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COVID-19: UK industry focus

Where next for consumer goods?

“More than ever, consumers want the assurance of quality, authenticity and availability.”

Where we are today

Most consumer goods companies have played a critical role during the COVID-19 crisis, keeping consumers around the world supplied and protecting the most vulnerable.

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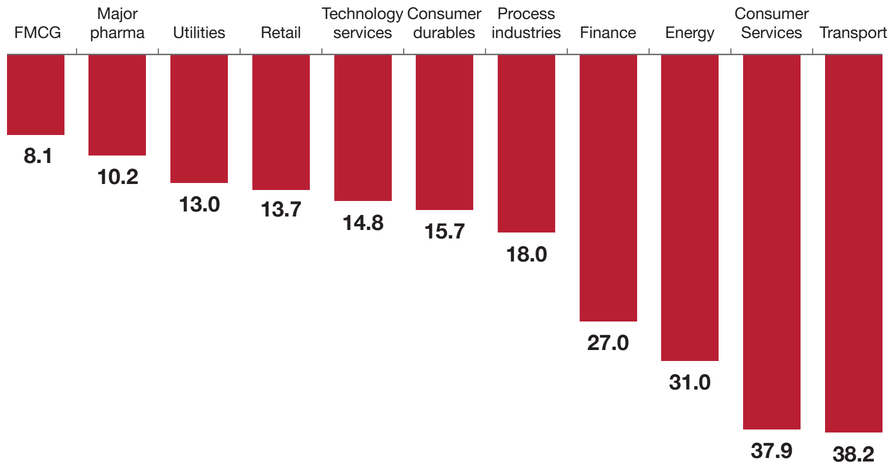
The economic impact of COVID-19 has affected many consumer goods companies, though perhaps fewer than expected. Some fast-moving consumer goods (FMCG) businesses, for example, have relatively strong liquidity, after introducing cost reduction and optimisation programs during the 2007-2008 global financial crisis. For others, demand has held up, even despite operational challenges – for example, in the four weeks leading up to the UK lockdown, grocery sales were up 21%, there were 79 million extra shopping trips and online grocery spending increased by 14%. In the US, trends were even more pronounced. This trading situation has led to lower shareholder value erosion for FMCGs compared to many other business sectors.

21%

increase in grocery sales in the four weeks leading up to the UK lockdown

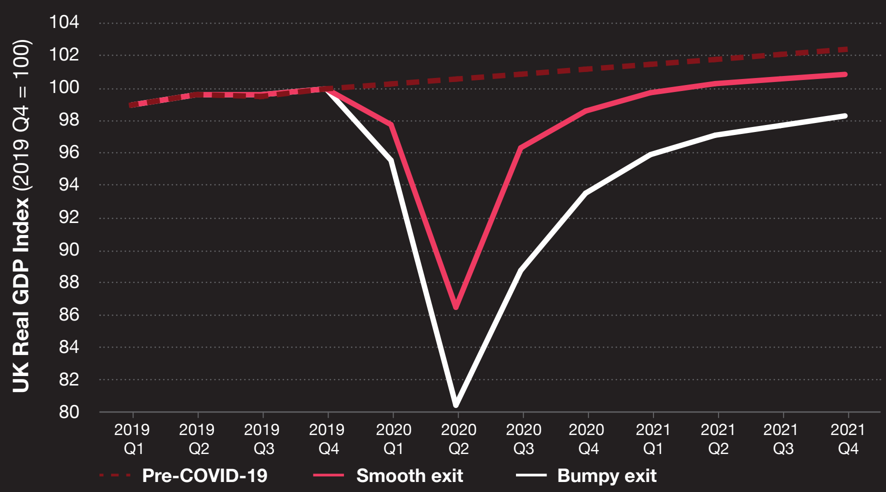
Fig.1 – London Stock Exchange – Three-month share performance by key sectors (as of 9 April 2020) % change in value



