summer football season, Adidas used its digital newsroom capability to maximize consumer interaction with its #FirstNeverFollows campaign. The product focus was footwear worn by a number of the world's biggest soccer stars, with storytelling to give consumers context about the feeling of being first.[41] There are numerous examples of companies engaging with consumers in this manner. It's likely that if consumers aren't interacting with their brand of choice, they can quickly engage with a competitive brand, making it imperative that many CP companies develop similar programs to stay in touch with their consumers in real time to solidify their user base.

Promoting e-commerce

Digital technologies continue to enable the growth of e-commerce. Though still only a small part of CP sales, online sales are experiencing dramatic growth: It is estimated that online sales of CP products will increase by 350 percent to $36 billion in 2018 from $8 billion as recently as 2013. By comparison, offline (brick-and-mortar) sales will increase by just 3.6 percent over the same period.[42]

Many CP companies are increasingly turning to e-retailers in addition to traditional sales channels. For example, after years of selling directly to consumers through stores and other retail partners, apparel manufacturers like Adidas and Under Armour are selling shoes and clothing through Amazon.[43]

Many CP companies continue to debate the benefits of selling directly to consumers vs. partnering with e-retailers. While e-retailers provide companies with access to their buyers, e-retailer sales potentially cannibalize a company's sales through brick-and-mortar and other traditional channels. E-retailers also control the relationship with the consumer, and often sell the product at a lower price, thus cutting into the manufacturer's margins. The shift to e-commerce is increasingly becoming about availability and access to customer data; the more e-retailers sell, the more they learn about their customers, enabling them to develop cross-sell and upsell strategies.

Blockchain applications

Blockchain applications can be invaluable for CP manufacturers, especially in the context of their supply chains. According to Deloitte's *Blockchain survey 2017: Blockchain reaching beyond financial services,* blockchain technology is emerging as a key business focus for US companies in many industries. In the CP and manufacturing industry, 42 percent of executives surveyed planned an investment of $5 million or more in 2017. This would potentially improve cyber defense as the platform can secure and prevent fraudulent activities through consensus mechanisms, and detect data tampering based on its underlying characteristics of immutability, transparency, auditability, data encryption, and operational resilience.[44]

Looking forward

It's estimated that online sales of CP products will **increase by 350 percent to $36 billion in 2018 from $8 billion** as recently as 2013.

Expect 2018 to be a year of newer approaches and bolder moves by many CP companies as they as look to build differentiation and growth. Against the backdrop of a more stable US and global economy that sets the stage for achieving globalization, innovation, M&A activity, and increased digitalization, CP companies will likely continue to reinterpret traditional levers to stimulate growth in a competitive business environment.

- In 2018, globalization will likely entail acquiring or partnering with companies in emerging markets to enable access to their consumers, leverage their market solutions and, in some cases, access sources of raw material.
- Many CP companies will look to newer approaches to innovation such as developing company sponsored venture capital-styled incubators, crowdsourcing, innovation through renovation, continuing to focus on health and wellness/good-for-you products, and applying more agile approaches to developing and testing products.
- M&A activity will likely continue to increase in 2018 as companies continue to consolidate and expand their global presence in the quest for growth and innovation, transforming CP companies into global giants.
- Many CP companies will continue on the path to digitization, focusing on customer engagement by connecting with their consumers in new ways and optimizing internal operations. Continual digitization will likely be a strong enabler in achieving the growth targets for CP companies.

Ahead are also uncertainties related to the current policymaking environment and the potential changing regulations in the United States proposed by the current administration as well as by Brexit in the United Kingdom. At present, it's challenging to predict how these will likely impact CP companies, but we'll continue to address these topics in forthcoming discussions, identifying potential scenarios and implications for CP companies.

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