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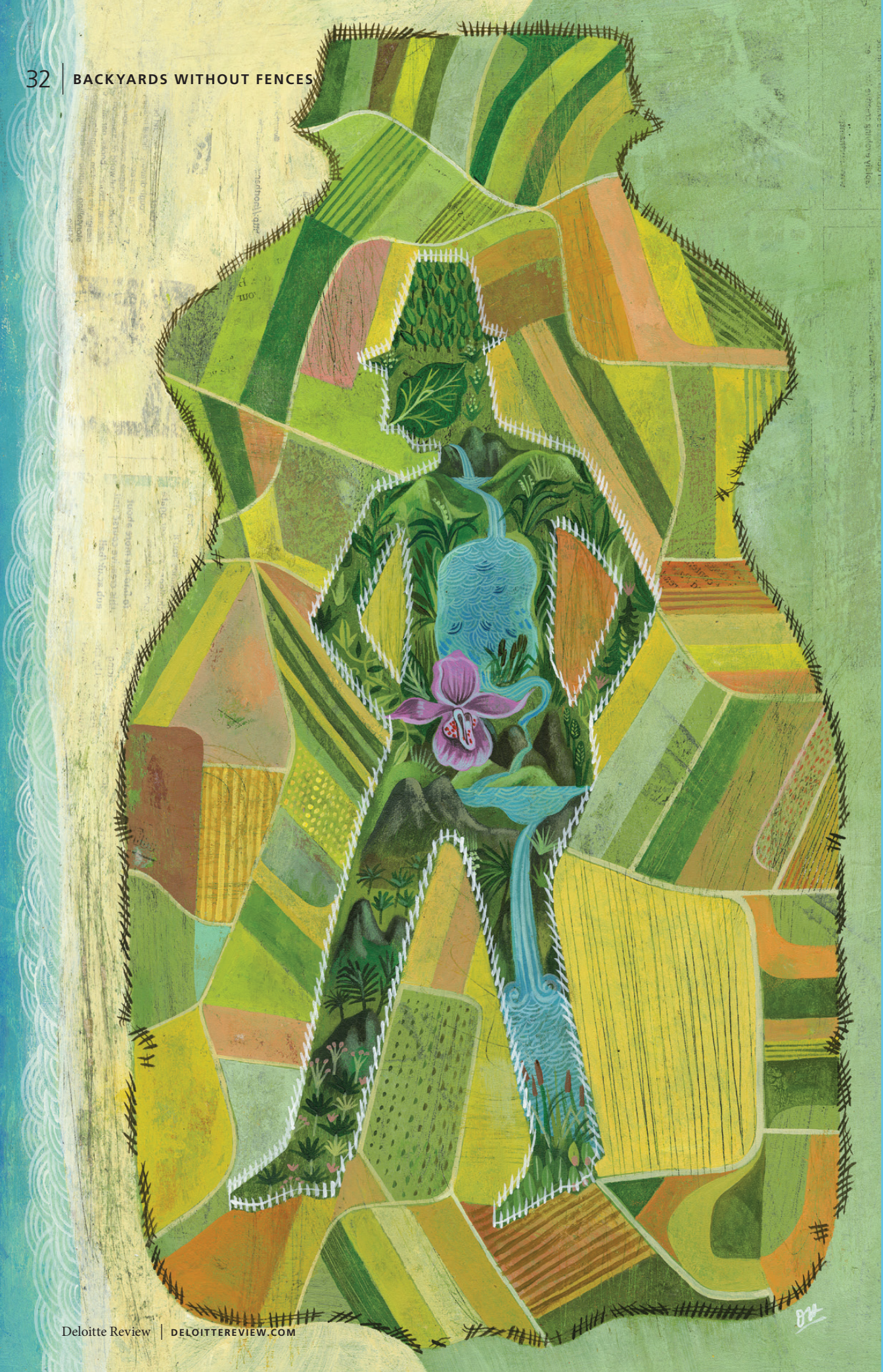
> ILLUSTRATION BY OLAF HAJEK



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Fences serve many purposes. For ranchers and farmers, fences not only mark the boundaries of their land, but also keep unwanted predators out and valued livestock in. Tall fences provide privacy, often leaving neighbors wondering what is behind the tall wall. Over time, however, a barbed-wire fence rusts, wooden fences rot, and stone fences crumble, allowing the unwanted in and the wanted out. For many farmers, repairing fences, maintaining boundaries, and strengthening fortifications is a never-ending task.

