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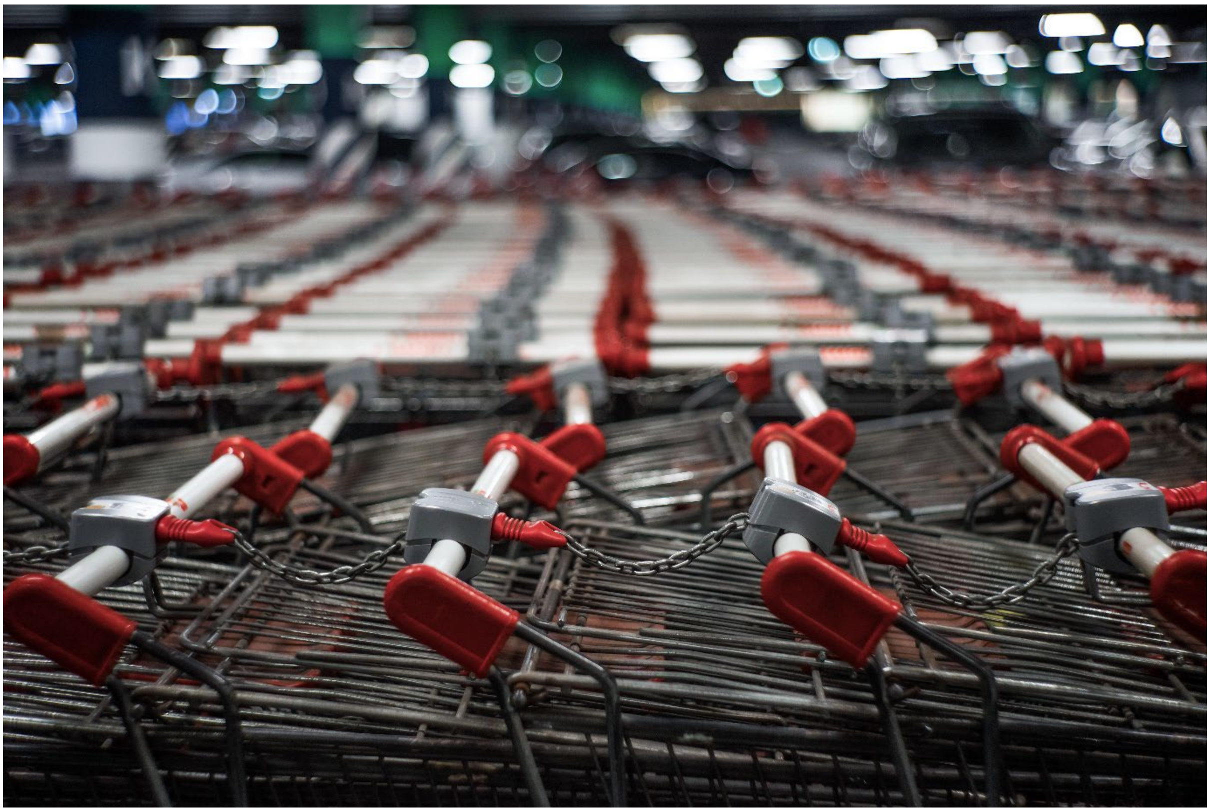

Surviving the Consumer Revolution:

Remaining Competitive in the Changing FMCG Industry

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Surviving the Consumer Revolution:
Remaining Competitive in the Changing FMCG Industry

Fast Moving Consumer Goods (FMCG) firms now sit within a landscape of unprecedented change and challenge. Incumbent firms face a future that looks vastly different from the environment in which they've operated over the last few decades.

Tech-savvy and inquisitive consumers are driving the change, keen to balance their three primary concerns: convenience, health, and environment. These concerns are impacting how they buy, why they buy and what they buy. In recent times these requirements have been amplified, with higher consumer expectations in the post-COVID-19 world.

As FMCG firms navigate this new landscape, many are innovating and radically changing their business models to adapt. Other incumbents are realising they're not changing enough – and are being left in a position of distinct disadvantage in the market.

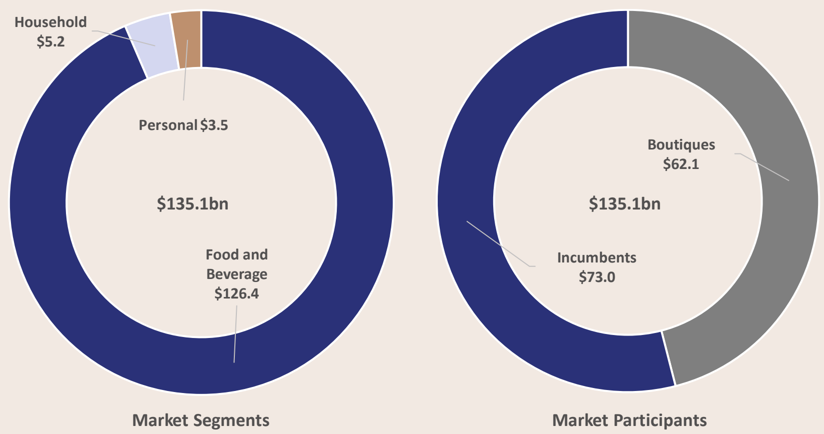
In this industry study, we deep dive into the challenges facing FMCG firms and investigate how they can adapt to find a place of competitive advantage in the market.

