

# Coping in a perfect CPG storm

A perfect storm is hitting the large food consumer goods companies. Consumer tastes are shifting and fragmenting at the same time. Margin pressures are high, resulting in large cost cuts.

Brand loyalty is no longer assured, especially among millennials. Marketing has become more complicated with the growth of influence of social media and at the same time more accessible by smaller companies.

One consequence is that innovation, once the domain of deep-pocketed large brands, is shifting to smaller companies funded by private equity and the large companies themselves. Innovation is also being outsourced to external development groups and co-manufacturers.

While large food companies are cutting Research & Development and Innovation spending internally, more innovation is coming from the ingredient companies who have new ingredients and an explosion in the biotech space with novel fermentation ingredients. Lastly, the retailers are relying less on the big brands for innovation and looking to do it themselves.

## CPG spending

### Reduction in spending on innovation by CPG companies:

Consumer Packaged Goods companies are losing steam. In 2017, US retail sales across all categories grew by only 0.5 percent. For grocery, the sales were essentially flat at +0.1 percent (IRI channel performance report July 26, 2017).

This sluggish consumer demand puts



added pressure on food companies to keep prices down and still meet quarterly earnings expectations. As the low hanging fruit of margin expansion with plant closures and purchasing consolidation is harder to come by, one consequence is a low spend on R&D at less than 2 percent. This is even lower than that for food companies.

The days of long-term bets on innovation done in house are becoming a distant memory. Kraft Heinz was able to expand margins since 3G took the reins. Even they have run out of runway, however, as illustrated in their most recent quarterly report where margins have contracted as they struggle to get growth from their iconic brands like Oscar Mayer and Kool Aid.

### Consumer preferences shifting and it's hard for incumbents to respond:

The Norman Rockwell family of the past represents a small minority of American family units today. Further, we are seeing unprecedented shifts in consumer eating patterns. As Denise Morrison (retired CEO of Campbell Soup), told the *Wall Street Journal* in a 2016 interview: "Our customers are really different today. Mom, Dad and two kids and a Labrador retriever are 24 percent of families. The family has definitely changed. I would say that we focus on two cohorts: baby boomers and millennials. More importantly, when you look under the hood, there are all different kinds of families. That has fundamentally transformed the way that people eat."

The biggest shift is the growing preference for healthier options and cleaner labels. Natural products continue to lead the growth while conventional brands are flat.

### Innovation coming from smaller

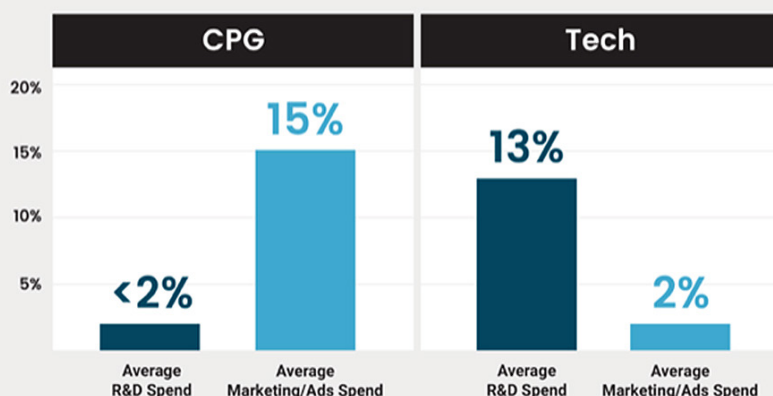
**companies:** With smaller R&D budgets at the Big CPG companies, innovation is coming from M&A, smaller companies, co-manufacturers, development shops, external R&D groups and ingredient suppliers.

The bad news for large companies is the collective share loss that the incumbent market leaders have suffered over the past decade to more disruptive innovation. These losses can be attributed to a complex set of changes that add up to a fundamental shift in consumer preferences that are

## Big CPGs Short on R&D

### Barely Invest in Innovation, Unlike Tech

CircleUp



Data is sourced from CapIQ and company filings reporting R&D and advertising spends. Averages are calculated based on the highest revenue-generating companies in CPG and tech.

difficult for the incumbent leaders to respond to in a timely and margin accretive manner (John Grubb, NBJ Oct 1, 2018).

According to Nick Fereday, a Senior Analyst with Rabobank: “The top 10 branded processed food companies in the US have lost 4 percent of their market share in the past five years as smaller, more innovative brands, have seized the initiative. Small and emerging brands are stealing market share because they are winning at innovation, have appealing brands, are social media savvy and have better awareness of and ability to take advantage of market opportunities.”