So it is with consumer product companies. Over the past three decades, many consumer product companies in the United States had strong fences to mark their territory and protect their business. Most large companies in the industry often enjoyed unquestioned consumer trust in their brands; a fragmented, often subordinate, retailer base; a vast innovation and quality advantage over store brands; a command of advertising media; and the resource and margin advantages associated with scale. The US consumer base, too, was relatively homogeneous, making it easier to capture the business of large numbers of consumers using relatively undifferentiated tactics.

But times have changed.

Today, many brands struggle to maintain relevance and command a price premium. The retail base has consolidated among fewer and larger national retailers. Sales are shifting from traditional channels to emerging channels, including e-commerce. Moreover, consumers today are more heterogeneous in their preferences and expectations, driving the need for more granular segmentation and targeting strategies.

Shifts such as these are eroding the traditional fences that large consumer product companies were once able to maintain around sizeable consumer populations. To build new, more effective fences, consumer product executives need an updated understanding of both the US consumer base and the landscape in which they operate—both of which have become substantially more complex than they were a few decades ago.

A DIVERSIFYING CONSUMER BASE

Ongoing demographic changes in the United States have driven increasing diversity in consumer tastes, preferences, and expectations.[1] Unlike in the 1980s and 1990s, when buying power was mostly concentrated in the hands of the Baby Boomers, there is no "typical" consumer profile that can be applied across today's US marketplace. In order to thrive, consumer product companies now need to take a much more differentiated approach. Four demographic phenomena in particular that consumer product companies should take into account are the increasing purchasing power of Millennials, the aging of the Baby Boomers, a growing Hispanic population, and the shrinking of the middle class (see figure 1).

Increasing Millennial purchasing power

Meeting the demands of the Millennial generation is critical, as this generation will represent 30 percent of consumer product spend by 2020.[2] Although research shows that Millennials are racially diverse and disparate in their needs and expectations, it is possible to identify some common themes running through their consumer product purchase behavior.[3]

Millennials tend to hold strong values that are reflected in their buying choices. According to a recent interview with a veteran executive from a leading food company, Millennials not only want their food to taste good, be affordable, be convenient, and deliver good value—they also want food that is natural, less processed, and devoid of additives.[4] In a recent Deloitte LLP survey, 59 percent of twentysomethings said that they would be willing to pay more for green products.[5]

While Millennials are typically not difficult to reach, as they are digitally savvy and constantly connected, it can be more complex to sway them. Brand reputation,

Figure 1. Important US consumer demographic segments

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for both old brands and new, is still important. Over 55 percent of twentysomething consumers follow at least one consumer product company on social media, and 63 percent said they purchased a higher-priced product when a cheaper alternative was available because the pricier product came from a brand they trust. Millennials are plugged in, trust their community, and do their homework—61 percent of twentysomething consumers research products they are interested in using mobile apps and websites.[12] However, traditional media still matters: 77 percent of twentysomethings indicated that they recently purchased a product because traditional advertising made them aware of it.[13]

Aging Baby Boomers

The aging of Baby Boomers also represents a major change for consumer product companies. While most consumer product companies no longer view Boomers as their primary target, the sector will continue to be a valuable, and an understanding

of their evolving needs is important. The Baby Boomers were the largest generation in American history; by 2017, they will comprise half of the US population.[14] As such, they account for a significant share of spend on consumer products (49 percent), and control 70 percent of the nation's disposable income.[15]