The Australian FMCG industry

Australia's mature FMCG industry is as diverse as it is large, covering segments from biscuit manufacturing to vitamins, perfume, stationery and fresh produce.

The annual revenue of the FMCG industry in Australia reaches beyond $135 billion.[1] While household names such as Bega Cheese, Ingham, Lion, and Blackmores dominate the industry, many boutique players also take a slice of the $135+ billion pie.

Size of the Australian FMCG Industry – Revenue 2021/22 ($BN)



Notes: Includes Manufacturers and Processors. Excludes Wholesalers, Food Services and Retailers. All Primary Producers have been excluded, which amounts to approx. $92bn. Of this, approx. $16bn is sold directly to Wholesalers, Food Services and Retailers.

Source: IBIS World, Indigo Bridge Analysis

[1] IBIS World (2022)

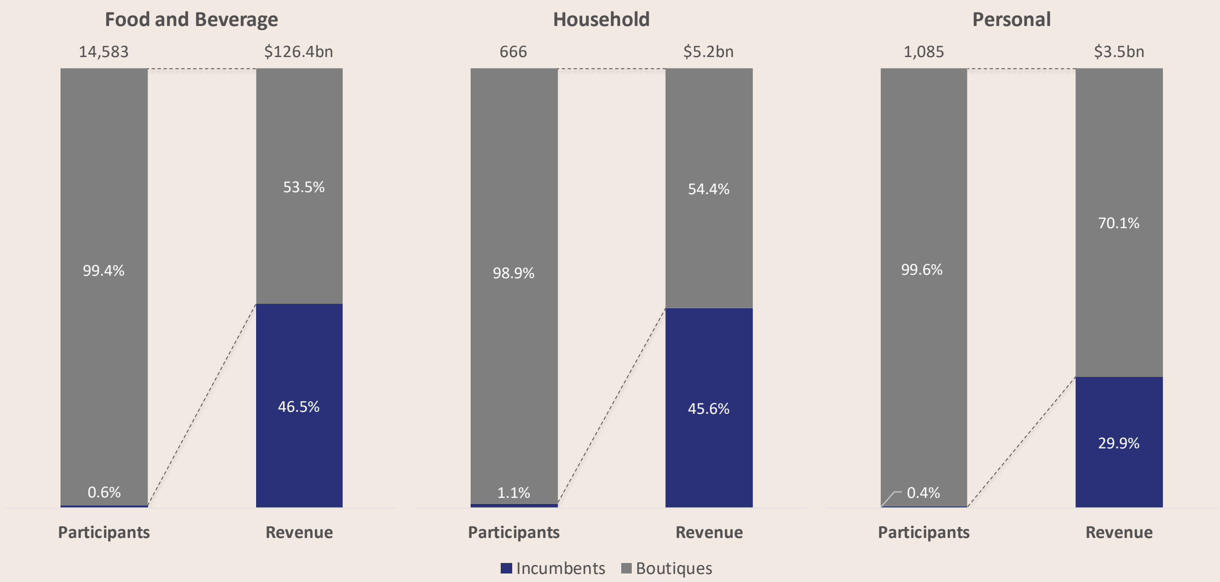
The Industry Players: Incumbents vs Boutique Firms

The major industry players – **the incumbent FMCG firms** – typically enjoy a market share above 5% and operate on a global or national scale. The smaller industry players – **the boutique FMCG firms** - on the other hand, are likely to have only a local or interstate footprint and typically less than 5% market share.

The incumbent firms also tend to have more integrated supply chains and are foreign owned or publicly listed companies rather than privately owned businesses.

From a revenue perspective, the incumbents clearly dominate the FMCG market.