Why are the smaller companies gaining share at the expense of the larger brands? With rapidly changing consumer preferences, the agility of smaller brands allows them to move faster and take risks that larger companies cannot afford to. It is not because they do not have the capability. It's largely because they still have huge legacy brands that account for the vast majority of their sales and profits. Working on smaller or new brands would be a distraction. The demands on the core business are high. And with slower growth of legacy brands, the demands are even higher.

According to Liz Mysilk, Chief Marketing Officer at Fresca Foods, the importance of the large brands at CPGs creates a challenge for them to respond nimbly to changing consumer demands as fast as an entrepreneur. Fresca Foods is finding that large CPG companies are increasingly turning to them not only as co-manufacturers but as a source of break through innovation. As Liz says: “we grew our business as an innovator and manufacturer partnering with

young, innovative brands that tapped into the shifting consumer tastes. As these brands gained market share and gained the attention of large CPGs, the large companies began seeking us out to do the same for them.” At the same time, as the start-up brands gain traction they are asking for help with some of the capabilities of larger companies like purchasing power and commercialization know-how.

To meet the requests of large companies moving more of their innovation outside, companies like Fresca are expanding their ecosystem of partners. For example, they partner with Summit Ventures to help translate consumer insights to viable concepts. Many companies partner with R&D consulting firms like CJB and Associates to bring world class product development and food science capabilities. In the case of Fresca Foods, because they are a manufacturer, they have a speed advantage since the prototypes they make are by design scalable to commercialization.

Marc Halperin, Partner and Co-Founder of CCD Helmsman also sees a trend of large strategic CPG companies coming to them for innovation and are looking for more of a “chef to shelf” turnkey innovation service. CCD Innovation and The Helmsman Group have recently joined forces to offer idea-to-market culinary innovation services and commercialization capabilities for their clients. CCD Helmsman will even handle initial distribution. Halperin comments that large companies are looking for short cuts in the innovation process to get products to shelf faster. He cautions, however, that taking short cuts at the front end of the process

will likely lead to longer development times as the products may miss the mark with consumers. He believes that engaging the chefs and food scientists up front will lead to better products and will be easier to scale up since the product developers will consider the realities of procuring the ingredients. He believes, ultimately, that this will get companies’ new products to the shelf faster and with trend-forward brands that the consumer will be more likely to adopt.

**Private label store brands:** As large CPG companies struggle to grow their legacy brands and deliver innovation, retailers are looking at private label brands or store brands as a way to help their margins. Coupled with lower brand loyalty among millennial consumers, retailers see an opportunity to grow their own brands. According to a report by Deloitte, one implication is “the retailer’s role in influencing consumer purchase decisions will increase and smaller, newer companies will leverage new technologies, third-party relationships and improved engagement to earn consumer trust and compete.”

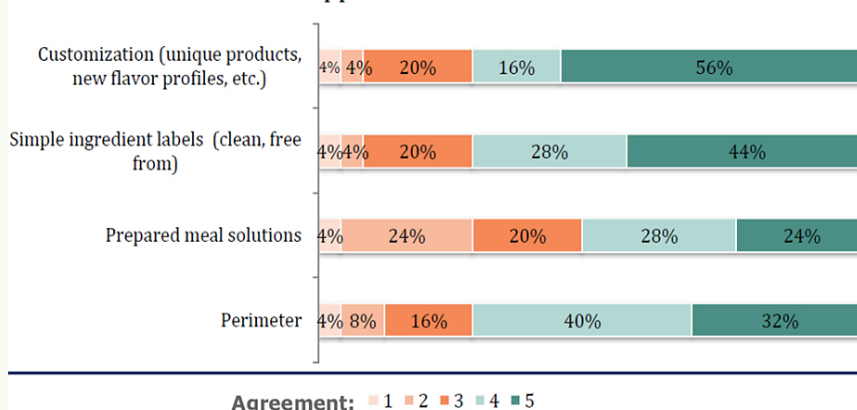
Mark Haas (partner with CCD Helmsman) confirms they are seeing a higher interest from retailers to innovate their store brands. However, they are mostly working on existing products. There is an opportunity for a store brand to be a trend-setter. For example, Trader Joe’s often has seasonal products that a consumer can only find at their store.

As retailers try to differentiate themselves from the pack with their store brands, they should think about going beyond “national brand equivalency” to

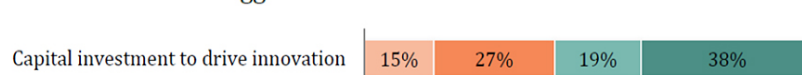


Coco Roos Coconut Cashew Brownie Cookie (Fresca Foods)

### Growth opportunities for Private Brands



### Biggest Threats for Private Brands



Source: FMI Power of Private Brands - 2017

superiority or, even better, to “new to the world” and exclusively available at their store. That will give shoppers a reason to go to their store and hopefully be less price sensitive. Retailers have aggressively expanded their offerings of prepared meals and side dishes featured on the perimeter of the store where most growth has been occurring.

