Beyond benchmarking

How CPG companies can rethink their organizations for growth in turbulent times
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Companies in the consumer packaged goods industry face a number of challenges. They must balance their investments and attention between emerging markets (which offer the promise of growth) and mature markets (which are still far larger but growing at a much slower rate). At the same time, smaller, focused companies are now outperforming large players, and companies are slowing their pace of offshoring and outsourcing. On top of these issues, digital technologies are creating new ways to interact with consumers.

To succeed in such a complex environment, the industry’s traditional reliance on benchmarks is not enough. Instead, consumer packaged goods companies should adopt a five-step approach to organizing for growth and profitability: (1) define their way to play; (2) focus on differentiating capabilities; (3) zero-base their costs, to focus investments only on those key capabilities; (4) use benchmarks judiciously; and (5) adopt productivity as a way of life.
Companies in the consumer packaged goods (CPG) industry, particularly food manufacturers, are struggling to deliver ongoing profitable growth. In North America and Europe, economists and market analysts are predicting that domestic demand will grow at the same rate as population, at best. In most regions, consumption levels have yet to fully bounce back from the slump caused by the last recession. And for most multinationals, these growth pressures are only marginally offset by growth in emerging markets. In addition, commodity cost escalation and price volatility have also put pressure on margins.

Industry veterans may be tempted to say, “So what else is new?” Profitable growth in consumer packaged goods, after all, has been tough to achieve consistently for a decade or more, irrespective of macroeconomic, regional, or marketplace trends.

The biggest challenge for most consumer products companies today is the difficult decision about how to organize for different markets around the world — international markets with promising growth potential on the one hand, and mature Western markets on the other. Their choices require a careful balancing act to deliver effectively and efficiently what each market requires.

What makes this challenging is that competitive pressures in the CPG industry are far different today than in previous decades. Size, which traditionally served as a proxy for scale, has ceased to add value, a change that creates opportunities for focused, smaller players to take market share.\(^1\) Digitization and technology are catalyzing profound changes in consumer behavior — including the ways people shop and the manner in which they communicate with companies — and these changes will accelerate as mobile technologies and “big data” capabilities evolve further. The need for differentiation has never been greater. On the other hand, it is still necessary to create and leverage scale across regions in key capabilities such as innovation and global brand management. Similarly, greater balance is needed in cost management and customer intimacy. For example, outsourcing/offshoring, which had emerged as a viable alternative to building cost
advantage through scale, is now being reexamined, and many companies are looking closely not only at their manufacturing footprints, but also at where they locate general and administrative support.

In this world, traditional benchmarking and cost-cutting strategies that served companies well in the past are no longer sufficient. Instead, leading companies must align their organization and cost structure to fit strategic choices for each market they face. This is especially true given the wide range of starting points for CPG companies across the world. CPG companies, in effect, need to make their own rules about how best to organize.
Competing in two worlds

The challenges in pursuing profitable growth in two different worlds are significant. Building businesses with local infrastructure that is relevant, introducing products to customers for the first time, finding tailored solutions that work with local customs, and building powerful global equities — all of these are very different tasks, with investment profiles very different from competing for share of market and share of value in mature markets. In setting up a global operating model, CPG companies face a series of choices. They must decide whether the business units should be defined by category or by geography, whether the corporate role should be strategic or operationally focused, and whether — and how — infrastructure should be shared across business units and regions.

Each company faces a unique economic and competitive landscape. Multinational CPG players still generate most of their sales from mature markets, even though emerging markets are growing much faster (see Exhibit 1, next page). Yet the range for individual companies varies widely. For example, Unilever derives 40 percent of sales outside North America and Europe, whereas Tyson Foods is 95 percent concentrated in North America. In addition, product portfolio complexity, the number of countries served, regulatory requirements, and a host of other factors can differ in significant ways.

No matter the starting point, every company with a global footprint is salivating at the opportunities in developing markets. Between now and 2020, 95 percent of the world’s 800 million in population growth will be in the developing world, and 1.4 billion households there will be earning middle-class incomes. The focus is no longer just on the BRIC countries (Brazil, Russia, India, and China). In fact, India and Brazil have lost some of their luster of late. Eastern Europe, Latin America, Mexico, and Southeast Asia are all on the radar for identifying growth opportunities and capturing market share.

All of these complexities and uncertainties drive very different trade-offs on how to organize. We see a range of models being adopted by different CPG companies to deploy capabilities globally (see Exhibit 2, page 9).
Exhibit 1
Sales per region for CPG multinationals, 2011*

<table>
<thead>
<tr>
<th>Region</th>
<th>Sales Percentage</th>
<th>Expected GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>~43% of sales</td>
<td>&lt;2%</td>
</tr>
<tr>
<td>Europe</td>
<td>~25% of sales</td>
<td>2%-6%</td>
</tr>
<tr>
<td>South America</td>
<td>~16% of sales</td>
<td>&gt;6%</td>
</tr>
<tr>
<td>Asia</td>
<td>~10% of sales</td>
<td></td>
</tr>
</tbody>
</table>

KEY: Globe size is relative to the region’s overall percentage of sales.