Profile of the Australian FMCG Industry

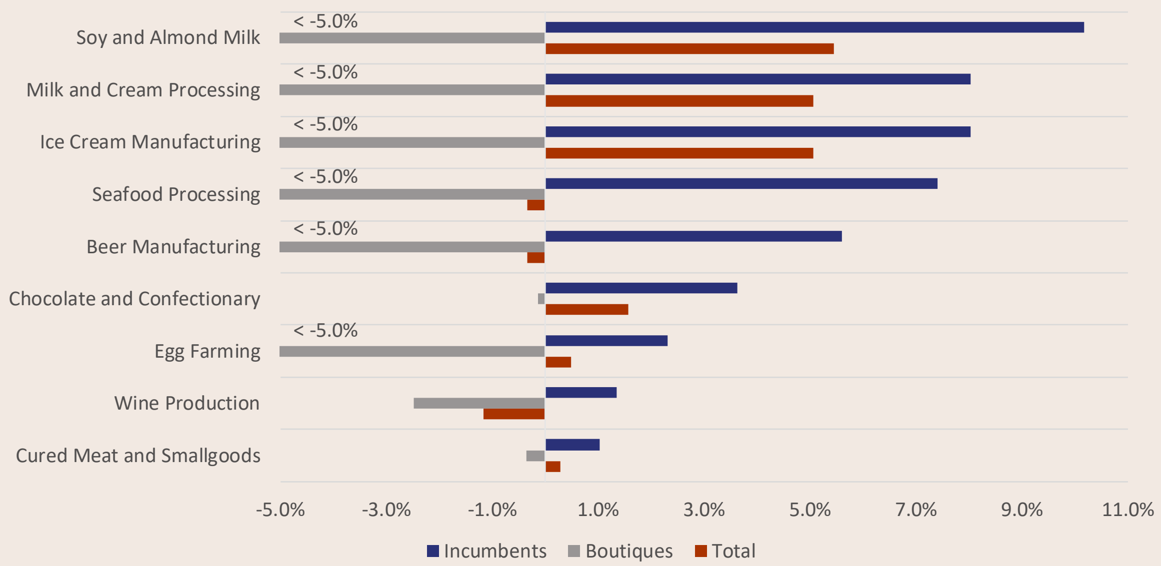


Notes: Incumbent/large firms are firms with >5% share in their respective markets. Revenue is based on 2021/22 figures. Totals may not equal 100% due to rounding.

Source: IBIS World, Indigo Bridge Analysis

Generally, incumbents consistently outperform their segments.

Market Growth (5 Year CAGR) – Incumbents vs Boutiques



Notes: 5-Year CAGR measured from 2016/17 to 2021/22. Incumbent firms with >5% market share, Boutiques are firms with <5% market share.

Source: IBIS World, Indigo Bridge Analysis

One thing all firms are facing, though, is the challenge of rapidly changing consumer attitudes and behaviours.

The Consumer Market Revolution

The changing needs, values and behaviours of consumers over the last decade have truly changed the game for the FMCG industry.

When making a purchase, today's savvy consumers are often thinking about at least one of these three primary concerns:

- Convenience
- Health
- Environment.

Convenience Is King

The rise of "on-demand", "on-the-go" and "one-click" options reveal how the consumers of today value convenience. Busy work schedules and lifestyles mean people often don't have time to drive to a store and browse the aisles. In fact, research suggests 46% of busy consumers find shopping a chore.[2]

[2] Nielsen 'Unlocking Growth in Meal Kits' (2018), Nielsen 'Global Health and Ingredient Sentiment Survey' (2016)

Living in a digitally connected world means consumers might visit an online review site or price aggregator on their smartphone before making a final decision about a big purchase.

What's Driving the Global Demand for Convenience?

- Rapid urbanization
- Smaller households
- Crowded transport
- Evolving gender roles
- Shifting age demographics
- Uptake of technology.

Source: Nielsen 'The Quest for Convenience' (2018)

> ***"Technology in the FMCG market is at the heart of convenience. It is essential for matching consumer demand for products and services that are 'right here… right now… and right for me".[3]***
>
> - Pedro Manosalva, Retail Vertical, Developing Markets, Nielsen

COVID-19 accelerated the need for convenience. As lockdowns and social distancing became the new norm during 2020-21, so too did online shopping. Eight percent of consumers started purchasing online after never having purchased online previously, and about one in four consumers who had previously shopped online regularly increased their online shopping activities[4]. In the post-COVID-19 world, the consumer's baseline for convenience has been set higher than ever.[5]

Health A Growing Concern

As we hear more about plant-based, vegan, whole foods and other eating trends, sugar is out – almost one in four Australian consumers follow a diet that limits the consumption of sugar and 44% say they avoid sugar as an ingredient[6].

It's not just sugar that's being shunned. Nielsen identifies that we're avoiding other ingredients, too.

[3] Nielsen 'Unlocking Growth in Meal Kits' (2018)
[4] BCG Australian Consumer Sentiment Snapshot #4
[5] Nielsen COVID-19 Elevated Convenience to a New Level, and That's How it Will Stay (2021)
[6] Nielsen, 'Not so Sweet: Sugar Consumption in Decline Due to Growing Consumer Health Concerns' (2016)

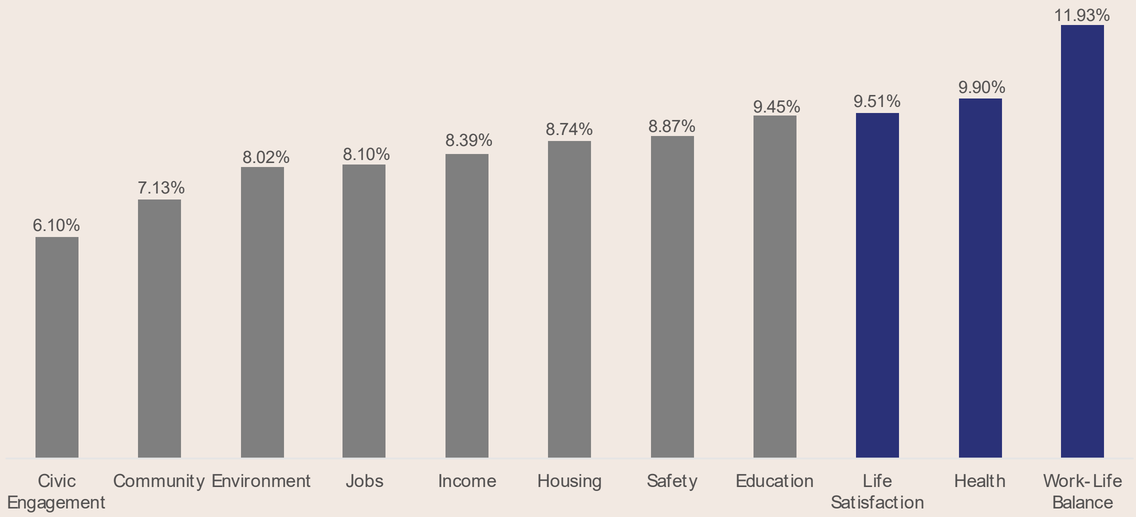
Ingredients	% of Consumers Avoid
Antibiotics and Hormones	60% of Australian consumers, 61% of New Zealand consumers
Artificial Preservatives	55% of Australian consumers, 54% of New Zealand consumers
Artificial Flavours and Sweeteners	53% of Australian consumers, 54% of New Zealand consumers

