

Opportunities in adversity

Consumer products survey snapshot

Overview

The global economic crisis has accelerated and compounded challenges that Consumer Products (CP) companies have faced for years. Overall consumer demand in many developed and emerging markets has slowed down, placing sales volumes under pressure. Consumers are also trading down in certain categories and territories, exacerbating the challenge posed by private label brands. The shakeout in the retail industry has further shifted the balance of power towards the large discount retail giants. As retailers and distributors heighten their management of working capital, they have affected consumer products companies by destocking inventories and revisiting supplier pricing, terms and other investments. The extreme levels of currency and commodity volatility resulting from the economic crisis has posed new challenges to global consumer products companies in managing growth and profitability, although currency volatility has led to some winners as well as losers. Overall though, despite a shift in the sector's dynamics and pressure on consumption, CP companies have shown significant resilience in the face of recession, in comparison with other sectors.

In June 2009, with the Economist Intelligence Unit, we interviewed senior executives from major consumer products industry firms around the world to gain insight on how they are managing their businesses during this tumultuous period. In many ways, the results were not surprising. Top-line focus on pricing and responsiveness to their retail customers' needs and bottom-line focus on working capital management, supply chain effectiveness and driving sustainable enterprise cost reduction were industry issues well before the financial crisis. What is perhaps more interesting is the message that these areas of concern have been used as ways to really drive competitive advantage. Since access to credit markets is tight, successful consumer products companies have been able to reduce their dependence on external funding through managing cash and working capital better on a day-to-day basis. They are also accelerating initiatives to increase speed to market, taking bolder decisions across the organization and improving flexibility to stay ahead.

In this report, Ernst & Young highlights how executives are actively managing to secure their companies' present, improve their performance and position to sustain their future.

About this survey

For this study, the Economist Intelligence Unit surveyed 569 C-suite and board-level executives.

Respondents were drawn from across the world and across industry sectors. Over half the executives polled worked for companies with an annual global revenue in excess of US\$1 billion.

The research was carried out in June 2009. Responses are rounded to the nearest percentage.



Market challenges: declining demand and increasing competition

While the consumer products industry has fared better than many other sectors, CP companies have still been hit by the global economic slowdown, especially those with weak brand portfolios and those operating at the luxury end. The instability of commodity and energy prices has affected every aspect of their business – from packaging and raw materials to transportation and distribution of products. Yet more consumers are, naturally, unwilling to pay correspondingly higher costs for branded products. In addition, the level of competition is heightened. As consumers trade down, major consumer products companies are seeing competition increase from private label brands in developed markets and local brands or other western brands in developing and emerging markets. This competition will likely create a sustained shift in the marketplace because the perceived quality gap between private label and branded products is narrowing, especially in large, mature markets.

Pressure is also growing from retailers where strong global players are leveraging their international scale to increase buying and negotiating power. This trend has resulted in large retailers that can resist price inflation and can demand higher discounts and rebates as well as enhanced payment returns. The pressure from retailers to discount, as well as compete against lower-priced private labels, has triggered CP companies to reexamine the effectiveness and sustainability of their cost reduction and supply chain efficiency programs.

Looking ahead, in addition to improving cost structures, CP companies recognize opportunities to grab market share through strategic transactions, innovation (in the form of product launches), expansion into under-penetrated emerging markets and stepped-up marketing campaigns. In this respect, CP companies have been aided by a fall-off in traditional media rates, as well as improving their ability to exploit lower-cost digital media opportunities.

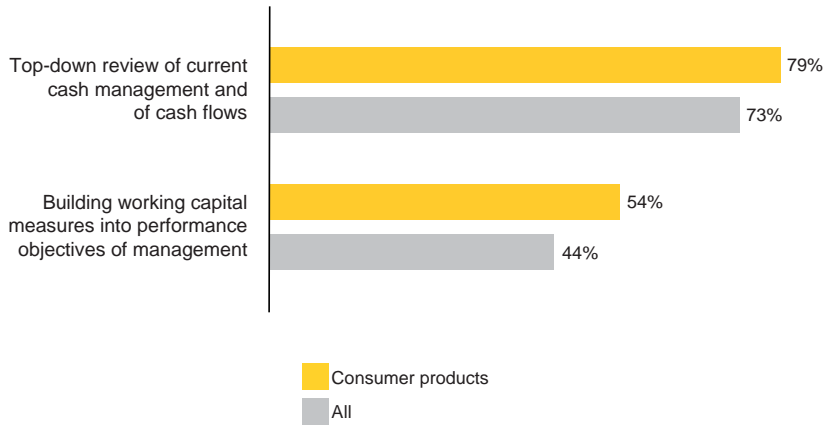
A survey of the consumer products industry

Compared with respondents from other sectors, consumer products executives are slightly more optimistic about industry prospects, perhaps unsurprising given the resilience of the sector. CP respondents were far less surprised at the speed and severity of the economic downturn than overall survey respondents, and almost half (46%) of the CP respondents said that business actually improved over the past 12 months, compared with just over one-third (35%) of overall respondents. Despite the more positive outlook, executives from consumer products companies have indicated that managing working capital, improving supply chain effectiveness and accelerating enterprise-wide cost reduction plans remain areas of extreme focus and activity.