* Campbell Soup Company, Coca-Cola, Diageo, Heinz, Henkel, Anheuser-Busch InBev, Kellogg, Mattel, Nestlé, Ralph Lauren, and SABMiller. Basket chosen on the basis of multinational status of companies, multibillion-dollar revenue, and availability of public data. Total revenue of basket is ~US$270 billion. Last 12-month total revenue for consumer staples sector is ~$5,682 billion, per S&P Capital IQ.

Note: Remaining ~6% of sales are for the “rest of the world.” Figures for regional split are taken from calculations and estimates based on company data and literature.

Source: Company websites; OneSource; World Bank; “Booz CEO: US Fares Better Than Europe,” Financial Times video, Feb. 5, 2012; Strategy& analysis
### Exhibit 2
#### Operating model choices and companies that use them

<table>
<thead>
<tr>
<th>Business units organized by category or geography</th>
<th>Primarily managed by category</th>
<th>Managed by category and geography</th>
<th>Primarily managed by geography</th>
</tr>
</thead>
<tbody>
<tr>
<td>L’Oréal, Newell Rubbermaid, Nestlé (waters, nutrition, pet food, Nespresso)</td>
<td>Procter &amp; Gamble, Kimberly-Clark, Kraft Foods Group, Unilever</td>
<td>Coca-Cola, Nestlé (food and beverage)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Corporate role</th>
<th>Holding company</th>
<th>Strategy and oversight</th>
<th>Active management</th>
<th>Operational involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>ConAgra Foods, Coca-Cola</td>
<td>Procter &amp; Gamble, Kimberly-Clark</td>
<td>Clorox, Wrigley</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Shared infrastructure (includes outsourcing)</th>
<th>Country- or business unit–based services</th>
<th>Regional shared services</th>
<th>Global shared services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unilever</td>
<td>Mars, Nestlé, Kraft Foods Group</td>
<td>Hershey’s, Procter &amp; Gamble, Coca-Cola, Kimberly-Clark</td>
<td></td>
</tr>
</tbody>
</table>

Source: Strategy& analysis
The challenge is to pick markets to focus on, with a viable strategy for each — often well below the country level. In China, for example, local tastes, customs, and market characteristics vary widely. As Edward Tse, Strategy&'s senior executive advisor for Greater China, notes: “Although China's markets are global in nature, they are also extraordinarily local, rooted in traditional customs and tastes, with extreme variations from one region to the next.” Success requires adapting current capabilities to the unique market conditions and thinking through which capabilities are applicable in multiple regions, where the company can leverage scale across regions, and where capabilities can be bought or borrowed through partnership structures.

For example, one candy manufacturer built a decentralized R&D system to cater to local tastes and leverage procurement of local raw materials, supplemented by processes and forums that quickly transfer successful products and ideas from one market to another. Contrast this with another food manufacturer that runs global strategic business units (SBUs) that drive R&D and marketing strategies centrally, while allowing some tailoring to local needs. This company built a streamlined process through which managers in each country engage with the SBUs to tailor offerings and marketing to local needs, with only three people involved in decision making: the global product manager, the regional manager, and the country manager.

Participation strategies in global markets also depend on factors such as unique demand characteristics, the ability to extend brands or acquire or build relevant local brands, the regulatory landscape, and supply chain infrastructure. Depending on these variables and the expected growth trajectory, a number of tailored operating models are plausible. At the highest level, decisions must be made between organic entry and entry via partnership. Under an organic model, a company must determine the local sales or marketing resources that are needed and what decision rights they will have, whether to own distribution or use a wholesaler-distributor, how to source or structure manufacturing, and what to hold locally or scale across countries. In partnering approaches, there must be a very clear statement of objectives, accountabilities, and appropriate resourcing to deliver on the objectives needed. Because these decisions are so complex, many companies end up with multiple operating models across the globe that evolve over time.