Key stat: 90% of consumers who avoid these ingredients do so because they believe they're harmful to their own or their family's health, rather than because of an actual medical condition.[7]

Our sugar shyness and aversion to artificial ingredients is driven by an overall move towards healthier choices, with 59% of Australian consumers saying their dietary choices are made to help prevent health conditions such as obesity, diabetes, high cholesterol and hypertension[8]. The IBISWorld Health Consciousness Index also identifies that health consciousness in consumers has risen over the past 5 years and is expected to continue growing[9].

Balance, Health and Satisfaction Top Priorities for Australians

- The majority of Australian respondents to the OECD Better Life Index survey identified their largest concern today is their work-life balance, followed by health and life satisfaction
- Australia ranks in the bottom 20th percentile on the OECD's Work-Life Balance Index



Notes: OECD's Work-Life Balance Index compiles an index based on the percentage of employees working 50 hrs/wk or more and the average amount of hours devoted to leisure and personal care, including sleeping and eating. The Better Life Index is an interactive web application that allows users to choose what weight to give to each of the eleven OECD dimensions, based on their own life priorities

Source: OECD 'How's Life in Australia? Report' 2017

[7] Nielsen 'Global Health and Ingredient Sentiment Survey' (2016)
[8] Nielsen, 'Not so Sweet: Sugar Consumption in Decline Due to Growing Consumer Health Concerns' (2016)
[9] IBISWorld (2018)

Rising Environmental Consciousness

We've been warned for years about the growing threat of pollution and climate change, and it seems we're starting to take notice. WWF states that 86% of Australians agree that climate change is real in 2018, compared with the CSIRO's report of 74.7% in 2011.[10] The HP Australia Environmental Sustainability Study (2018) also found that more than nine in ten Australian consumers are concerned about the environment and sustainability.

Importantly for the FMCG industry, consumers are also showing that they're willing to put their money where their mouth is – 83% of Australians want their food to come from sustainable sources and 71% of Australian consumers (and businesses) are willing to pay extra for sustainable products[11].

> ***"Environmental sustainability is one of the biggest issues faced by… mankind at present. Increasing population along with tremendous escalation in anthropogenic activities has raised several questions on the sustainability of natural resources on our planet. No part of the Earth is now untouched by the effect of human activities or pollution."[12]***
>
> - Naveen Kumar Arora, Environmental Sustainability Journal

The Competitive Landscape

The consumer market revolution has put enormous pressure on existing business models within the FMCG industry.

As FMCG firms navigate the new landscape, and attempt to respond to changing consumer concerns, new challenges emerge to add to the pressure. In the food and beverage segment, for example, "cruelty-free", "grain-free", "grass-fed", "corn-free" and "free range" are the fastest growing health and wellness claims on products in the US market.[13] However, consumers are skeptical and many look beyond the labels – less than two in three consumers trust these health claims.[14]

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[10] CSIRO Australian Attitudes to Climate Change (2010 - 2014)
[11] WWF's Backyard Barometer Summary Report (2018), HP Australia 'Environmental Sustainability Study' (2018)
[12] Environmental Sustainability Journal (2018)
[13] Nielsen 'Total Consumer Report' (2018)
[14] Nielsen 'Total Consumer Report' (2018)

Consumers Also Want Transparency

With the internet at their fingertips, consumers are able to quickly spot those products that offer tangible health benefits – and skip past those whose marketing departments are just jumping on the bandwagon.

Transparency in sustainability, ingredients and processing claims is the key to maintaining success – along with tangible proof that FMCG firms are acting ethically and sustainably. These days, consumers may want more than “free-range” eggs, for example. They’re also keen to know how many “free-range” chickens are roaming each hectare of land.