Source: PwC analysis

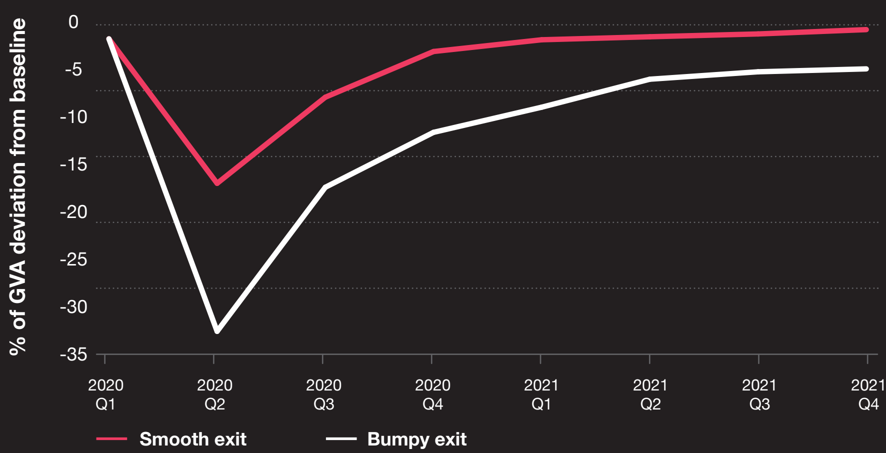
As we exit this crisis over the coming months, the extent of economic impact will become clearer. We currently project UK GDP to decline by around – 5% to – 10% compared to 2019 and the IMF estimates that global GDP could fall by 3% compared to 2019. The short term impact is likely to be significant: in the 'Smooth exit' and 'Bumpy exit' scenarios (Fig 2.), overall UK GDP could contract by around 12% to 16% quarter-on-quarter in Q2 2020 respectively. This is likely to have severe consequences for economic activity and employment, resulting in downward pressure on consumer spending and disposable incomes.

Comparison of real GDP index by scenario and pre COVID-19*



*Relative to baseline projection
Source: Strategy& UK Economic Analysis April 2020

Impact of COVID-19 on Consumer goods GVA by scenario



Source: Strategy& UK Economic Analysis April 2020

25%

of workers normally come into physically close contact with >20 fellow workers

Physically close contact is defined as a distance of 2m. Source: PwC Research QuantiBus April 2020.

54%

of workers can work from home

The Work From Home index is based on a survey carried out by PwC Research, and is the equivalent to the % of respondents saying they can work from home.

What are we learning?

Demand is unpredictable. Supply chains are under strain

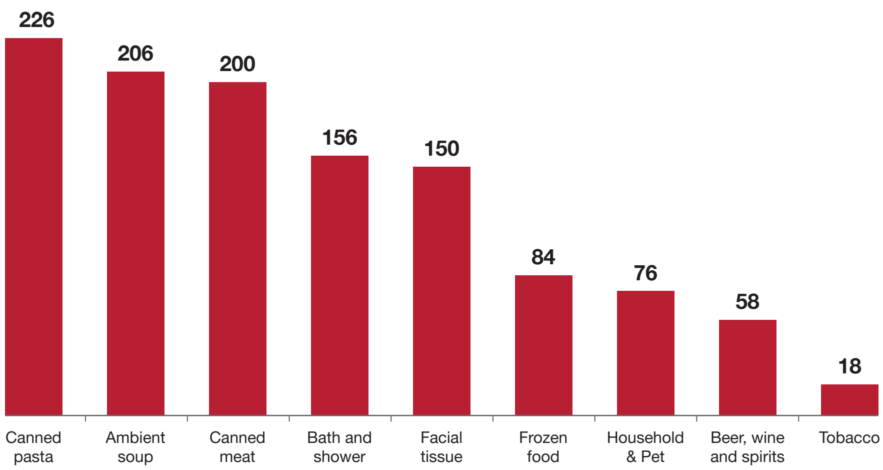
It has taken a crisis to re-evaluate the definition of essential. And just as "essential workers" has taken on new meaning, so has "essential items". From toilet rolls to fitness trackers, from hand sanitiser to video calling apps, consumer demand is proving unconventional.

