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Consumer products industry faces sluggish and fragmenting consumer demand

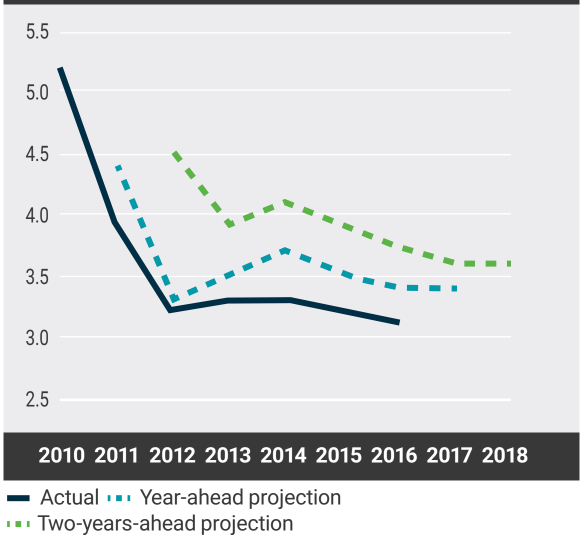
With stagnating top lines and a sharper focus on deeper levels of cost savings in order to fund critical growth initiatives, there's no doubt the global consumer products (CP) industry faces an uncertain future. And that uncertainty will only intensify as six powerful forces continue reshaping the landscape.

We previewed those six themes in our first article on the consumer products industry earlier this year as:

- Digital transformation
- Sluggish and fragmenting consumer demand
- Shifting of power to consumers
- Mainstreaming of corporate social responsibility
- Transformational supply chains
- Next-generation efficiency

As a follow-up to that article, we now take a deeper look at sluggish and fragmenting consumer demand. The sluggish macroeconomic environment has hampered and will continue hampering many CP companies. Making things worse, demand has fragmented with regard to geography, socioeconomics, generations, and product benefits.

FIGURE 1: WORLD OUTPUT YEAR-OVER-YEAR CHANGE (%)



Source: IMF World Economic Outlook 2011–17

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SLUGGISH MACROECONOMIC ENVIRONMENT

Global growth continues to struggle—and to underdeliver on expectations. CP companies are facing uneven and slow recovery across the United States and Europe and in cooling emerging markets, led by the slowdown in China (figure 2). In addition, overall macroeconomic sluggishness has translated to anemic growth for the industry (figure 3).

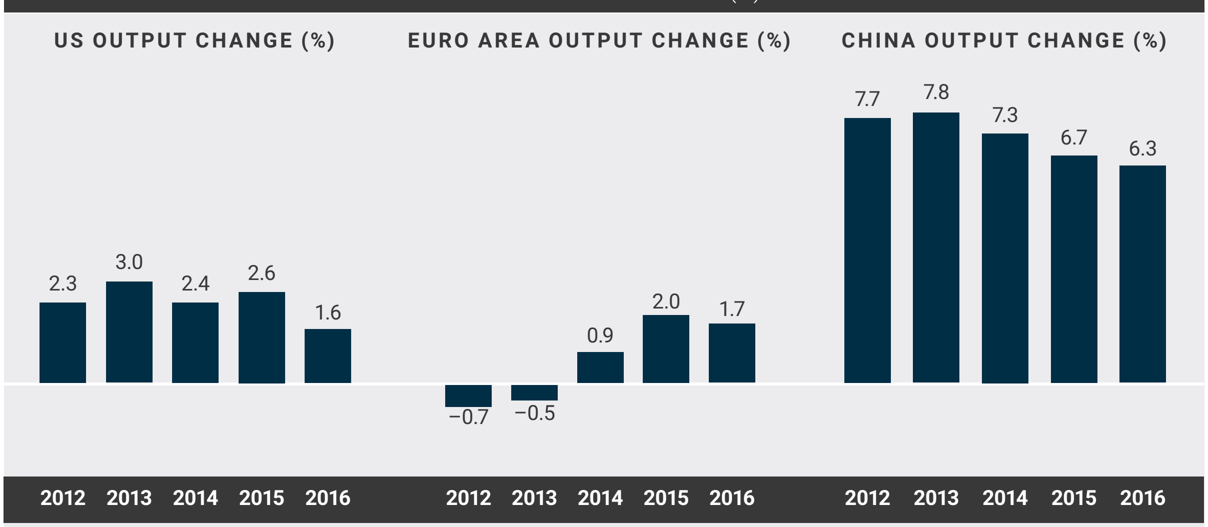
After lackluster output in 2016, economic activity is projected to pick up the pace in the second half of 2017 and through 2018—especially in emerging-market and developing economies. However, there is a wide dispersion of possible outcomes around those projections—especially given the uncertainties of the new US administration's policies and the effects they could have globally.[1]