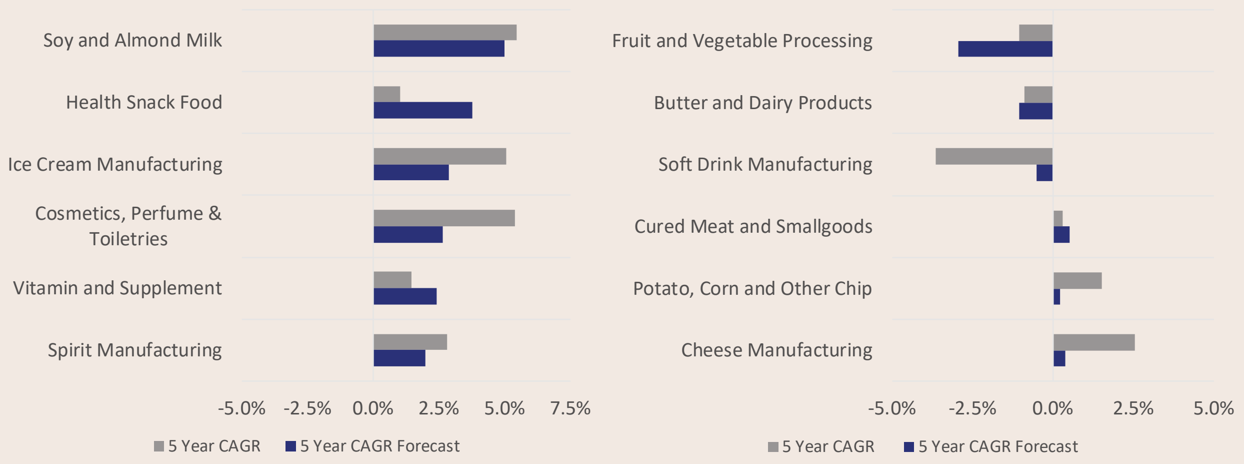
Adapting in Changing Times

It’s becoming clear that to survive – and thrive – incumbent FMCG firms must meet changing consumer preferences. Generally, this means making changes that radically alter the industry or redefine their segment.

Growing vs Declining Categories

“Fuelled by growing health consciousness, diversified, healthy ranges, and premium products”

“Dampened by consumer health and sustainability concerns”



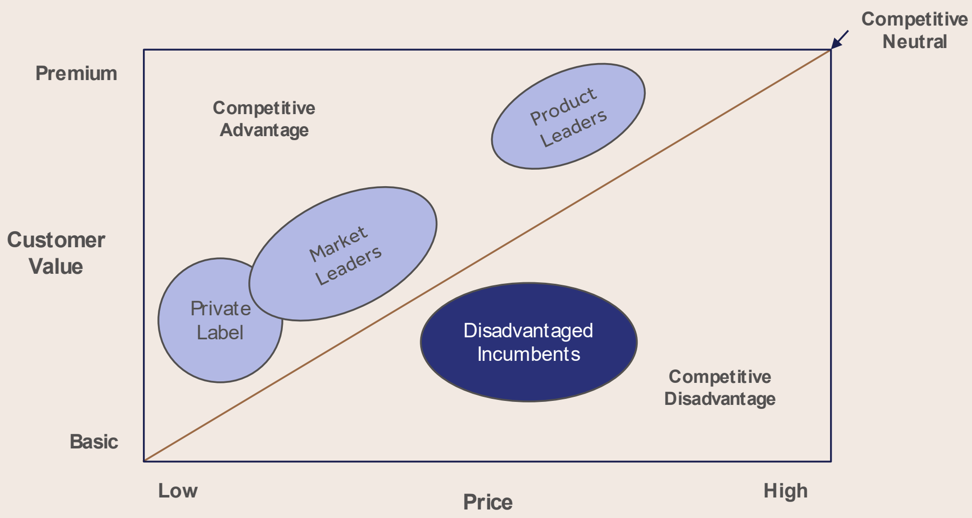
Notes: 5-Year CAGR measured from 2016/17 to 2021/22. 5-Year Forecast CAGR measured from 2021/22 until 2026/27.

Source: IBIS World, Indigo Bridge Analysis

Left Behind and "Stuck in the Middle": Key Threats for Incumbent Firms

As FMCG firms navigate the new landscape, three types of players, each with a distinct operating model, are drawing away from other incumbent players. These other incumbents are effectively left at a disadvantage as the others draw away – they're left behind and "stuck in the middle".

Disadvantaged Incumbents



Note: Customer value is defined as how well competitors satisfy one or more of the three primary consumer concerns; convenience, health, environment

Source: Indigo Bridge

1. Private Labels

Products manufactured under contract or by a third-party manufacturer and sold under the retailer's brand name occupy the so-called "lower ground". However, across total FMCG sales, these private label products have grown more than branded products, both in dollar sales and units, as dominant supermarkets are starting to offer affordable premium products or boost quality and convenience while remaining at the lower price point.

More than 90% of all private label sales are within the packaged grocery segment, where they are 44% cheaper than branded products.[15] Most Australians believe private label products are a good alternative to branded products and 76% agree that store brand quality has increased.[16]

With international comparisons suggesting there's still much potential for expansion in the Australian private label market, already-disadvantaged incumbent firms risk being undercut further.

[15] Iri, 'Private Label: The Rise and Evolution of Private Label in Australia Report' 2017
[16] Iri, 'Private Label: The Rise and Evolution of Private Label in Australia Report' 2017

2. Market Leaders

Market leading firms typically have the most optimised and efficient supply chains in the industry, allowing them to increase scale, sacrifice margins and stay competitive in their segment.

These firms are also well positioned to acquire smaller firms who pose a threat, so they can increase their market share and become more dominant within the segment.

3. Product Leaders

Product leaders clearly understand the consumer revolution. They know their target market, are laser-focused on understanding one or more of the key consumer concerns, and give their market exactly what they want. They continue to innovate and introduce highly focused products into the market ahead of consumer trends, solidifying their place as product leaders.

