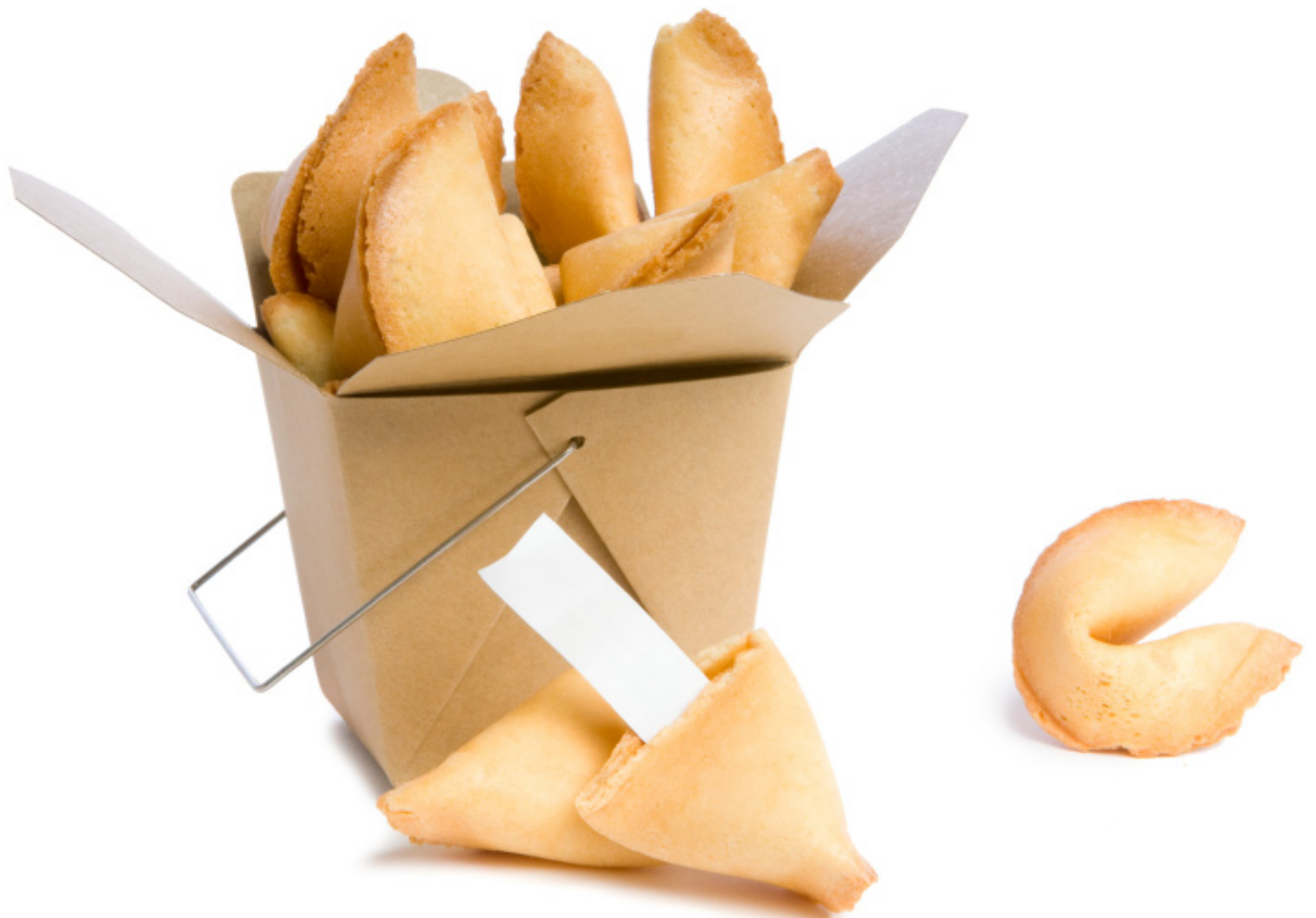




2009 Industry Outlook:  
Consumer Products  
Challenging Times,  
Emerging Opportunities





# Consumer Products



A tainted-milk scandal in China and e-coli-related recalls of tomatoes and salsa in the United States are drawing heightened attention to the need for consumer products (CP) companies to more closely manage and evaluate their supply chain risks on a global scale, while concurrently trying to improve efficiency and extract optimal value in troubled economic times.

Supply chain concerns, sustainability/social responsibility, branding imperatives, and an evolving regulatory environment are among the top issues facing consumer products companies in 2009. Factoring in a consumer spending slowdown in a maturing and troubled U.S. market, CP companies likely will find themselves playing a zero-sum game: The only way they will be able to grow significantly in the coming year is through strategic acquisitions or by stealing market share from competitors. The Consumer Products sector has grown about seven percent a year over the last five years, driven by emerging markets, mergers & acquisitions (M&A) and product innovation. Food & Beverage is its largest, most mature sub-sector, followed by Agribusiness. Other sub-sectors include Household Products, and Apparel & Textiles. Despite top-line growth, CP companies face margin pressure from rising input costs, leading many

to concentrate on cost-containment strategies, product reformulations and price increases to sustain profitable growth. A surge in commodity costs and a sluggish U.S. economy are expected to drag on sector growth in the coming years, although global growth continues to be strong. As a result, revenue for U.S. consumer products companies is forecast to grow less than five percent from 2008 to 2011. Many CP organizations are responding by focusing on growth in emerging markets, particularly the BRIC countries of Brazil, Russia, India and China, where retail sales and disposable income are growing at double-digit levels.

