CONSUMER AND RETAIL GROUP

The Importance of and Approach to Revenue and Margin Management for CPG Companies Today

The Importance of and Approach to Revenue and Margin Management for CPG Companies Today

Rising cost pressures, CPG manufacturers' pricing actions, and historic retail inflation felt by consumers have dominated headlines in 2022, and rightfully so. But beyond the most ubiquitous issue of inflation, other factors like increasing omnichannel complexity, labor shortages, and rising customer acquisition costs make these times perhaps the most challenging competitive climate for CPG companies ever. And with the mandate to disproportionately steal and grow share never wavering, now is as important a time as ever for CPG companies to turn to Revenue and Margin Management (RMM).

RMM is a cross-functional approach that enhances companies' decision-making capabilities and drives sustainable, profitable growth across product categories, brands, channels, and markets.

RMM To Better Navigate Today's Complex CPG Environment

Core RMM competencies are now becoming table stakes for CPG companies, but more advanced capabilities can be turned into a competitive advantage.

Inflation

Inflation is reaching levels we have not seen since the early 1980s, resulting in input cost increases at every step of the journey – from basic ingredients to fuel for outbound transportation. The Consumer Price Index in September 2022 rose 8.2% from a year ago. PepsiCo reported commodity costs for Frito Lay, Quaker, and Pepsi increasing anywhere from 8% to 37% during the fourth quarter of 2021. Pricing is an important lever that companies are utilizing; however, it may be exhausted in some categories. To be successful and protect market share from cheaper, private label alternatives, CPG companies will need to move to other RMM levers.

SKU Proliferation

New entrants, line extensions, changing consumer taste profiles for younger generations, and the overall battle for incremental shelf space have given consumers what can feel like an overwhelming number of options. SKU proliferation when not controlled properly can have negative impacts. Operationally, complexity consumes capacity, reduces yield, increases working capital needs and damages service levels – any complexity that does not generate value in excess of the incremental cost must be eliminated through portfolio reviews.

Increased Competition

Crowded aisles of increased competition and challenger brands necessitate the use of trade as a strategic lever for CPG brands to stand out. Rising private label penetration encourages a hard look at promotions as a means to generate consumer interest and ward off competitive pressures. And as CPGs now manage more channels than ever before, price pack architecture serves as an opportunistic growth lever to reach new consumers, satisfy new purchase occasions, and create tailored solutions to drive omnichannel penetration and growth.

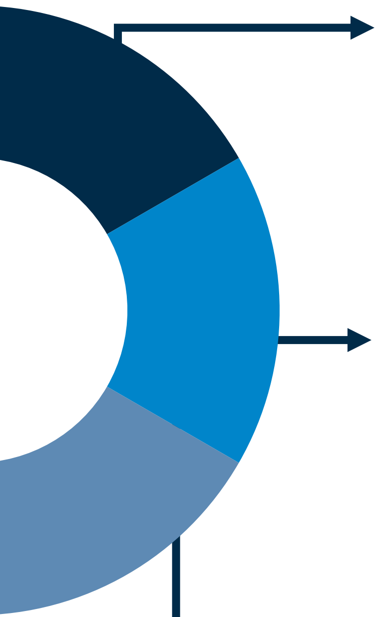
No matter the complexity factor, as the retail waters get murkier and rougher, comprehensive RMM programs can serve as a CPG's beacon to navigate the ambiguity and turbulence.

[1] https://www.modernretail.co/retailers/how-cpg-giants-like-pepsico-kellogg-and-coca-cola-are-navigating-inflation/

A&M CRG's Unique Approach to RMM

Successful RMM programs allow CPG companies to capture the advantages and opportunities that the broader consumer, retail and competitive environments afford. Whether early on in an initial journey, attempting a renew a previously waned effort, or trying to replicate sustainable results in a systematic, repeatable way, we'll show you where to inspire action and get you the tangible results you need.

Here's what you can expect from a CRG RMM program



COMPREHENSIVE SET OF COMMERCIAL LEVERS

We can employ all five levers – **portfolio, price pack architecture, pricing, promotion, and trade** – to develop a tailored RMM strategy, execute actions, and achieve outsized results.