With a higher price point and a more considered brand portfolio, these product leaders satisfy the extremely lucrative niche markets.

Choosing to Stay Competitive

Disadvantaged incumbents – those who are becoming left behind and “stuck in the middle” – have two broad strategic options available to them to become more competitive and sustain that position over the long term.

They can choose an operating model focused on operational excellence, to become a market leader, or they can adopt an operating model focused on product leadership to become product leaders in a narrower market segment.

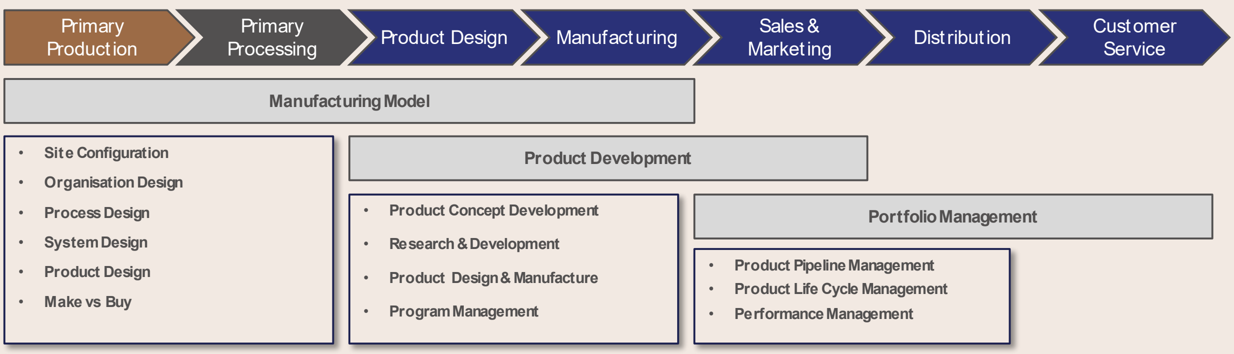
Choosing to place emphasis on a single operating model significantly boosts their chance of becoming competitive. Once the choice is made, firms will still need to have some elements of the opposing model. However, their choice will define both the nature of the firm and its competitive advantage, through a sophisticated and coherent operating model.

Two Broad Strategic Choices

Operational Excellence	Product Leadership
• Achieving operational expertise across every facet of the organisation • Combining disciplined process execution, technology application and performance management • Bringing together the whole organisation into an entity that is singularly focused on delivering a combination of price and quality	• Consistently striving to provide the market with leading-edge products or new applications of existing products • Creative, innovation focused with business processes designed for fast commercialisation of products • Balancing the tension between developing new products and managing the life cycle of existing products

Source: Indigo Bridge

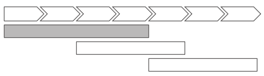
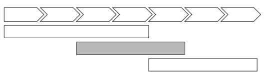
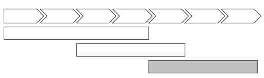
Understanding the FMCG Operating Model



Source: Indigo Bridge

Becoming A Market Leader

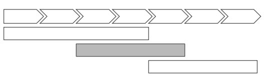
Becoming a market leader means serving the largest possible market, generating scale and developing new products that leverage existing assets. To achieve this outcome, an efficient manufacturing model and supply chain dominates the firm's operating model.

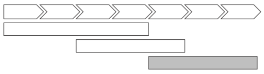
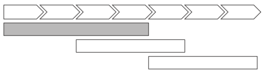
Function	Capabilities
Manufacturing Model 	• Scale manufacturing, steady and smooth production with minimal fluctuations • Fully or partially vertically integrated manufacturing and supply chain • Efficient processes with extensive use of automation • Standardisation of products to minimise production variations
Product Development 	• Leverage existing assets across a national or global footprint • Less product variety, more focused on product extensions that use existing products and assets • Centralised control and planning • Tactical, less strategic involvement of upstream marketing, sales and customer service functions
Portfolio Management 	• Portfolio performance is based on return on assets / capital employed • Less emphasis on portfolio management versus product category level management • Minimal variation / diversification • In general, portfolio revolves around a single base-product with small variations typically through convenience and packaging

Source: Indigo Bridge

Becoming A Product Leader

Product Leaders focus on a narrower market segment. This means releasing breakthrough products and growing new market segments where there is an unmet consumer demand. To achieve this outcome, product development dominates the firm's operating model.

Function	Capabilities
Product Development 	• Speed to market, fast commercialisation • Creative ideas from the broader organisation • Cross-functional teams, intelligence from upstream marketing, sales and customer service functions • Clear prioritised choices regarding the categories and segments in which to develop innovative products • Agile management processes

Function	Capabilities
Portfolio Management 	• Expert product life cycle management with new product, in-market and end-of-life stages defined and monitored • Extensive research to understand key niche segments as well as forecast upcoming trends/concerns • Supported by sophisticated measurement of portfolio performance • A “fast fail” approach to innovation, able to discontinue or alter products that are not performing
Manufacturing Model 	• Flexible manufacturing operations, able to deal with more complexity • Able to mix and match assets and production equipment • Partially or completely outsourced manufacturing • Less integrated and more flexible supply chain

Source: Indigo Bridge

The Journey from Disadvantage to Competitive Advantage

Disadvantaged incumbents can transform their organisation through an organic or inorganic / M&A (merger and acquisition) approach.