At the same time, emerging-market debt has hit record highs and continues to rise, further compounding growth challenges in emerging markets. As economic prospects dim and as borrowing costs rise and as the US dollar strengthens, swelling debt levels threaten to pose a host of problems.

Economists are predicting that a spate of corporate defaults across emerging markets are going to hit the financial sectors, burden state balance sheets, and crimp lending that is vital to spurring growth. That financial malaise in emerging markets is spilling over into other world economies too.

Britain's exit from the European Union and President Trump's election in the United States are pushing nationalistic agendas to the forefront and inserting considerable uncertainty into the global economy.

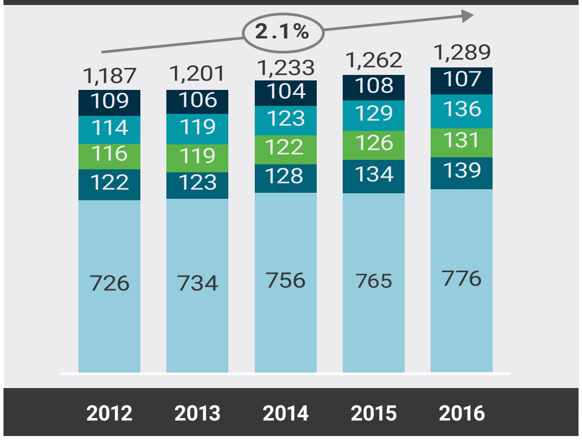
FIGURE 2: REGIONAL OUTPUT YEAR-OVER-YEAR CHANGE (%)



Source: IMF World Economic Outlook 2011–17

[1] IMF World Economic Outlook January 2017.

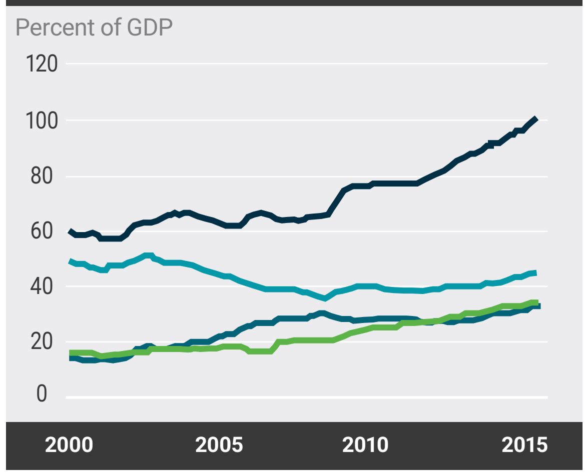
FIGURE 3: US PERSONAL CONSUMPTION EXPENDITURES ON CONSUMER PRODUCTS (US$ BILLIONS)



Tobacco Personal care Household supplies Alcoholic beverages Fodd and nonalcoholic beverages

Source: US Bureau of Economic Analysis; AlixPartners analysis

FIGURE 4: EMERGING-MARKETS SECTORAL INDEBTEDNESS



Nonfinancial corporates Governments Housholds Financial sector

Source: International Institute of Finance

After staying pat on interest rates for many years, the US Federal Reserve System has begun the tightening cycle. Expectations are rising for more-aggressive interest rate increases. And any movement in US interest rates is likely to have ripple effects throughout the global economy because such movement removes liquidity from both the global markets and the global economy.