FMCG businesses can accurately forecast demand in a stable environment. Where demand fluctuations are predictable, seasonality and promotional plans are typically the biggest drivers of change. However, COVID-19 has significantly changed volume across categories (Fig. 4). While consumer preparation for lockdown is a key driver, channel shifts are another. In categories that typically see high on-premise consumption (such as food and beverages), some of the demand has shifted to off-trade retail channels.

70%

of consumers saw trust as the most important factor when buying from a brand

Fig.4 – Sales growth in the UK (week ending 21 March 2020 vs the same week in 2019) %



Source: Nielsen

Fewer products, brands and SKUs

Capacity constraints have forced brands to rationalise their stock keeping units (SKUs): UK grocer Tesco cut its 33 ranges of toilet paper down to 10 and Morrisons reduced its bakery line from 17 to 6. Sausages, pasta and milk ranges have also been streamlined to create a less complex range that ensures better availability and supply. If this aggressive range management resulted in longer term structural rebalancing of grocery assortment sizes, the competitive dynamic between full-line grocers and limited range value retailers could alter in interesting ways.

Shifting channels. Switching brands

As we learned during the global financial crisis, changing circumstances lead to changes in behaviour. In 2007-08, it was constrained spending. In 2020, it is a combination of constrained spending and restricted movement.

The result is that consumers are shifting channels, particularly to digital – UK online grocery spend increased by 13% in the four weeks prior to 24 March – but also from B2B to B2C. Consumers are even switching brands – some are trading down; others are moving to where availability can be guaranteed.

Any exit from lockdown will be phased and may be followed by further lockdowns to control the spread of the virus (at least until a vaccine or treatment is available). This will lead to some behavioural changes becoming long-term or even permanent.

Trust is more important than ever

In a recent PwC survey, over 70% of consumers saw trust as the most important factor when buying from a brand. It is now even more significant, particularly where availability is uncertain and safety is at a premium.

This impacts multiple parts of consumer packaged goods (CPG) businesses. Price compliance and tracking across trade partners becomes critical to prevent exploitative pricing in less controlled trade channels. Consumer goods has often discussed transparency, authenticity and traceability as a promise to suppliers and consumers alike – now is the time to embed that within the business model and also yield the cost efficiencies it creates alongside increased trust. Elsewhere, advertising and marketing campaigns will need to be revisited, not just for content, but also due to the likely structural change in both marketing budgets and the media channels through which to reach the new target consumers.

“In this crisis, brand owners have a clear purpose: to ensure the delivery of high-quality, safe products that improve consumers’ lives.”

How do we respond?

Protect your trusted brand

In this crisis, brand owners have a clear purpose: to ensure the delivery of high-quality, safe products that improve consumers' lives. Empty shelves or haphazard shelf presentation can erode trust. So too, can any action that looks like it's taking advantage of the crisis. The UK, and other consolidated modern trade grocery markets, have a high degree of trade and price transparency and can control significant price spikes. However, that same level of price compliance cannot be taken for granted in markets with a greater diversity of routes to the consumer.

Brands must live their values and ensure that trade partners do the same, penalising transgression where necessary. More than ever, consumers want the assurance of quality, authenticity and availability.

Those committed to a sustainability agenda – a net zero goal in many cases – must not ignore it during the crisis, and brands that do the right thing during the time will emerge stronger.

Refine products and assortments

An increase in 'forced experimentation' – where changing circumstances force people to try new approaches, solutions or products and discover in the process that some stick – applies to brand owners as well as consumers.

Will the involuntary rationing of products and assortments see brand owners and retailers improve efficiencies? Will faster technology adoption enable late-stage customisation that provides a better choice without affecting inventories or supply chains? Will the shift from on-premise to home-based consumption create new consumption moments? The answers may require changes to post-crisis product assortments and reconfigured storefronts.