In deciding on the best strategy, the pros and cons of both modes of transformation should be evaluated carefully and in context.

Organic or Inorganic Transformation?

Organic Approach

Advantages:	Disadvantages:
• Natural ownership, easier for an organisation to adopt / accept changes • Can control rate of growth • Consistency of leadership and strategic direction • Minimal cultural issues • Lower, more favourable investment profile	• Longer timeframe to build capabilities / Slower in building competitive advantage • Organic growth alone may never achieve growth targets / ambitions • Illusion of self-sufficiency

Inorganic / M&A Approach

Advantages:	Disadvantages:
• Shorter timeframe to build capabilities / Rapid building of competitive advantage • Potential to profoundly transform an organisation leading to greater value creation • Enter new markets, products and geographies in a short timeframe	• Requires significant upfront investment to cover acquisition and integration costs • Potential integration issues • Potential cultural mismatch • Potential management retention issues • Illusion of value creation

Source: Indigo Bridge

In practice a **hybrid approach** is often required, since M&A is rarely successful without at least some level of organic change. Organic change helps stabilise the organisation and builds a core capability that can manage transformational change into the future. Overall, there can be a more favourable balance between risk and investment.

Building capability internally should be a high priority, before any M&A activity.

To build internal capability, incumbent firms need to address the three tiers of capability inherent in all organisations:

- **Foundational** – fundamental and strategic in nature, this tier involves making decisions on product design, process technology and the culture of an organisation

- **Structural** – this tier addresses economies of scale, the level of utilisation of assets and the extent of complexity in the organisation
- **Systemic** – more tactical in nature, this tier involves procedures and processes, and changes to the supporting systems and functions

Although difficult to implement, transformation at the foundational level will have the greatest impact for disadvantaged firms.

Start with the Foundations

Operational Excellence

Change the fundamental processes, technology and culture that support the organisation.

The emphasis is to standardise and centralise to ensure there is conformance across the company

- Limit product portfolio to a few base products
- Standardise product engineering and manufacturing processes
- Adopt technologies that fundamentally change the cost to produce products

Develop a culture that is process focused, disciplined and values teamwork

Manage key functions from a central core, with high skill levels at the centre of the organisation

Product Leadership

Move to being led by the "customer journey", with the emphasis on a customer centric culture and core processes focused on innovation.

Develop a culture that focuses on the customer

- Live and breathe the customer, with the consumer at the centre of every decision
- Board and executive level changes with business leaders that are customer focused
- Create a vision for the organisation to become customer focused

Make innovation and the commercialisation of new ideas the core processes of the organisation

Innovative product development processes, with a "fast fail" approach to releasing new products

Source: Indigo Bridge

Using M&A Wisely

An M&A approach enables FMCG firms to either consolidate or expand into new markets. M&A can be distinguished into three types, with each carrying its own level of investment, risk and timeframe to achieve benefits:

Consolidation Merger	A **consolidation merger** is a consolidation of similar sized firms to build market share and scale. The emphasis is on cost reduction, and stakeholders generally expect to see tangible actions early in the merger program. Integration of IT systems and HR management is required over a shorter timeframe.
Expansive Merger	A merger of firms that serve different product or geographic markets is an **expansive merger**. The emphasis is on revenue growth and while the integration of IT systems and HR management can operate within a longer planning horizon, the timescale to achieve benefits may also take longer.
Tuck-In Merger	A **tuck-in merger** typically involves a larger company acquiring a smaller company and integrating into its own structure, inventory, systems and other operational aspects of the business. The smaller company, over time, may lose all of its original systems and structure as a result of the acquisition.

Source: Indigo Bridge

Moving into Market Leadership

FMCG firms aspiring to achieve **operational excellence and market leadership** will benefit most from building scale through consolidation. However, mergers of this type have their integration risks. Tuck-in mergers offer an alternative approach by building scale piecemeal, while being more manageable and involve less risky integration.

Consolidation Merger	Realise significant benefits by eliminating duplication, including: • Consolidating supply chains, manufacturing footprint and distribution channels • Eliminating duplications between manufacturing lines and business systems • Consolidating product range to a few base products • Realising cost synergies across operations, support and head office functions Use the opportunity to improve processes and technologies that are crucial to an Operational Excellence model, including: • Addressing the fundamental processes and technologies of the merged entity • Standardising product engineering and manufacturing processes

Tuck-In Merger	Build market share and scale by acquiring a number of smaller firms in the market. • More manageable from an integration perspective, with each acquisition managed individually • Enables a more progressive approach, with learnings and experience from one acquisition used on the next • Advantages are significantly less integration risk • Disadvantages are longer time frame to build scale

Source: Indigo Bridge

Performing Well as a Product Leader

An expansive merger presents FMCG firms aspiring to achieve **product leadership** with an alternative pathway to develop innovation capabilities. An acquisition of an innovative firm can act as a catalyst for change. However, this also has its integration risks, with cultural change needing to be managed carefully. Tuck-in mergers offer an alternative approach to fill in gaps in innovation capabilities.

