CONSUMER AND RETAIL GROUP

# FOOD FOR THOUGHT

## HELPING FOOD COMPANIES NAVIGATE A SEISMIC SHIFT

ALVAREZ & MARSAL

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## Helping Food Companies Navigate a Seismic Shift

As the pandemic raged in early 2020, the unprecedented surge in demand initially buoyed the performance of most food companies. Nine months later, as the economic crisis continues to impact families, there have been significant “sticky” shifts in consumer spending, preferences and eating behaviors. COVID-19 effects have gone far beyond pantry loading, and what started as imposed behavior changes are now becoming learned behaviors, here to stay for consumers. CPG food companies must be cognizant of these swings and evolve to meet these redefined consumer needs.

Have food companies equipped themselves to adapt to the disruptive forces of the pandemic? How can they create the resiliency to both navigate the near term, as well as prepare themselves for those changes we believe will survive beyond the pandemic? We at A&M’s Consumer and Retail Group explore these impacts and a set of imperatives for CPG food companies to thrive in the new normal.

## Pandemic impacts on consumer eating

Since the beginning of the COVID-19 pandemic, several trends emerged or accelerated that separated the immediate beneficiaries from the victims. As consumers sheltered in place, were hit hard financially, increased in-home consumption, and tried to balance better eating practices with the increased stress imposed on their lives, certain dynamics became apparent:

- **Consumers sought more value** – The financial crisis has strengthened value-seeking behavior. Income constrained consumers have become even more pressured, which increased price sensitivity and reduced the sales of "nonessentials." Months into the pandemic, private-brand sales were outpacing regular-branded product sales, according to Nielsen, and around a quarter of consumers tried private label brands for the first time, with at least 30 percent saying they planned to stick with them, according to eMarketer.
- **Larger, established brands made a resurgence** – Although small brands have been growing over the recent years, COVID-19 has driven consumers back into the hands of the big brands. As consumers spent less time per shopping trip, they were more inclined to reach for their more well-known brands. Also, larger, more established brands were quicker to deploy more digitally-oriented marketing tactics and drive conversion.

According to Forbes, "The reality of what we've seen during the pandemic is the return of comfort foods and familiar brands that made [consumers] feel calm and comfortable – brands with a long heritage that solidified their reputations for being safe and a sure bet – shoppers knew what to expect from them – and part of it was that they just plain tasted great. And they were on the shelves."

- **Health and wellness grew in tandem with indulgence** – Health and wellness marked an accelerating trend across categories even before the pandemic struck and should continue to grow for the foreseeable future. While health and wellness is a broad characterization, it is underpinned by several microtrends including growing consumption of plant-based diets, specifically proteins and milks, the absence of ingredient label "bad guys" like high fructose corn syrup and artificial colors and flavors, as well as the inclusion of real ingredients. Weight management, gut health and better well-being are top of mind for consumers. Interestingly, consumers are looking to balance this desire for healthier alternatives with complementary moments of comfort, peace, joy and connection. According to the 2020 State of Snacking report produced by Mondelez and The Harris Poll, snacking has been a source of comfort and community in isolating times. We note that 88 percent of people are increasing or maintaining their snacking habits during the pandemic, and 52 percent of snackers are more likely to often or always choose snacks by how indulgent they are, up 5 percent from 2019. Moderated indulgence has and will likely always be an important part of the American diet, and given that 66 percent of people say snacking "is one of the few sources of reward and satisfaction in my day," that trend should continue to increase.

"Recent ADM OutsideVoice research shows that 77% of consumers intend to make more attempts to stay healthy in the future."

## New business model acceleration

As COVID-induced work and lifestyle changes persist, the home will continue to operate as the center of the universe. People are eating, shopping and consuming from home more than ever. As a result, there has been a massive acceleration and introduction of new business models with the recognition that consumer behavior changes are not temporal and companies must meet consumers in the new ways they want to shop and consume.