Many Boomers are health- and value-conscious. In a 2014 survey, 77 percent said they prefer products with fewer ingredients. Sixty-six percent said they were more open to trying store brands than they were a year ago.[16] As they age, Boomers can still be influenced by traditional media: 74 percent of consumers over age 60 agreed that traditional advertisements and promotions make them aware of products they want to buy.[17]

Growing Hispanic population

Although the term "Hispanic" refers to people whose origins span many countries across Latin America, these cultures share many common characteristics. This growing consumer segment will account for 20 percent of the US population by 2020; by 2050, that number will grow to 30 percent.[18] Not only their growing numbers but also their attitudes and behavior make the Hispanic population important. Their preference for national brands, frequent shopping trips, and connectivity via mobile devices makes them a particularly attractive segment for consumer products companies, which have an opportunity to leverage these attributes to drive sales among this population.[19]

According to the 2014 Deloitte American Pantry Study, Hispanic consumers, compared with non-Hispanic consumers, were more likely to indicate that they were interested in preparing fresh meals, and they were more likely to agree that they love to cook and prepare great meals for their families. They were also more likely to indicate that they shop often; on average, they make nearly twice as many trips per month to the grocery store as non-Hispanic shoppers. In the 2014 survey, they indicated that they were spending more per month across major food and household categories than in the previous year.[20] All of this suggests that the Hispanic consumer segment could offer a growth opportunity for consumer product companies.

Marketing efforts based on brand can be especially effective among Hispanic consumers, who tend to be more loyal to national brands than non-Hispanic shoppers, as well as more likely to see national brands as aspirational. As one seasoned food executive noted, "[Hispanics purchase] brands that they know and trust."[21] In the 2014 Deloitte American Pantry Study, Hispanic consumers were more likely to agree that they believe that the brands they buy say a lot about who they are, and they were more likely to say that they intend to buy more national brands as the economy improves.[22]

Technology could be an important tool with which to influence Hispanic shoppers. With a higher mobile phone penetration rate than the national average,[23] Hispanic shoppers, compared with non-Hispanic shoppers, indicated that they are more likely to use a mobile device while shopping and more likely to use a smartphone to compare prices and download coupons.[24]

Shrinking middle class

The large market once created by a substantial American middle class is shrinking. The middle class is being squeezed from both sides, with nearly 50 percent of US households earning under $50,000 and over 21 percent earning over $100,000.[25] The emergence of this bifurcated, barbell income distribution poses a threat to companies that historically enjoyed playing in the middle, as it weakens the traditional consumer base for many national consumer product companies.[26]

VANISHING FENCE POSTS

The challenges posed by the growing diversity of the US consumer population are exacerbated by the weakening of many traditional fence posts that consumer product companies once relied upon to safeguard their market position. Forces such as the technology-enabled explosion of information and choice, retailer consolidation and channel conflict, and the proliferation of smaller brands due to lower barriers to entry are reducing the ability of big consumer product companies to protect and serve a large market of consumers.

Diminishing brand loyalty

Loyalty to national brands, once a bulwark for large consumer product companies, has been declining over the last three decades. A recent Deloitte survey found that consumers consider only 31 percent of the brands they buy to be "must have" brands—brands they will buy at the retail price even if other products are on sale.[27] Further, the survey found that for 41 percent of the national brands measured, the percentage of

consumers who ranked the brand a "must have brand" has decreased from 2011 to 2013.[28] A perceived lack of innovation and differentiation among brand offerings, an increase in the number of product choices, and evolving consumer preferences are a few of the myriad forces contributing to this erosion.

One factor weakening loyalty to national brands is likely to be the increase in quality, real and perceived, among store brands: 88 percent of consumers in a recent survey indicated that they have found store brands that are "just as good as national brands."[29] Indeed, store brands continue to gain market share in many product categories; in the supermarket channel, for example, nearly one out of every four products sold is a store brand.[30] The tiering of store brands to include basic and premium levels as well as the growth of niche and alternative market brands further contribute to luring consumers away from national brands.