In more mature markets, there is a general recognition that relying on growth in GDP, consumption, and population will not be sufficient to win. The continued shake-up of grocery retailing pointed out in Strategy&'s recent study with Food Marketing Institute (FMI) only confirms this, making it necessary for CPG companies to invest in other
growth levers. At the Consumer Analyst Group of New York’s 2013 conference for CPG companies, for example, nearly every company attending emphasized the importance of innovation as a factor in staying relevant to consumers. Kraft Foods Group has transformed its innovation capability from its biggest weakness into its biggest strength. Hillshire Brands aims to gain 13 to 15 percent of revenue from innovation by 2015, up from an average of 9 percent over the past four years.
Upending old doctrines

If the challenge were simply balancing a highly innovative and productive model for mature markets with a nimble and flexible model for entry markets, deciding how to organize would not be all that difficult for CPG companies. Unfortunately, it is not that simple. On top of the duality of operating in mature and emerging markets, additional factors are causing CPG and other industries to reevaluate choices about investments and costs. In some cases, these are complete reversals of the doctrines of the last two decades.

Scale matters, but smaller, focused players can outperform. Sheer size provides cost advantage on many metrics, as any examination of benchmarks will show. What is interesting, however, is that it does not guarantee outperformance on a total returns basis. Strategy& recently completed an analysis of the top 25 food and beverage categories and found that small players (those with sales of less than US$1 billion) are outperforming the competition in 18 of these categories, including the largest ones. These standouts tend to have operating models that are extremely focused on a few key categories and on a few differentiating capabilities, creating an insulated competitive model. Given the success of this strategy for smaller companies, larger players need to focus less on size and more on relevant scale — creating and leveraging scale in a few critical capabilities.

Outsourcing/offshoring is being reexamined. The reversal in thinking on outsourcing and offshoring is nothing short of staggering. General Electric is adding new production lines in its appliances facility in Kentucky after decades of moving production offshore. Whirlpool and many other manufacturers also are investing domestically. Drivers of this trend include not only rising wages in low-cost countries, higher fuel costs globally, and lower natural gas costs in the U.S., but also more flexible workforces, better ability to link product development and design for manufacturing, and increasing concerns about far-flung supply chains and risks. The trend is not restricted to manufacturing. Many clients are looking closely at elements of general and administrative costs as well, making the choice to bring more elements back in house, and finding they can be both more effective and more efficient. This is perhaps not a surprise. Any major movement tends to
swing too far, and the pendulum comes back at some point. Nor is it an indictment of the concept, which still works in many situations. It is clear, however, that blindly assuming that outsourcing is the answer is no longer safe.

_Digitization is redefining how to engage with consumers and customers._ C-suite executives identify technology and digitization of consumer experience as one of the greatest catalysts of change. Consumer adoption of mobile technologies continues to increase dramatically as functionality and accessibility grow. Although they’re not fully understood yet, big data–centric analytics are expected to be a differentiator in tailoring offerings to and communication with the consumer in the future. There is a unique window of opportunity for CPG manufacturers to harness the power of these exploding data sets and analytics to help retailers in shaping shopper experiences, including the migration from in-store to online purchases.
Moving beyond benchmarks

In this new era, benchmarks can provide cues, but one size does not fit all — and most transformations based on emulating “what other companies are doing” deliver only short-term value. Every major CPG firm has been through multiple transformations along these lines. The pattern is predictable, and organizations have learned to game it. It starts with a feverish round of establishing baselines and benchmarks. Next come heated discussions about why the benchmarks don't apply in this particular situation, or exercises in parsing the data more and more finely in an attempt to find comparables for subfunctions at a level of disaggregation that narrows any analysis down to very small groups of people. After much debate, each function agrees to some form of consolidation, such as demand management (e.g., project cuts), and perhaps looks at pushing some additional work out the door to lower-cost providers. In some cases the work itself is redefined or streamlined, but this often proves harder to do. In the end, a savings target is realized and a lot of cost comes out, but three years later, inertia overcomes the reorganization, and the costs all creep back in.

These failures breed more cynicism for the next time the ugly cycle comes around. The efforts are demotivating and distracting. They are laden with undertones and overt statements about organizations being fat and complacent. They call into question the value of individuals who show up to work every day, work hard to advance the goals of the company, and genuinely care about and take pride in what they do. We know client companies that have been through this every couple of years. They view it as a necessary evil.

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Five steps to organize for growth and profit

Despite the challenges and complexities, the productivity opportunity in CPG remains substantial, and there is a better way to approach it. What makes it hard is that there is no easy solution to defining the right operating model. It starts with an understanding that benchmarking your operations to those of other companies is only a beginning. It is necessary to design a deliberate, lean, fit-for-purpose operating model. Some companies are already doing this. They are streamlining their operations by making disciplined choices concerning their capabilities, and undertaking continuous improvement to drive efficiency and effectiveness. We recommend five steps for helping CPG companies think through the process:

1. Define your way to play

Companies that thrive in challenging environments have defined how they add value, built the capabilities required to do so, and ensure that what they sell fits. Their customers have a clear understanding of how the company creates value for them, and what is different about the company compared with its competitors. Their employees understand these concepts as well — and how their role fits with the company’s strategy. This identity, or “way to play,” defines the company’s focus and prevents it from being all things to all people. It allows the articulation of what the company will or will not do. There are a number of pure-tone ways to play, but in practice, companies are a composite of a very limited set.