Expansive Merger	Immediate benefits in terms of revenue improvement from new innovative products and expansion of the firm's product portfolio into new markets. Acquiring other innovative firms can act as a catalyst for change • Introduce a customer focused culture into the organisation • Bring in new innovative processes that act as a benchmark for the newly merged firm Success of this type of merger depends heavily on cultural change: • Cultural mismatch is one of the key reasons why mergers fail • The new structure for the organisation must be clearly defined early in the merger integration to support the change in culture
Tuck-In Merger	Acquiring a smaller firm, such as a small boutique, to fill in specific gaps in capabilities or in the product portfolio. Advantages include: • Less disruption to the incumbent firm Disadvantages include: • May be too small to make any lasting change • Over time may be entirely absorbed into the incumbent firm

Source: Indigo Bridge

Where to From Here?

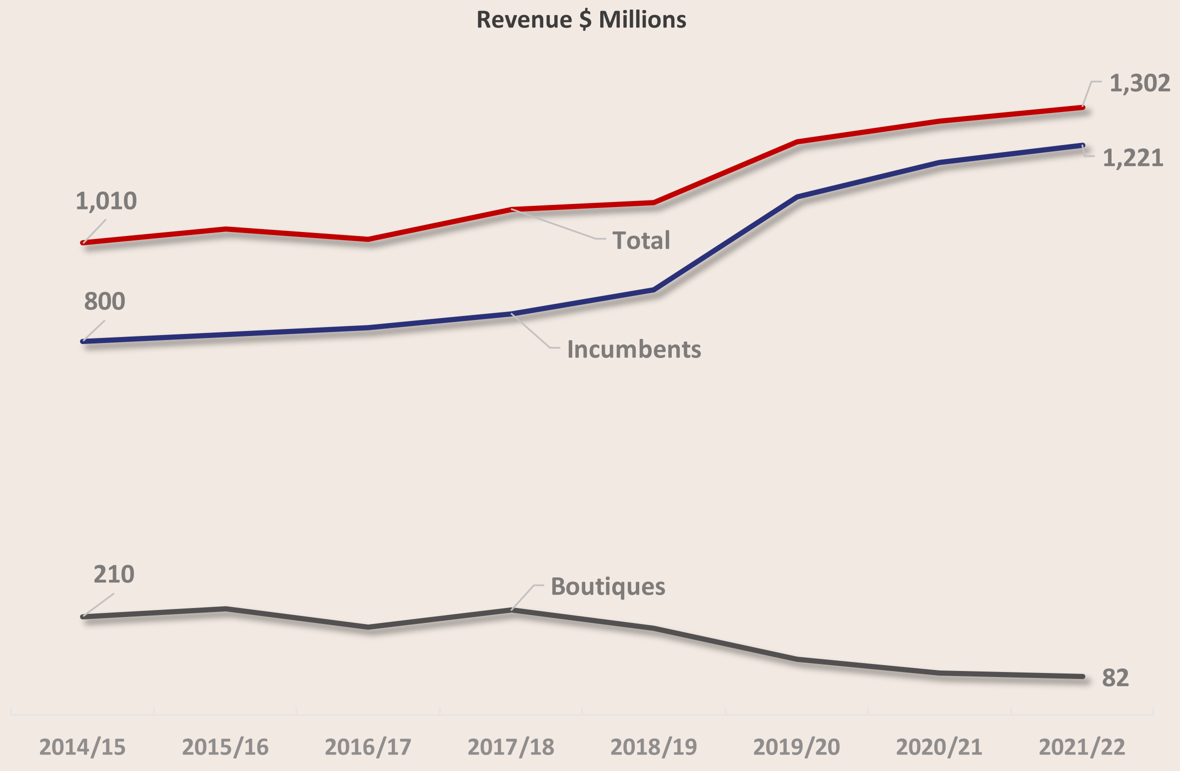
By making a clear choice to pursue either market leadership or product leadership, incumbent FMCG firms can move into a position of competitive advantage.

Making this choice – and developing the right strategy to meet consumer concerns and demands – can help you survive and thrive in the FMCG industry, even in the midst of enormous change and challenge.

What Ice Cream Can Teach Us About Remaining Competitive

How has the ice-cream category fared during the consumer revolution?

As consumer health consciousness rises and research increasingly links sugar and fat to obesity and heart disease, the ice cream industry is – ironically – recording some of the strongest growth in the food and beverage FMCG market.



Why?

Incumbent ice cream manufacturers are reading the consumer market well, understand how tastes are changing and have shown the flexibility and proactivity to adapt to change (before it's too late).

Firms haven't necessarily met every consumer demand in their strategy but have selected a specific consumer demand to appeal to, such as health consciousness, and positioned their products accordingly to target those specific consumers.

About the Author

Theo Konstantopoulos is a Director based in the firm's Sydney office. Theo has over two decades of advisory experience spanning several industries. His experience advising FMCG clients includes helping executives develop viable business strategies, and assisting clients transform their operations to remain competitive.

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Indigo Bridge

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Indigo Bridge	is a boutique management advisory firm, advising CEOs, Boards and senior managers on all aspects of business strategy and performance improvement.
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We develop	practical solutions, and we're on hand to help implement them.
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