The big gorilla in the room is the impact of direct to consumer selling with Amazon leading the way. Amazon private-label food products are currently very underrepresented relative to private label offerings in other categories. That is almost certain to change going forward.

**Corporate venture arms continue high activity:** Corporate accelerators are active across snacks, beverages, dairy, ingredients and food delivery services. PepsiCo announced it is seeking to start-ups from North America as it expands its Nutrition Greenhouse accelerator to North America following success in Europe. In the dairy category, Land O’Lakes Inc. chose six candidates for its 2018 Dairy Accelerator. In ingredients, DuPont Nutrition & Health announced a clean label hub at its Brabrand facility in Denmark in an effort to increase their offerings in the growing healthy and clean label texture modifier offerings.

At their third-quarter earnings call, Mondelez announced that they will launch a business unit in November aimed at developing the future of snacking. “SnackFutures is about capitalizing on new trends, mobilizing this ecosystem of entrepreneurs and the best of internal all towards our end goal which is consumer-centric growth and to really advance our global snacking leadership,” says Tim Cofer, Mondelez EVP and Chief Growth Officer.



*Bobo's, a brand of baked oat bars, recently announced a Series B round.*

The SnackFutures group will work like a much smaller company, cutting out some of the large organization bureaucracy and testing and scaling products quickly, he says. At the same time, Mondelez aims to learn from start-ups it will support under SnackFuture's venture arm.

Nutrition Capital Network recorded 443 transactions in the Food and Nutrition category in the first half of 2018. Just in the last few months, we have continued to see unprecedented M&A activity with large Strategic CPG's leading the way. For example, in September Keurig Dr Pepper agree to acquire allied brand partner Core Nutrition LLC for \$525 million. Core Nutrition makes Core Hydration, a nutrient-rich bottled water. Coca-Cola Company

acquired Organic & Raw Trading Co. an Australian kombucha maker. Hershey acquired Pirate Brands, maker of Pirate's Booty for US\$420 million. Private equity remains very active. Bobo's, a brand of baked oat bars, announced a Series B round led by repeat investors Boulder Investment Group Reprise and Ridgeline.

**Ingredient houses upping innovation:** As ingredient companies look for new avenues for growth, they are not solely relying on innovation coming from their customers. They are creating demand through their own internal or sponsored innovation. For example, Givaudan opened a food incubator MISTA in San Francisco this year. Joe Schumaker, founder of Foodspace+Co, sees increased activity from ingredient companies. Schumaker commented that some ingredient companies have explored renting space at the incubator he is starting up. He also sees more participation from companies like Ingredion and ADM at events like Foodbytes and Future of Food Tech.

### Where will this all lead?

Ultimately, the consumer should benefit from an increased range of food and beverage choices to suit their increasingly fragmented preferences. Brick and mortar stores will still be important but direct to consumer delivery options will make getting your groceries more convenient than ever. Large branded companies will also continue to be important but innovation will come from a much broader range of sources. ■

Carlos Barroso is President of the consultancy firm CJB and Associates.

For more information:  
[www.cjbandassociates.com](http://www.cjbandassociates.com)

## CrownConnect facilitates new industry-first “almond” blockchain technology for FACT water

In a first for the beverage industry, Crown Bevan Europe & Middle East launched its CrownConnect technology in conjunction with UK-based FACT – an all-natural sparkling drink last summer. Each can is marked with a 2D unique scannable code, making FACT beverage cans the first ever to be produced with a unique digital identity. The product was displayed as a key innovation at BrauBeviale 2018. Crown partnered with tech-savvy entrepreneur Olly Bolton, to launch Almond, a blockchain platform that allows consumers to scan a unique hidden product code and rewards them by unlocking tokens that are redeemable for cash. The platform, also unlocks details of FACT Water's story, giving unprecedented access to supply chain information and building deeper, trusting relationships with consumers that will ultimately foster brand loyalty.

Crown's involvement in the project is very much as an enabler of the technology. As well as producing the physical beverage can for FACT Water, on which Almond will be launched, its CrownConnect technology provides the 2D codes beneath the tab of the beverage can that facilitate the engagement between consumer (via a scanning application) and brand. The platform, developed in partnership with IoT company EVERYTHING then comes into effect, intuitively generating rewards and offers based on previous purchases and offering discounts and rewards to users based on their habits and the products they buy.