FRAGMENTING CONSUMER DEMAND

As overall demand growth continues to be sluggish, CP companies also face an increasingly fragmented marketplace. Demand for their products has fractured across geographic, socioeconomic, generational, and benefits lines.

Geographic fragmentation

The global middle class will add billions of new consumers in the next decade—reaching nearly 5 billion consumers by 2030. The United Nations has described that phenomenon as a historic shift not seen in 150 years. Critically, most of those new, middle-class consumers will be in emerging markets like China and India. By 2020, the middle class will make up less than a third of the world's total—down from more than half since 2009. And by 2030, Europe and North America's middle class will amount to less than quarter of global middle-class consumers (figure 6).

In response, CP companies have invested heavily in emerging markets in recent decades. Food and beverage giants PepsiCo, Inc., and Coca-Cola Company represent just two examples of the highest-profile ones. PepsiCo announced an investment of $5.5 billion over six years to expand its Indian operations, which was part of the company's effort to build its business in emerging markets when its sales in developed countries slowed (*Wall Street Journal*, November 11, 2013). PepsiCo's announcement followed a similar one from rival Coca-Cola, which had previously said it would invest $5 billion in India by 2020. However, recent turmoil in emerging markets is forcing executives to rethink their commitments.

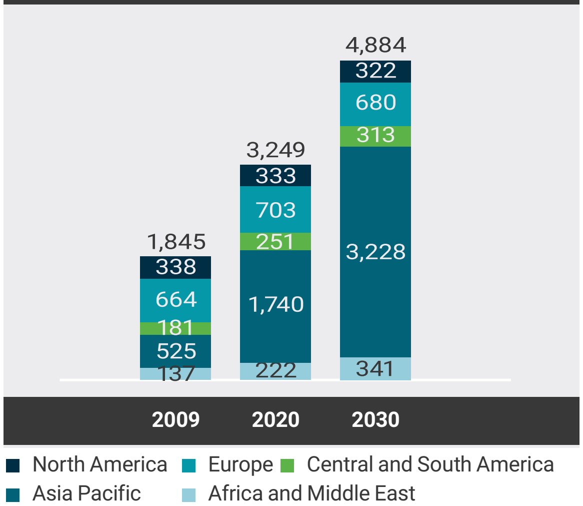
Relatively speaking, recovery in advanced economies is expected to pick up slightly, whereas activity in emerging and developing markets is projected to slow down (*IMF World Economic Outlook October 2015*). That slowdown reflects primarily the weakening prospects of some of the larger emerging-market economies and oil-exporting countries—like Russia and China. CP companies that invested aggressively in emerging markets must now contend with declining commodity prices, reduced capital flows to many of those regions, currency pressure, and increasing financial market volatility.

Clearly, the once rosy outlook for emerging-market and developing economies has clouded over. CP executives have a choice: should they focus more on the long-term potential they foresee in emerging markets or more on the stronger, near-term opportunities in developed markets? The long-term promise of emerging markets is here to stay, but in the near term, the balance will shift toward developed markets. Right now, CP executives should stay disciplined about how they allocate their resources between developed and developing markets while also keeping an eye on the longer-term potential of large consumer markets in emerging economies. They will have to answer questions that ask where they can scale back and where they must continue to invest despite near-term challenges.

Socioeconomic fragmentation

Globalization has led to the rise of a new middle class in many emerging markets, yet those same forces—along with the digital revolution and the rise of automation—have caused lower- and middle-class incomes to stagnate in developed countries. The widening gap between rich and poor, also known as *income inequality*, has emerged as a major possibility for causing destabilization of the global economy. As income inequality widens, CP companies may gain more premium consumers and value consumers, but they're losing their mainstream consumer base and thus disrupting their longtime and successful business model. In this bifurcated world, consumer products companies should efficiently address the needs of consumers across the price-value spectrum.[2]

FIGURE 5: GLOBAL MIDDLE-CLASS CONSUMERS (millions)



Source: OECD Development Centre, The Emerging Middle Class in Developing Countries, January 2010

Generational fragmentation

Consumer products marketers are excited about millennials—especially in the Western Hemisphere. There are many reasons for excitement about that generation. There are 2 billion millennials globally, of whom 86% live in emerging markets.[3]

They recently overtook baby boomers in population size in the United States. Spending power, too, is changing hands as millennials build their careers.