Among the top issues facing CP companies in 2009 are:

## **Supply chain complexity**

Increasingly, supply chain management is an issue that is keeping CP executives up at night. Global sourcing and market expansion, consumer safety and quality concerns, and changing consumer preferences are creating a CP supply chain that is much more complex than in the past. Globalization places big challenges on companies to maintain quality levels while still maintaining reasonable cost structures. While companies want to leverage the cost benefits of investing in production capacity, especially in China and India, headline-grabbing recalls of products manufactured abroad are creating a need for CP companies to implement quality measures like those in the U.S. – or pay the price in worthless inventory, government fines, damaged reputation and lost market share. Similarly, increasing transportation costs and growing support for “green” initiatives are prompting CP companies to consider manufacturing their products closer to home.

Fortunately, forward-thinking CP companies are recognizing that automating their business and supply chain processes can help to significantly improve product quality, add organizational agility, and reduce costs. For example, the Hershey Company in 2007 announced a three-year supply chain transformation program which reduced the number of U.S. production lines, outsourced production of low-value-added items, and constructed a production facility in Mexico. Kraft Foods, Inc., reduced the number of its North American manufacturing facilities to 64 in FY07, compared to 86 in FY03. During the same time period, its manufacturing facilities in the European

Union increased to 67 from 39; and in Asia Pacific to 19 from 16. CPG giant Procter & Gamble's operations stretch from its global headquarters in Cincinnati to every part of the globe.

In a related matter, the regulatory environment around supply chain and food/product safety is evolving. If CP companies want to avoid increased government regulation (and its associated cost increases), it is in their best interest to proactively self-regulate the industry – even going above and beyond what is required. If viewed through a positive lens, self-regulation can help to build customer goodwill and loyalty because it can convey the impression that CP companies are making higher-quality and safer products.

#### **Sustainability and Social Responsibility**

Sustainability and corporate responsibility will continue to be a focus for consumer products companies in 2009. Trend-watchers point to a change in sentiment among many consumers, particularly the young, who have become much more eco-conscious and less consumption-oriented. Our increasingly resource-constrained world is causing some consumers to reason that they don't need more "stuff." As a result, spending will be pared back, say these strategists.

A March 2008 Retail Forward Intelligence System study<sup>1</sup> showed that consumers are increasingly aware of a brand's sustainability and social responsibility initiatives. Among those rated most important were supporting worker's rights, participating in charitable practices, offering product recycling, and working to reduce waste.

Sustainability and social responsibility offer CP companies growth opportunities through new products and marketing. For many organizations, "green" product sales are growing faster than sales overall. Furthermore, CP companies are addressing increasing cost inflation by reducing packaging costs and by employing stealthy price increases. Clorox, for example, invested about \$20 million to develop its Green Works line of all-purpose, dilutable, bathroom, toilet-bowl and glass-and surface cleaners. The

products are priced at a 15 to 20 percent premium, and Clorox expects strong growth from these categories.

While CP companies increasingly view investments in sustainability and social responsibility as beneficial, they also are trying to quantify their commercial value. A recent, broad-based survey of consumers and cause marketing experts found that a company's investments in social marketing, cause marketing and corporate social responsibility initiatives enable it to charge an average premium of 6.1 percent<sup>2</sup> – and consumers say they are willing to pay a premium for brands viewed as "green." However, in tough economic times, it is important to know where the tipping point is for consumers who are making purchasing decisions based on sustainability and social responsibility. Clearly, there is a point at which a consumer won't pay more for a green product because the tradeoff for its higher price is either not obvious or not worth the additional cost. To date, however, the industry has not been able to identify where that tipping point is.

#### **The branding imperative**

Effective branding is always important in the consumer products sector, but it is expected to become a front-burner issue in 2009. In troubled economic times, consumers are inclined to scrutinize each purchase more closely, particularly in terms of branded versus private label products. CP companies will need to clearly differentiate their products from competitors' if they hope to grow (i.e., steal) market share in 2009. Consumers have to believe that a product is safer, of higher quality, or tastes better to make paying an up-charge worthwhile. When consumers can't differentiate, their tendency is to buy private label – especially when pennies count. If poor economic conditions persist into 2009, watch for continued growth of private label products, countered by aggressive marketing efforts by name brands. Similarly, CP companies should avoid competing on price to the exclusion of all else, particularly in increasingly commoditized categories such as electronics, fashion and processed foods. Those brands that differentiate on other attributes will be the winners of the future.

<sup>1</sup> [http://www.retailforward.com/retailintel/rfis\\_default.asp](http://www.retailforward.com/retailintel/rfis_default.asp)

<sup>2</sup> Millward Brown Client Interviews; Factiva, Company 10-Ks

While shoring up brand preference among current consumers, CP companies need to learn how to establish lasting relationships with members of the “Thumb Tribe,” the group of tech-savvy, under-18 individuals who are just starting to enter the workforce. These potential customers have never known a world that didn’t have computers and their increased thumb dexterity from text messaging and playing video games has been well documented. CP companies must learn how to effectively speak their language and leverage technology to spur product purchase.

#### **Working through the economic downturn**

Due to the effects of a softening U.S. economy on consumer spending, top-line growth will be a primary concern for CP companies in the coming year. To that end, M&A becomes an important tool as domestic markets grow slowly and offer CP companies limited ability to raise prices. It goes back to 2009 being a zero-sum game: Setting aside expansion in emerging markets, the only way to grow in a big way is through strategic acquisitions and the juggling of product portfolios. Those CP companies that have the capital to do this should be able to work through the current economic downturn by acquiring and maximizing access to new markets as a source of growth.

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