The impact of store brands can be seen in the contribution of private labels to sales at Kroger, a national supermarket chain. Excluding fuel and pharmacy sales, sales of private labels increased from 23 percent in the first quarter of 2012 to about 25 percent in both the first and second quarters of 2014.[31] Private label sales at Kroger are currently estimated at almost $20 billion annually.[32] Kroger's "good, better, best" tiered strategy for private labels helps it to serve a broad customer base at a variety of price points.

Retailers are gaining power

Historically, large consumer product companies enjoyed empowered relationships with their retail partners, most of which were small, fragmented regional players. With the balance of power arguably in their hands, large consumer product companies could negotiate favorable positions vis-à-vis their retail partners. By contrast, consumer product companies today face a rapidly changing retail environment in which retailers wield increasing power. The consolidation occurring in the grocery channel, the concentration of consumer product company sales through their top retail partners, the growth of store brands, and increasing consumer loyalty to specific retailers are all factors contributing to retailers' rise in relative power.

Channel dynamics are becoming more complex

In the past, simpler channel dynamics enabled large consumer product companies to serve a sizeable consumer base with relatively simple approaches. Today, however, time-starved, fiscally minded consumers have multiple channels to choose from, both online and physical, when they want to buy a given product. They are increasingly looking to non-grocery channels such as mass merchandise stores, supercenters, and dollar stores to fulfill their needs for both food and

non-food items. For example, club stores today are often meeting consumer needs traditionally served by the grocery channel. Seventy-two percent of retail and consumer executives in a recent Deloitte survey expected the space allocated to fresh food and beverages in club stores to increase over the next two years, and 75 percent expected the space allocated to health and wellness in club stores to increase.[33]

In addition, online shopping for groceries and other consumer product items is increasingly becoming a reality. With delivery models such as Instacart and Amazon Fresh, shoppers are learning that e-commerce is not only for shoes and books. In one recent survey, consumers indicated that they planned to buy more of their food, beverage, personal care, and household consumables online.[34] Another survey revealed that, of consumers who had shopped online in the past year, 51 percent agreed that an online retailer had increased in importance in meeting their family's needs.[35]

As consumers gain access to a greater variety of channels, and expect to purchase a broader variety of products within each channel, consumer product companies are being challenged to satisfy these consumer expectations. Consumer product companies are tasked to develop and execute new channel-specific approaches; these approaches must contend with the associated complexity this creates for an often siloed organizational structure as well as the sales, marketing, and distribution strategies.

Size no longer necessarily equals strength

Historically, consumer product companies were able to protect their markets from competitors by leveraging their large asset bases and scale. Large brands supported by these sophisticated and complex organizations, supply chains, and distribution systems created barriers against attacks from outside forces. However, in today's age of crowdsourced funding; rapid prototyping; outsourced development and distribution; and social-media-enabled research, testing, and marketing, smaller companies without large asset bases are becoming a growing threat to larger companies. A recent Deloitte analysis revealed that while consumer product companies with sales over $10 billion do enjoy a higher return on assets, smaller companies, particularly in the food, beverage, tobacco, and household and personal products subsectors, are slowly beginning to narrow that gap.[36]

In addition, in one consumer products subsector, the gross margin advantage that scale once helped to provide is crumbling. Gross margins in the food, beverage, and tobacco subsectors have been falling, possibly due to the pricing pressure created by empowered retailers and more-informed consumers coupled with rising input cost volatility.[37]

BUILDING NEW FENCES

In light of changing demographics and the accompanying shifts in tastes and preferences, together with declining brand loyalty, consumer product companies should consider revisiting the way they engage with consumers.