Their seemingly unique motivations—like their levels of health consciousness and their interest in natural and ecofriendly products—appear to make them easier to understand and target.

Millennials may represent an attractive target, but there are a couple of reasons CP companies should be cautious about focusing exclusively on millennials. First, millennials are not one homogeneous group; there are many different kinds of millennials in the Western Hemisphere—especially when compared with their Asian counterparts.

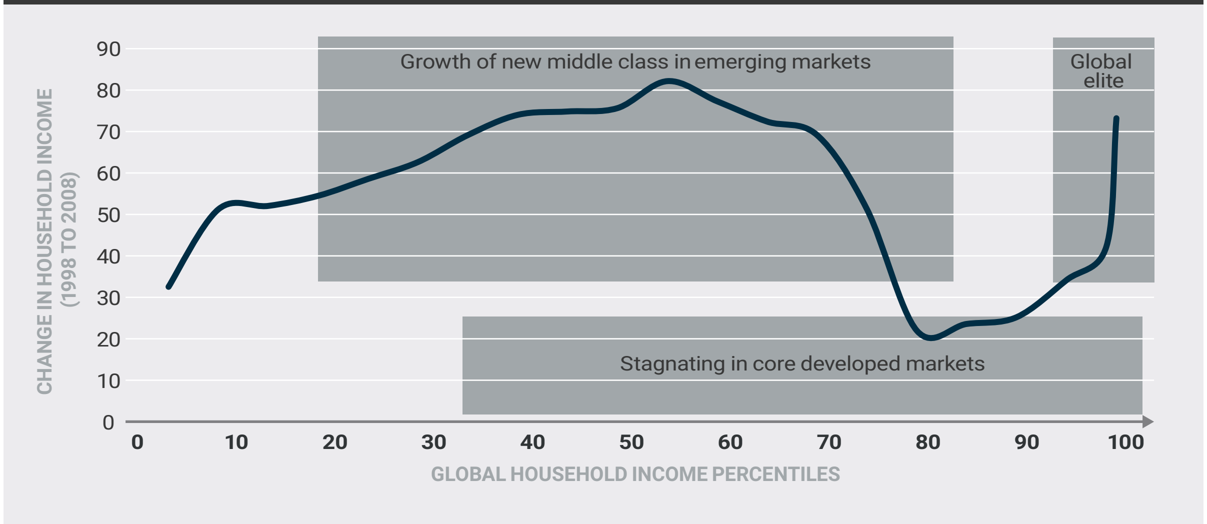
Second, a focus exclusively on millennials will miss out on two important generations that are very important to the success of any CP company: Generation Z and baby boomers. Gen Z is set to eclipse millennials as an economic force for CP companies around the world.

It is the first generation to be born in a post-Internet world—with smartphone in hand. And even though we don't know very much about this rising demographic and its spending patterns, the early consensus is that Gen Z is a conscientious and hardworking group with a sober sensibility about the future.[4] They are highly educated, technologically savvy, and naturally creative, innovative, and resourceful, and it will be critical for CP companies to factor Gen Z into their plans for the future.

Most of the Gen Z population lives in developing and underdeveloped countries—in contrast to many of the mature markets, where populations are older. The largest Gen Z populations are in some of the largest, youngest, and most-dynamic countries—namely, India and China, but also Nigeria and Pakistan.