By focusing their way to play, the strongest companies are able to turn industry evolution to their advantage, developing and deploying differentiating capabilities and forcing competitors into other, less attractive corners of the market. In effect, they become supercompetitors, driving industry evolution rather than riding along with it. The only way to reach such a dominant position is by differentiating through capabilities — being uniquely better at something that is at the heart of how you add value.

Hershey’s, for example, has very successfully focused on driving innovation in its core confectionery categories, owning critical seasons
like Halloween, Christmas, Easter, and Valentine’s Day in North America, while organically taking iconic products like Hershey’s Kisses to international markets. Reckitt Benckiser has been extremely successful with its sharply honed innovation model, applied consistently to power brands. This includes sensing consumer micro-needs and extending product variants to meet those needs. For example, the company now offers its Nurofen brand of pain relief medications in standard, express, topical, and other indication-specific forms as well as pharmacy-only formulations.

2. Focus on differentiating capabilities

Companies that know their way to play also are adept at defining and investing in a few essential differentiating capabilities to create value, have a clear lens through which they prioritize investment, and spend less everywhere else. In many companies, the tendency is to aim for excellence across the board. Many strive for functional excellence for its own sake. However, the more judicious approach is to excel at a finite number of things, and invest in these areas to be best in class.

If a company’s winning play involves fast-paced, flavor-based innovation, for example, it should be building a rapid innovation and commercialization capability. A company that focuses on developing science- and claims-based products, on the other hand, should build an end-to-end innovation capability that includes gaining approvals from relevant authorities for claims. Even in support functions like human resources, a talent management model that enables seamless transfer of key expertise across geographies could be a differentiating capability for some multinational companies.

3. Zero-base everything

Companies that have the most success with strategic cost management practice a zero-basing approach to budgeting. Though the specifics of this approach may vary, the underlying principle is the same: The current cost structure is not taken as a given for the next planning cycle. The approach we recommend makes a distinction between costs associated with differentiating capabilities and those for all other activities. Designing a robust management process that applies this lens to annual planning and budgeting exercises can create a strong business-performance management discipline. For all costs not associated with differentiating capabilities, companies can pursue multiple approaches to streamline costs, such as benchmark-driven target setting, continuous improvement through lean methods, and other structural changes like consolidation and outsourcing.
Recent examples of this approach are especially evident in private models, such as 3G Capital’s influence on cost reduction through the merger of InBev and Anheuser-Busch, and the expectation of similar pressures to come at Heinz. In our experience, companies that adopt a new and more efficient global operating model often see 10 to 20 percent reductions in costs as a result.

4. Use benchmarks judiciously

Given the complexity and unique value promise of businesses, traditional benchmarking provides directional guidance at best. The ideal use of benchmarks is in a top-down exercise — i.e., to measure the gap at the highest level and to understand the drivers of the gap. This helps you put a stake in the ground on the opportunity. It is then judicious to move forward to a bottom-up effort and challenge the organization to think innovatively about the cost structure. Any number of traditional cost management tools can be leveraged to capture the opportunity, such as business-process reengineering; lean; or inherent, structural, systemic, and realized (ISSR) cost analysis.

5. Adopt productivity as a way of life

Companies that have adopted the above approach develop a strong productivity culture. Companies like Church & Dwight have created their own unique approach that embodies the principles discussed here. Church & Dwight’s value proposition rests on a portfolio of brands — both premium and lower-cost — that hold leadership positions in niche categories. The company acquires brands with residual equity in these categories and adds value by enhancing their distribution. It focuses on a small set of power brands at a time, supported by pioneering innovation — sometimes leading, sometimes following, depending on their position in the category. These investments are enabled by aggressive overhead cost management, often described as a “private equity–like” financial culture. Other companies have developed their own brands of productivity focus, such as comprehensive margin management or lean-focused centers of excellence, and have embedded them deeply into their cultures.
CPG companies face new and increasing challenges of geographic emphasis, growing product portfolios, and changing customer expectations — all driving complexity in their operating models. Now more than ever it is necessary to develop your own principles, and your distinct way to play based on your differentiating capabilities, rather than on traditional, imprecise benchmarking. These principles and this approach are particularly relevant for companies that have undergone multiple restructuring efforts in recent years and yet find themselves struggling with excess costs and resource-starved capabilities. Each company’s model will be its own, but each must be fit for purpose. The reward will be in building your own right to win in the specific markets where you have the best expectations for continued, profitable growth.


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