360° PERSPECTIVES

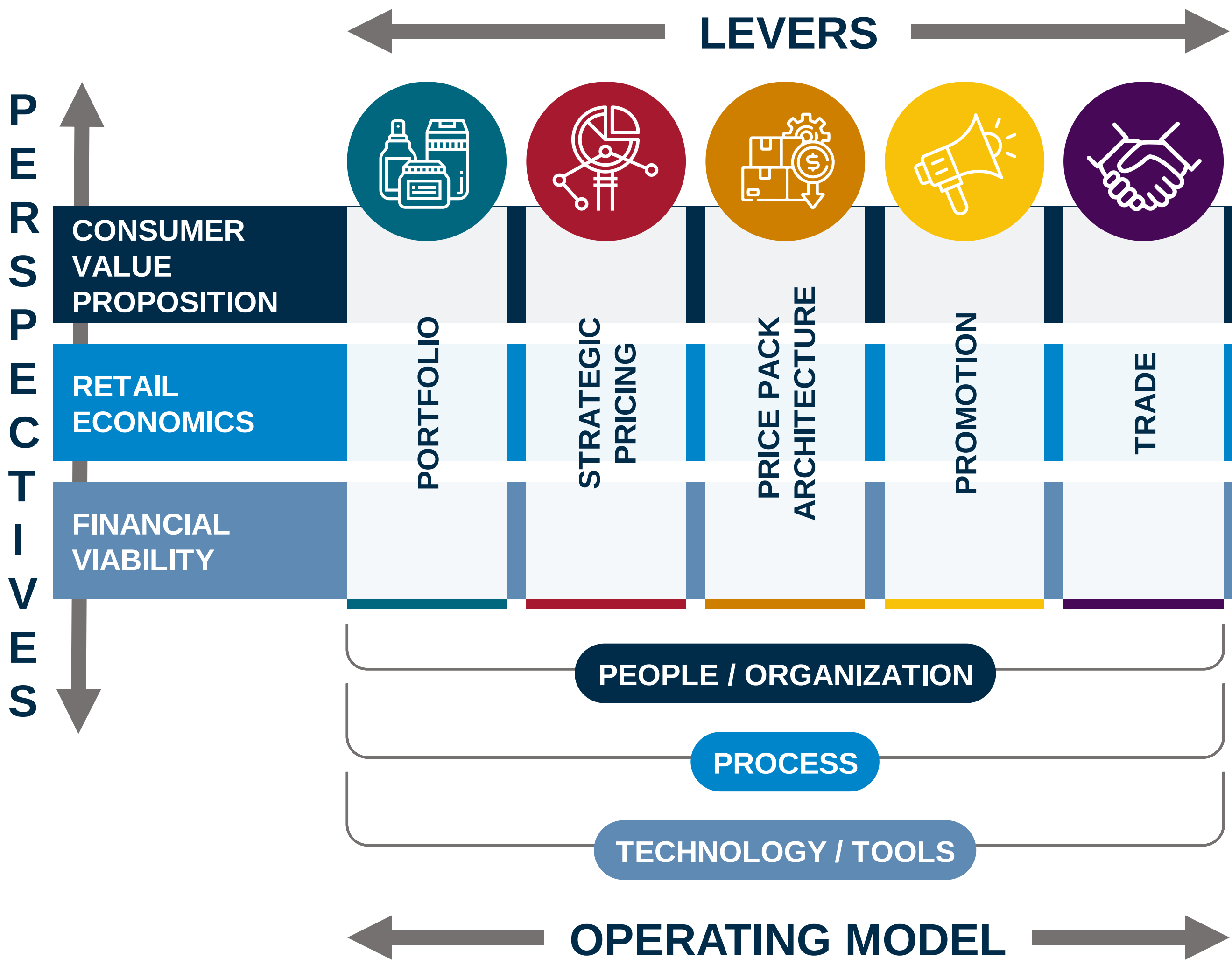
While positive net revenue and gross profit growth for the company is paramount to any CPG's RMM program, our holistic approach ensures sustainable results through 3 different perspectives to avoid a myopic solutions: **Consumer value proposition; Retailer economics; CPG company's financial viability**

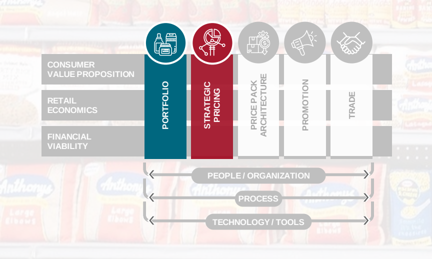
VIABLE OPERATING MODEL

We assess and drive operating model improvements across organizational structure, ways of working, and technology and tools to ensure the company can successful execute an RMM plan.

A&M CRG's Unique Approach to RMM

The complexity of today's CPG market is requiring companies to become more sophisticated in their approach to RMM.





Magnifying the 5 Levers to Best-in-Class RMM

Justified Product Portfolio

Consumers continually challenge CPGs to produce exciting new innovative products to keep offerings fresh and maintain brand relevance. And with strong insights-driven innovation, CPGs can generate incremental sales by addressing new need states and usage occasions.

However, without a focus on maintaining an optimal assortment, a CPG's product portfolio can create undue operational and manufacturing burden. Each incremental SKU may drive higher fixed costs, changeovers and lower line capacity, and a higher risk of service fill issues, out-of-stocks and, thus, lost sales.

Every SKU in a product portfolio should justify its existence with its contribution margin able to offset the additional complexity cost. We worked at a large North American household snack brand that built a long tail of SKUs over time that negatively impacted the P&L. Looking at its hero brand, only 3 of its 11 flavor varieties generated enough revenue to rationalize their year-round production while remaining SKUs fell below break-even thresholds after 6-9 months. Understanding the importance of a healthy portfolio, the CPG pivoted its strategy to maintain a tighter core of SKUs year-round while rotating through incremental seasonal flavors.