When asked about the cash management options their companies were taking, consumer products respondents were more inclined than overall respondents to indicate that top-down reviews of cash management and cash flows were taking place, with nearly 80% of sector respondents indicating this level of management attention. The majority of consumer products respondents also indicated that they are building working capital measures into the performance objectives of management.

Consumer products companies are focusing on working capital management. Those companies that excel in this area are not only extracting more cash from their businesses, but are also less dependent on external funding.

Q: Which of the following cash management actions is your company currently taking?

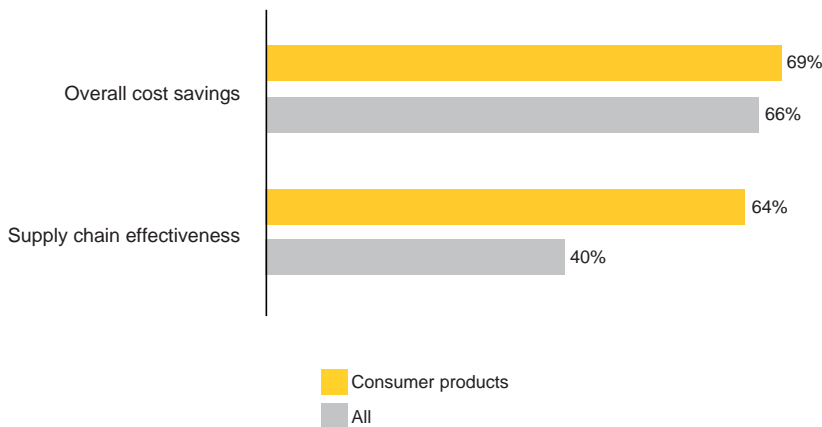


Shown: percentage consumer products respondents compared with overall respondents.

Clearly, consumer products companies are focusing on working capital management as part of their cost reduction initiative, most likely because there are significant opportunities to make major improvements in working capital efficiency. Companies that excel in this area are less dependent on external financing and have increased leeway to make bolt-on acquisitions.

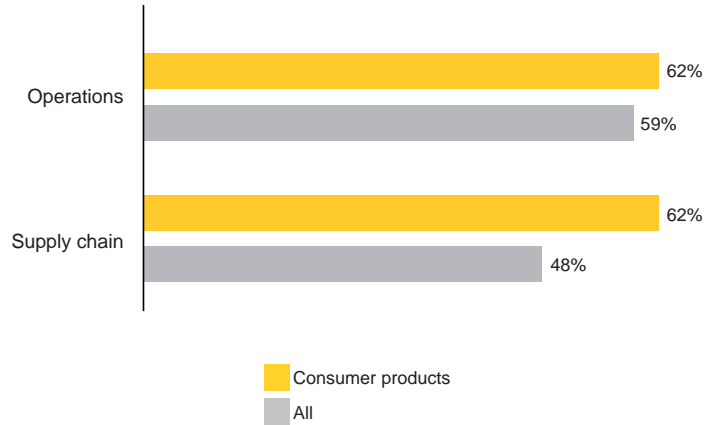
Consumer products respondents have also shown consistent attention to improving the effectiveness and efficiency of their supply chain and operations. More than two-thirds of consumer products industry respondents said they have effectively or very effectively achieved targets for overall cost savings and supply chain effectiveness. Looking ahead to the next year, sector respondents indicated that their work is far from done, with nearly two-thirds of respondents also stating that additional opportunities for cost reduction can be wrested from supply chain activities and overall operations, as companies strive for greater agility, speed and resilience.

Q: Over the past 12 months, how effective have you been in achieving your target cost reductions in the following areas?