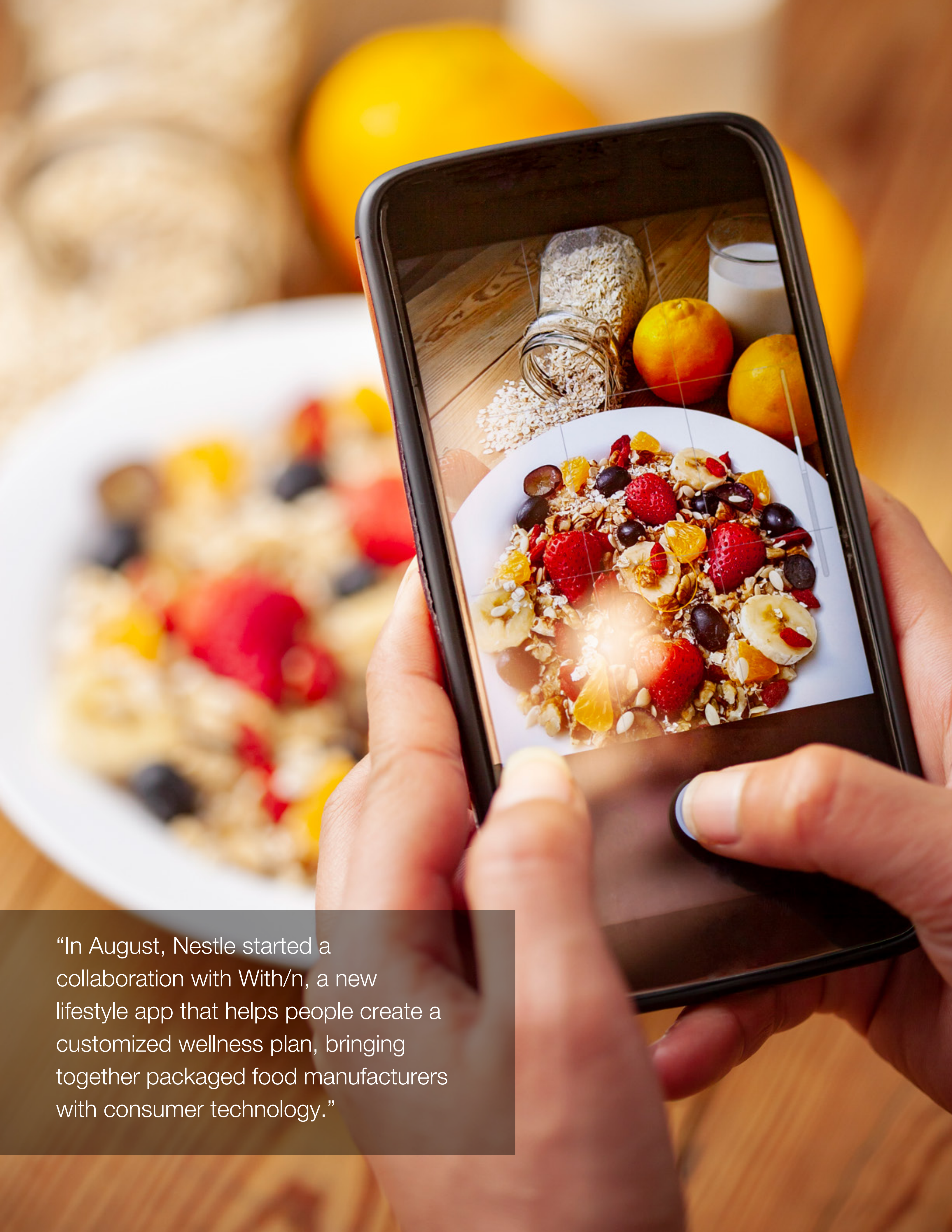
- **E-commerce and online categories** – Based on necessity at the onset of the pandemic, even the least tech-oriented consumers have transitioned online. eMarketer reports that online grocery sales in the U.S. will increase by nearly 53% in 2020, reaching $89 billion in sales. And once initial adoption rates of grocery e-commerce skyrocketed, the activation energy had been cleared and new buyers were converted once they realized how easy grocery delivery or curbside pickup could be. That supports eMarketer's projections that online grocery sales will reach $130 billion by 2023 and will account for nearly 10% of total grocery sales. Over the last few months, we saw a transformation that was previously projected to take decades. There's no more time to sit on the sidelines, and those that postponed investments before will have to change rapidly.

"Research from Aki Technologies and TapResearch found that 68% of new grocery e-commerce shoppers said they would continue to shop online in the future."

"Instacart alone hired 300,000 workers during lockdowns in March and April."

- **The battle for the last mile** – With e-commerce exploding and the home continuing to act as life's epicenter, the ability to effectively perform last mile delivery will become integral to meeting customers where they want to be met. The increase in shipments will make it easier to reach scale but also make obsolete CPG businesses not engaged with innovative delivery. Market activity supports this movement. On top of its 2017 acquisition of Shipt, Target acquired Deliv in May to build out its same-day delivery capabilities. And less than a month after securing a $380 million round of funding that valued the delivery startup at $3.9 billion, goPuff announced its acquisition of alcoholic beverage chain BevMo for $350 million in an effort to expand its micro-fulfillment network for consumers' instant needs. Food manufacturers are starting to build capabilities to support last mile for either their own direct-to-consumer offerings ( e.g. subscription-based purchases such as Nestle's Baby Store) or their retail partners' omnichannel offerings (e.g. drop-shipping, or fulfillment to micro-fulfillment centers.)

- **Health, technology and consumption** – An increasing number of U.S. adults across age groups are relying on technology and devices to track their health. Consumers are basing consumption decisions on the recommendations that health and lifestyle-based apps provide. This affords food manufacturers an opportunity to tailor their offerings to these customers with curated product bundles. More importantly, partnering with these companies provides manufacturers with invaluable data that can inform several strategic initiatives from innovation to promotions to marketing and consumer engagement.



“In August, Nestle started a collaboration with With/n, a new lifestyle app that helps people create a customized wellness plan, bringing together packaged food manufacturers with consumer technology.”