Update the consumer segmentation strategy

The process begins with reviewing which distinct consumer segments to target. First, company leaders should push marketers and data scientists to target consumers based on attitudes, preferences, and behaviors in addition to traditional demographics. Consumers with common attitudes and behaviors (for example, those inclined toward frugality or brand loyalty) may not divide along traditional demographic lines such as gender, income, geography, age, and ethnicity. Targeting based on what is in a consumer's mind instead of simply demographics and location may not only drive greater ROI, but also change the way consumer product companies engage with consumers.

Second, consumer product companies should not limit segmentation to a handful of clusters; instead, they should push the thinking to consider many micro-segments. This strategy reflects a shift in mindset away from the belief that growth comes primarily from focusing on the largest segment of like consumers toward the notion that growth comes from effectively targeting smaller consumer segments. Targeting smaller segments may feel uncomfortable at first, but consumer product companies that meet distinct, granular consumer needs better than their competitors can be well positioned for growth in the long run. For example, one food products company started creating products with spicier flavors two decades ago in order to target consumers who preferred a spicier cuisine. As ethnic populations grew, and tastes shifted toward spicier food across the United States, the company has reaped the benefits.

Effectively targeting narrow consumer segments requires more than just finely segmenting and prioritizing target consumers. It requires drawing a solid line around the segments that are most valuable and having an unwavering commitment to maintaining the appropriate product offerings, channel strategy, and brand messaging for that discrete segment. As a company begins to shift its thinking toward smaller consumer segments, it could also consider customization opportunities—areas in which individual consumers will pay a premium for a product designed specifically for them (for example, unique flavors or formulation). This mindset can apply in both seemingly mature markets and growing markets. As companies pursue this refined segmentation path, they can consider nesting sub-brands beneath

an umbrella brand; this approach will allow the company to maintain the primary brand identity while also creating tailored offerings.

Use technology to better understand and serve consumers

Technology is playing an increasing role in protecting existing consumer relationships and building new connections. Consumer product companies should focus on enhancing the consumer experience during the pre-store planning process, the in-store or online shopping activity, and during post-purchase interaction to drive greater brand loyalty. For example, leaders could consider deploying mobile and online technology to entice shoppers before they begin shopping, to interrupt and encourage them to purchase products in-store, and to prompt them to share positive product opinions after the purchase. Post-purchase interaction is important, and brands should work on building lasting relationships. Technology gives consumers a voice, and word of mouth matters: Using technology, consumer product companies can seek to empower consumers to develop communities and to become brand ambassadors.

The use of technology and the ability to gather consumer data also enables companies to apply insights from the data systematically to drive the product development process. The data trail of consumer activity and preferences becomes an important input to the innovation process. A deeper understanding of the consumer can fuel innovation that encompasses more than tweaks to product features and

extends beyond the product itself. The scope of innovation can be broadened to include product delivery (for example, coffee pods, meal kits), product formats (for example, fresh versus canned versus frozen), and complementary services (for example, menu planning, recipe management). Consumer data can also point companies toward growth opportunities in adjacent product categories where a brand currently does not have a presence and where the consumer experience could be enhanced with a broader set of offerings.

Optimize brand and product portfolio in each category

An effective brand and product portfolio strategy is one tool consumer product companies can use to take greater control of their retailer relationships. Challenged by intense competition for shelf space, the growth of store brands, and the increase in retailer relationships with consumers via loyalty programs, consumer product companies may wish to focus their efforts on high-growth products rather than trying to meet a broad range of consumer preferences and price points. Armed with a robust understanding of their target segments, cost to serve, product profitability, and competitive set, companies may need to consider jettisoning products, or even abandoning categories, where they cannot sustain profitable growth. With a potentially narrower array of offerings, consumer product companies can focus their efforts on meeting their target consumers' needs through product reformulations and innovation. As they redouble their efforts within the most important brands and categories, consumer product companies can regain some power relative to retailers through strong brand equity, higher margins, and streamlined operations.