[2] Income inequality: an existential crisis in the consumer goods industry
[3] Generation Next – Millennials Primer, Bank of America and Merrill Lynch, May 2015
[4] Alex Williams, "Move Over, Millennials, Here Comes Generation Z." New York Times, September 18, 2015; https://www.nytimes.com/2015/09/20/fashion/move-over-millennials-here-comes-generation-z.html?_r

FIGURE 6: GLOBAL INCOME GROWTH



Source: Branko Milanovic, *Global Inequality: A New Approach for the Age of Globalization*, 2016

Older generations, including baby boomers, offer another attractive opportunity. Although younger generations are capturing the attention of CP marketers, older age-groups represent the fastest-growing population globally. Worldwide, 901 million people were 60 years old or older in 2015, and that number is projected to grow to 1.4 billion in 2030 and to 2.1 billion by 2050 (UN, *World Population Ageing Highlights 2015*). That growth is a global phenomenon: virtually every country in the world will experience from 2015 to 2030 a substantial increase in the size of its population aged 60 years or older.

Aging consumers who want to look and feel their best are the primary drivers of the global antiaging industry. For example, European women older than 60 years account for 34% of the facial-skin-care market, buying twice as many products as women younger than 25. The global antiaging-market size was estimated at $122.3 billion in 2013, but an expanding consumer base is expected to drive that figure upward by a compound annual growth rate of 7.8% from 2013 to 2019, to reach an estimated value of $191.7 billion.[5]

Product-benefit fragmentation

Shifting consumer preferences are also shifting demand away from consumer products companies' traditional mainstream core. Increasing fragmentation is fueling innovation away from the sweet spot of incumbents. One example is a resurgence of the craft beer industry. After stagnating for years, the craft beer category has exploded since 2008, when consumers began demanding a wider variety of beer tastes and palates. Microbreweries and brewpubs have sprouted across the United States in response to that growing demand, yet large consumer products companies have struggled against the fragmentation and thereby ceded share to smaller companies. Similar fragmentation is happening across many consumer products categories. Two key trends are driving the fragmentation. First and foremost are fragmenting tastes and preferences and the rise of the long tail. The second driver is demand for cleaner, healthier products. In response, mainstream consumer products companies have resorted to innovation, proliferations of stock-keeping units, and/or acquisitions of smaller and more-innovative companies. But most have failed to stem the tide of market share erosion.

Moving from surviving to thriving

Faced with that challenging environment, consumer products companies have rallied around three dominant business models. On one end of the spectrum, several large companies have given up on organic growth and focused on blockbuster mergers. AB InBev and Kraft Heinz are two examples of the highest-profile ones. Their business models are anchored in cost reductions through synergies and increased scale. On the other end of the spectrum, small, innovative start-ups are gaining share at the expense of larger companies. And then there are the several companies that are stuck somewhere between those two models. These companies have not given up on the goal of topline

[5] Transparency Market Research.

growth, but they've failed to drive organic growth internally, resorting to buying smaller companies as their primary way of driving growth. They continue to spend large amounts of money on innovation internally, but with limited success. One chief marketing officer in this group even said his company would have been better off if it had not invested a single dollar in innovation.

Many companies have added the role of chief growth officer to reignite growth. However, that alone wouldn't be sufficient. Competing in the new world means consumer products companies should fundamentally rethink their strategies, organizations, and processes. They have to view the shifting world through the eyes of consumer demand rather than take a traditionally supply-centric view. They should redefine scale not according to how many billion-dollar brands they have in their portfolios but, rather, according to how much share they're capturing. What's more, the traditional TV-centric advertising model has to give way to a more digital-centric model. Successful CP companies will jettison their traditional stage-gate innovation processes, which fuel conformance to their historical cores, as opposed to innovation. They should instill cultures of reward for risk taking, as opposed to reward for risk avoidance. In short, they will completely rethink their business models.

In light of the many challenges they face, forward-thinking CP executives should take time now to consider—and answer—questions like:

- How do we completely rethink our supply and go-to-market model to provide step-change transformation in revenues, costs, and margins?
- How do we take a fresh perspective so as to drive disruptive change in our cost structure to fund critical growth initiatives and drive the bottom line?
- How do we leverage precision in targeting and activation to win across the fragmented consumer landscape?
- How do we fundamentally revamp our innovation and product launch processes?
- How do we drive change across the organization for long-term success while delivering on near-term objectives?

Executives can use those questions—and their answers to them—to make informed decisions about where they can scale back and where they should invest. Those who make the right decisions can position their companies to win big down the road—even in this uncertain climate.

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