## Imperatives for 2021

With the realities of a constantly changing consumer demand landscape, forced shopping behavior shifts, and newly learned behaviors by consumers in the ways and what they eat, the future of CPG food companies is at stake. We believe food companies must focus on a few key areas:

- **Accelerate portfolio renovation** – Now is the time for food companies to critically evaluate their portfolios. This goes beyond the typical cycle of SKU rationalization to improve assortment productivity. At a more fundamental level, product categories and brands that are not core to the consumer spaces they seek to serve should be divested. At a more micro level, as consumers seek to continually diversify their basket, seeking new flavors and variety, it is easy to be lured into adding complexity if companies are not disciplined. Supply chain challenges during the pandemic forced companies to cut back on their portfolio; however, several organizations are going to make these reductions permanent. Long tails of unproductive SKUs that spawned from flavor or form proliferation should be reassessed and replaced with accretive innovation that addresses new consumer need states and demand whitespaces.
- **Make brands matter** – The foods that consumers choose to eat have always dually said something about the consumers themselves. Consumers have used the food brands they buy to express themselves in addition to seeking great taste, satiety and nutrition. Now more than ever, consumers are looking to brands and what they stand for and choosing those with which they share a common set of values. As a result, food companies need to be more purposeful in their efforts and the way they speak to consumers. This can take many forms. Whether using cause-based marketing in a way that connects to your brand, pursuing sustainability efforts in physical product and packaging design, or just simply being much clearer in your marketing messages about what your brand stands for, consumers are listening.

"PepsiCo's Chief Customer Officer, Mike Del Pozzo, has said the Frito-Lay division could end up trimming 3 percent to 5 percent of its pre-pandemic offerings in stores."

- **Unshackle supply chains** – Supply chain agility has been talked about for years but in a low-growth environment, investments in areas beyond demand generation were always on the back burner and never kept pace with the rhetoric. COVID-19 has brought both resilience and agility to the forefront. Accelerated channel shifts, unpredictable demand swings and evolving purchasing patterns have emerged as the new normal. Responding to these changes requires supply chains to sense continually and respond rapidly, enabling real-time decision making. The ability to sense demand accurately, evaluate a myriad of supply and fulfillment scenarios, and make the optimal choices requires organizations to embrace big data and technology at scale in never-before ways. Siloed structures and sequential processes must give way to nonlinear processes and agile, cross-functional structures. While retail supply chains are many steps ahead by virtue of their omnichannel journey, food supply chains have a long way to catch up. They need to embrace big data analytics and technology at scale, across the value chain, to build speed, agility, flexibility and resilience.

"A recent study conducted by IRI in collaboration with the Center for Sustainable Business at NYU Stern highlights that sustainability-marketed products delivered 54.7% of CPG market growth between 2015-2019. Sustainability-marketed products grew 7.1x faster than products not marketed as sustainable and continue to grow despite the pandemic."

**Some examples of how companies can unshackle supply chains are to:**

- Automate to reduce labor risk exposure
- Leverage predictive analytics and machine learning techniques to improve planning, right from demand forecasting to asset deployment
- Move from siloed supply chain planning and optimization to end-to-end optimization, to understand all degrees of freedom and tradeoffs
- Improve supply chain visibility (e.g., logistics, inventory) using control towers to rapidly translate data, to insights and to action

"In October, Nestle acquired Freshly, a leading fresh-prepared meal delivery service, in an innovative partnership that elevates the importance of understanding consumer at-home eating behavior, fresh and healthy eating, and at-scale home delivery."

- **Acquire, invest and partner** – The pace of change and disruption will only accelerate. Responding will necessitate bold and decisive moves. As in any economic upheaval there will be opportunities to step up the pace of acquisitions to enter new spaces and launch new business models. The paths of smaller, nimble brands have taught us that an obsessive focus on the consumer, supplemented by a truly digitally enabled ecosystem of partners can be a recipe for success. This is a lesson that must be taken to heart, and food companies must actively expand their partnership ecosystem to include inputs and innovation, data and insights, and marketplaces, down to execution and fulfillment to drive success.

"As food and pharmaceuticals converge, ADM Ventures is making a significant investment with Paris-based Health for Life Capital, a leading capital fund dedicated to health, nutrition, microbiota, and digital health."

- **Stay lean and reinvest** – In the aftermath of a prolonged cycle of cost cutting necessitated by slow growth and challenged profitability, food companies appeared to have turned the corner prior to COVID-19. While the pandemic appears to have further boosted this notion, food manufacturers cannot afford to relinquish the discipline in cost management that helped them weather the storm. Episodic interventions will not work. As consumers seek value, price and packaging innovation erodes margins, and as retailers gain some of their leverage back, profitability will come back into the limelight. Staying lean, allocating resources with discipline and keeping a relentless focus on eliminating waste will create headroom required to invest in what matters.

The food industry is going through a strategic transformation that will present new challenges but also create new opportunities. The time to act is now. Organizations that recognize that COVID-induced changes are not transient and that embrace them and respond decisively with purpose will thrive.

Here at Alvarez & Marsal, within the Consumer and Retail Group we are helping food companies navigate the turbulence, adapt quickly and prepare for the future. Our CPG toolkit is designed to build sustained value for companies through a sea of uncertainty. Interested to learn more? Reach out to our team today.

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## ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 5,000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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