Rationalize channels and embrace digital commerce

An effective way to address channel blurring and recapture some influence over retailers can be to reevaluate the channel strategy. For some products, ubiquitous access is an important determinant of success. For others, however, a selective approach to channel availability would enable a consumer product company to focus its innovation, planning, marketing, and distribution efforts. Traditionally, consumer product companies have hesitated to limit product availability to a few retailers or channels, since this was viewed as potentially reducing negotiating power with retailers. However, providing the right strategic retail partners with fewer opportunities for channel conflict—and perhaps, at times, offering exclusive products—could strengthen relationships with retailers and result in more prominent placement in stores.

In refining channel strategies, consumer product companies must understand what needs different channels satisfy for each target segment and develop an

optimal channel strategy that allows the consumer to discover, build awareness, purchase, share enthusiasm, and repurchase. Each channel should be considered as part of a holistic, cohesive channel strategy that allows consumer product companies to engage with and, ideally, learn from the consumer at each touchpoint.

An important component of a channel strategy is the inclusion of digital commerce approaches, including a consideration of direct-to-consumer options. Digital commerce offers consumer product companies a way to market products that cannot command coveted shelf space in a brick-and-mortar store, to provide customized formulations, to drive new product trials, and to entice consumers with convenience. Further, direct-to-consumer approaches empower consumer product companies to engage with their consumers and to learn more about their preferences. Consumer product companies should look to offset the advantage that retailers have with point-of-sale transaction data and loyalty program data with their own analytics to better target individual consumers with tailored offerings. While pursuing these approaches, it is also important for consumer product companies to maintain mutually favorable relationships with their retail partners and to strive to minimize the potential for conflict.

Become the right-sized business

Large consumer product companies should not assume that scale provides a competitive advantage. Sometimes, scale helps; sometimes, it is a hindrance. For each brand, consider the continuum of options along the following dimensions:

- **Consumer segments:** Are there additional, potentially lucrative consumer segments to target? Or should the brand focus on fewer target consumer segments?
- **Product categories:** Should the brand expand to include more product categories? Or should the brand narrow the product categories on which it focuses?
- **Variety and number of SKUs:** Should the brand expand its SKU count and increase variety in existing product categories? Or should the brand focus on fewer SKUs in existing product categories?
- **Channels:** Should the brand expand or narrow channel availability?
- **Marketing:** Will more advertising and marketing improve marketing ROI? Or will less advertising and marketing improve marketing ROI?
- **Innovation:** Should brands increase R&D and also focus R&D on non-product aspects? Or should brands stop R&D or externally source it?

- **Supply chain, manufacturing, and distribution:** Would an increase or decrease in volume substantially improve margins?

Consumer product companies should not only consider the extremes at the ends of the continuum, but also points in between. One important consideration in determining the most effective size for the business is the mix between developed and developing target markets. Many consumer product companies may find that their opportunities for growth lie outside of traditional mature economies, as economic growth is creating a growing middle class in many emerging markets, including Brazil, India, Indonesia, China, and sub-Saharan Africa.[38] In many of these markets, consumers aspire to buy internationally branded products. As the sources of growth continue to evolve, consumer product companies should consider continually reassessing the size of the business to support the geographic distribution of their infrastructure, human resources, and focus.

FENCES FOR A NEW ERA

While consumer product business fundamentals have remained similar over the decades, it is clear that the landscape has changed from what it was 25 years ago. Many traditional fences are eroding or protecting less desirable land, giving way to the need to place stakes in new ground. Yet the need for fences is enduring. To make them effective in this new era, consumer product companies should build them with an understanding of the diversity of today's US consumer and the complexity of today's consumer product marketplace. **DR**

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37. The process for conducting this financial study involved defining the scope of the consumer staples industry, which includes three key sectors—(i) food & staples retailing, (ii) food, beverage & tobacco products, and (iii) household & personal products. We collected historical financial data, that is, from 1980 to 2012 for all the companies that belong to these three sectors in the United States from S&P's CompuStat database. We developed a bottom-up methodology for analyzing the gross margin performance of these three sectors.
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