Shown: percentage of consumer products respondents who stated either effective or very effective, compared with overall respondents

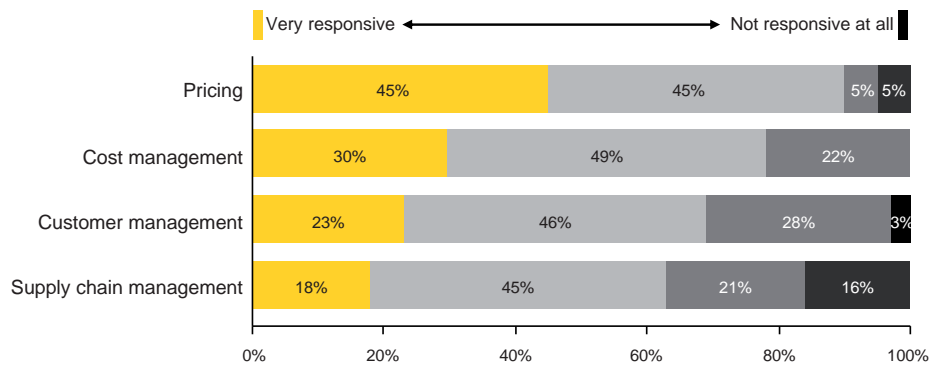
Q: How would you rate the additional opportunities for cost reduction over the next 12 months across the following functions in your business?



Shown: percentage of consumer products respondents who stated they saw either opportunities or significant opportunities, compared with overall respondents.

We asked our survey participants how responsive to rapid change their organizations have been in the past 12 months in certain key areas. Given the preceding discussion, it is no surprise that a large majority of CP respondents indicated that they were either responsive or very responsive in the areas of cost and supply chain management. In addition, over two-thirds of consumer products respondents indicated that they have been responsive to changes in customer management, and nearly 9 out of 10 stated that they have had to exhibit responsiveness in the area of pricing. Although these response rates are impressively high, they can be largely explained by the highly dynamic nature of pricing within the sector and fundamental importance of staying close to and forging close collaboration with retail customers.

Q: How responsive to rapid change have you found your organization to be across the following functional areas over the past 12 months? Rate on a scale where 1 = Very responsive and 5 = Not at all responsive.

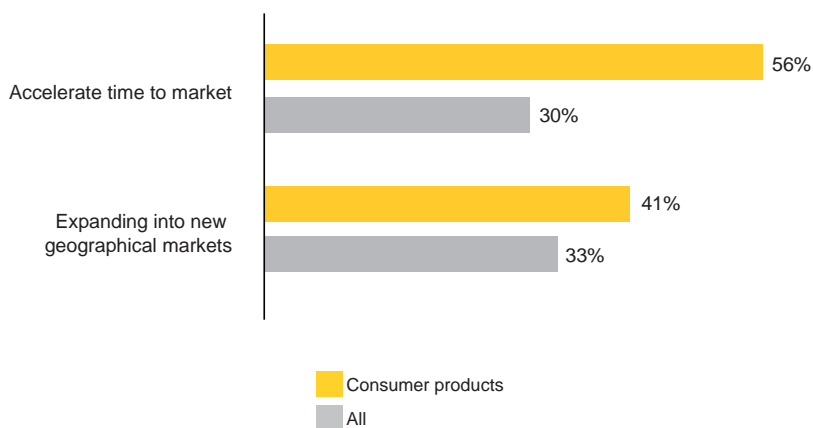


Shown: percentage of consumer products respondents. Total may not add to 100% due to rounding.

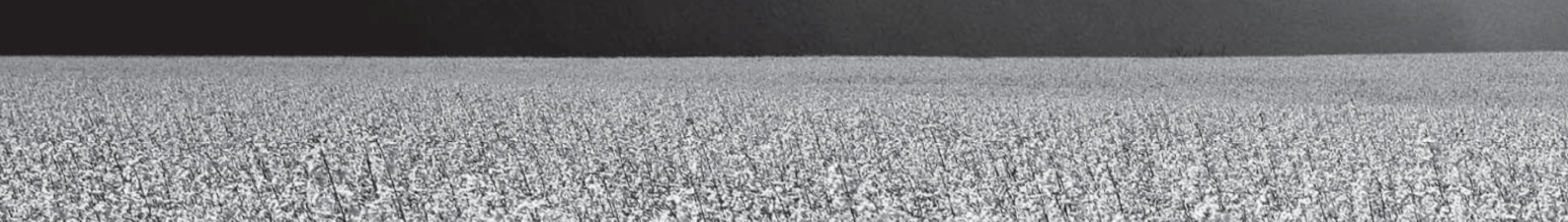
In the CP industry, the effectiveness of overall operations and supply chain go hand in hand. Supply chain initiatives that do not fully consider the total delivered costs to the customer and balance it against customer service are destined to fail. Done properly, both supply chain and enterprise cost reductions become “embedded into the DNA” of the organization in a way that cost advantages become sustainable and as a way to maintain or achieve market leadership in the current economic climate.¹

When asked about actions they plan to take in the next 12 months to emerge from the economic crisis stronger than their competitors, the top pick for consumer products companies was accelerate time to market. This not only refers to their ability to bring innovative new products to market but also their ability to execute effectively and with speed right across the organization. Consumer products respondents are also looking forward to expanding their geographic footprint with more enthusiasm than respondents in other sectors. This highlights the challenges of volume growth in highly competitive, mature markets, as well as the enormous opportunities for long-term growth still on offer in developing and emerging markets. While the BRIC countries (Brazil, Russia, India, and China) will continue to be the future growth engine for CP companies, less established markets across Asia, Latin America and Africa also offer significant growth prospects. As future geographical expansion takes shape and the balance of power shifts towards emerging territories, CP companies will increasingly make adjustments to their operating structures and geographical clusters.