Review base price levels and promotional strategies

Established price elasticity of certain items will have changed in recent weeks. Right now, brand owners should reset base prices and tackle historical price laddering challenges.

However, the depth, timing and frequency of promotions are equally, if not more, important. In our experience, over 80% of promotional activity is identical to the previous year. Brands must change their approach. As demand normalises in the coming months, consumer goods companies need to be clear about their revised promotional strategy.

Recalibrate brand marketing and media planning

Just as promotions conceived pre-crisis need to be re-thought, marketing and media campaigns need to be overhauled. Marketers should review media agreements to see where spending can be stopped, postponed and repurposed as a form of normality returns. They must also engage with media agencies and publishing partners to explore what is possible beyond their current contractual agreements. We expect an acceleration, on the part of brand owners, in their pivot away from traditional marketing channels to digital engagement channels.

At the same time, brands have an opportunity to show integrity, purpose and values by supporting consumers and communities in difficult times. Consumers and employees want a respite from the crisis and brands have the opportunity to create uplifting, entertaining experiences for them.

“Successful brands will be those that best detect demand patterns, at an increasingly local level.”

Know your contestable spaces and prepare for them

Brand switching and channel shifting give consumer brands and retailers new opportunities – for example, the limitations of the current grocery supply chain may allow new entrants into the market.

Equally, the crisis may push direct-to-consumer brands and subscription-based supply models to the next level. When assessing the crisis as a catalyst for change, a strong example is Chinese multinational technology company Alibaba, which launched its TaoBao platform to create digital channels for SME one week into a national quarantine during the SARS epidemic in 2003. Today, it has over 600m unique monthly users and was a core element of Alibaba’s growth story over the last 20 years.

To prevent unnecessary brand switching, businesses must understand what parts of their portfolio are at risk, while at the same time strengthen their insight and foresight capabilities when reviewing contestable spaces.

Upgrade demand sensing capabilities

We’ll see varying patterns of unpredictable consumer demand long after COVID-19. Successful brands will be those that best detect demand patterns, at an increasingly local level. Because of this, many businesses will recognise the need to improve their demand sensing capabilities. While supply chains have increasingly been digitised, innovations in demand sensing abilities will become essential for FMCG companies.

Build flexible supply chains

The pandemic has exposed the need to evaluate bottlenecks and risks across the supply chain. Firms looking to rebuild their supply chain must balance economics, strategic fit, service levels and risks. For example, where the supply chain previously and exclusively focused on scale and efficiency, firms may now consider a diversified manufacturing and warehouse footprint.

In the future, we will see shorter supply chains closer to end consumers, with higher degrees of automation to aid resilience and protect against reduced human capacity. Where there was once a mix of contract and spot purchases for commodities, we will see an increasingly contract-heavy solution.

Finally, in the spirit of brand trust, authenticated and transparent supply chains will be standard.

Drive opportunistic inorganic moves

When employed strategically, mergers and acquisitions (M&A) can drive growth, even against the strongest economic headwinds. Some challenger brands and businesses will not survive the crisis and of those left standing, some will be unable to continue alone in the long term. This will create attractively priced M&A opportunities over the next 12 to 18 months for large consumer goods businesses with deep pockets.

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The opportunity for CPG businesses

COVID-19 has caused substantial changes to consumer and trade behaviour. The critical question for businesses is how much of this remains after the pandemic. Although not fully clear yet, previous consumer disruptions that have created forced experimentation have led to long-term behavioural changes. The degree of stickiness of changing consumer (demand side) and supply side behaviours will determine the future of the CPG industry for some time.

Despite the uncertainty, companies need to work hard to protect their brand, refine their offerings and prepare their supply chains. If they concentrate on these, while strengthening their insight and foresight capabilities, they will be well-prepared to stay ahead of wherever consumer markets are headed.

Who to talk to

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