Q: In the next 12 months, what actions do you plan to take to position your business to emerge stronger from the crisis than your competitors?



Shown: percentage of consumer products respondents compared with overall respondents



Consumer products industry executives are reassessing their strategy, planning and business models. Leaner, sharper and fitter organizations will be well placed to drive volume growth when the global economy emerges from recession.

Market responses

In response to the impact of the global financial crisis, although it might have had less of an effect than in other sectors, the consumer products industry executives are reassessing their strategy, planning and business models. Our work with leading consumer products industry participants has helped identify a path forward, which comprises the following actionable advice:

- ▶ **Securing your present.** Assessing the portfolio for potential divestments with increased rigor has been a key theme, as CP companies have sought to offload weak secondary and tertiary brands. Improving supplier terms and extending payment days have also been on the agenda for some companies. A number of CP companies have also stepped up their strategies to combat private label by extending their ranges into “value” products, thereby allowing consumers to trade down within their brand portfolio. In general, CP companies with strong brand portfolios have had little trouble in securing financing.
- ▶ **Protecting your assets.** Consumer product companies have focused on mitigating supply chain risk and gaining full visibility of the extended supply chain. Some companies have actually broadened their supplier base to mitigate potential disruption of a key supplier. Some have even helped smaller suppliers secure credit in order to help them stay in business.
- ▶ **Improving your performance.** As already highlighted in the survey, cost cutting, working capital and supply chain have been key areas for driving improved performance. Increased centralization is driving further efficiencies. For example, the industry is continuing to implement shared service centers across a wide array of areas. Major transformational programs have resulted in leaner, sharper and fitter organizations, but there continue to be further opportunities for significant cost savings. In many cases, the easy wins have been made, with the challenge now shifting to making harder but more strategic gains. As the survey showed, the consumer products pricing environment is highly dynamic and largely dependent on local competitive forces. Managing the trade off between price and volume is one of the perennial conundrums facing CP companies, but is especially vital in such a challenging trading environment. Delivering an effective innovation pipeline, naturally, continues to be a major focus, as does maximizing return on investment(ROI) on marketing and trade spending – success in these two areas will be the principal drivers of future top-line growth.

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- ▶ **Sustaining your future.** The global economic slowdown may have temporarily curbed some CP companies' expansion plans into emerging markets, providing an opening for stronger competitors – which remain attracted to markets with an emerging middle class, and in many territories a still-positive growth rate. In addition, CP companies can solidify relationships with key retailers. Finally, acquisition activity is likely to be rekindled across the industry, and stronger competitors can use the opportunity to expand product lines, geographic footprint or market share at reasonable prices. Assets are being brought to market in what is a buyer's market, although there are still gaps in buyers' and sellers' price expectations. There are also significant changes in the ways deals are being financed, as traditional debt financing has become more constrained and private equity funding has slowed. Alongside anticipated merger and acquisition activity, further potential strategic and operational innovation will be on the agenda – be they changes to the operating model driven by an unerring focus on the customer and end consumer, competitor collaboration or even vertical integration.

Conclusion

In the wake of the global economic slowdown, consumer products companies have placed intense focus on pricing, cost and supply chain strategies, as well as actively managing cash. On the whole, they have so far ridden out the recession relatively well. In part, this is due to the natural resilience of much of the sector to downturn. But it also reflects these companies' ability to execute faster and harder on many of the performance improvement initiatives already underway before the recession struck.

Many CP companies are also looking forward, planning to restore and drive meaningful volume growth once the world economy emerges from recession. The sector's winners have undoubtedly used these tough times opportunistically to get fitter, leaner and in the best possible shape to take advantage of the good times when they return. It is likely that companies that will be able to deliver superior results will display a number of common traits: from being bold in their decision-making and supremely agile, with the ability to respond swiftly to market changes, to retaining and engendering a culture of entrepreneurship – so important to deliver sustainable, profitable, long-term growth.

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¹Driving sustainable enterprise cost reduction within the consumer products sector, EYG no. EN0125.

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