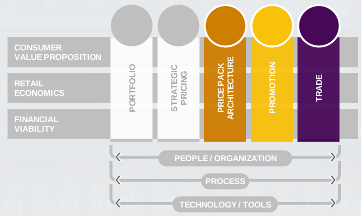
Conscientious Pricing

Especially in today's inflationary climate, CPGs often utilize list price increases as an expeditious way to offset input cost increases. CPGs typically compare retail price points to competition, measure anticipated consumer elasticity of demand based on past price gap differentials, and attempt to maximize pass-through to retailers and consumers.

But what happens when a brand's absolute or relative price points begin to exceed its overall value proposition promised to consumers? CPGs must be mindful of how their products' perceived value fits within a consumer's overall basket and how substitutions may come into play. Thus, in addition to investing in price change analysis and cross-elasticity of individual actions, CPGs should take a more holistic view on value curves over time.

One CPG food company at which we worked employed a pricing strategy that mixed standard list price increases with other levers, such as packaging downsizes and introductions of larger bags at new price points. With this approach, price per ounce comparisons were not as strikingly obvious to consumers, and the CPG found that elasticity impacts of the increases were significantly less. By collaboratively working with retailers using this strategy, the CPG was able to employ steady and predictable annual margin increases year-over-year.

Magnifying the 5 Levers to Best-in-Class RMM



Adequate Price Pack Architecture

Price pack architecture (PPA) is an effective tool to drive incremental sales by tapping into new consumer needs and purchase occasions. While the same consumers shop across multiple kinds of retail channels, the unique consumer motivations underneath different purchase occasions can drive very different needs when shopping at big box versus small box retailer, for example.

Despite this consumer truth, CPGs often stumble entering alternative channels by designing product forms and packaging based on what is most operationally feasible and easiest and cheapest to make instead of what best solves for unmet consumer needs.

We routinely witness Fortune 500 companies struggle in the convenience channel, for instance, failing to rethink product forms and packaging configuration for immediate consumption. Plus, they allow cost variance to drive pricing strategies and end up breaking local retail price curves across pack sizes. Both hurdles can be overcome with an effective consumer insights-driven PPA strategy.

Holistic Promotions

A robust promotional strategy is paramount for CPGs to invest behind their brands with retailers and compete on-shelf with consumers. However, without supporting deep analytical measurement discipline, CPGs cannot know whether incremental profit dollars are reaching the bottom line.

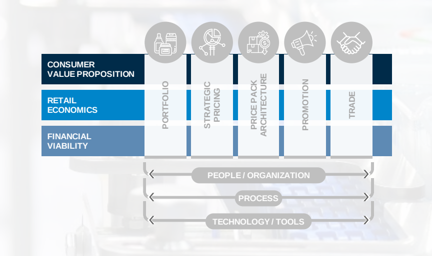
Typically, CPG companies understand promotional performance at the extremes – which promos are strong performers and which never pay back. However, most promotions fall in the middle, causing CPGs without analytical discipline to bias to sales lift alone as the evaluation metric.

During periods of high inflation, we have partnered with large CPG organizations that mistakenly devoted resources exclusively to list price increase and elasticity analytics, putting promotional effectiveness measurement on the back burner and, thus, sacrificing margin dollars. CPGs need to maintain discipline especially in cost-pressured times and use promotions in conjunction with pricing as complementary levers to drive consumer value and positive P&L impact.

Trade

With big bets made in retail media networks, proprietary consumer data platforms, and eCommerce platforms, retailers have intensified pressure upon CPGs to invest with them. Trade spend can take many forms, from retailer price protection to participation in these supplemental retailer programs. As a result, CPGs can lose track of the total cost-to-serve against their retailer partners, which can significantly impact profitability.

CPGs need help creating better cost-to-serve models and knowing the most effective usage of trade dollars. This way they can shift spend to higher ROI levers while still satisfying commitments to key strategic retailer accounts.



Viewing the RMM Strategy Across 360° Perspectives

In order to ensure immediate and sustainable results, it is essential to view the 5 Levers through multiple stakeholders' perspectives

Consumer Value Proposition

Over time, consumers form perceptions on brands' price-value propositions that can be very stubborn and hard to break. Likewise, CPGs go to great efforts to anchor brands' identities in clear positioning statements and competitive positioning on features, benefit, and value.

It is critical when employing RMM levers that outcomes remain consistent with a brand's overall positioning and do not violate consumers' perceptions of value in absolute terms and relative to competition.

Retailer Economics

Since CPGs do not control retail pricing, the use of RMM levers not only have to improve the company's P&L but also have an eye toward improving retailer economics to optimize sell-in and on-shelf performance.

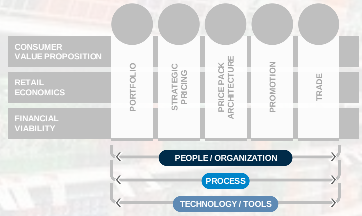
A thorough RMM program ensures actions fit within and potentially improve on-shelf metrics of importance to retail customers, such as dollar velocity, gross profit per linear foot, and gross margin return on investment (GMROI).

Company Financial Viability

With adherence to brands' consumer value proposition and retail partner economics expectations fulfilled, CPG companies should aim to maximize earnings potential and positive P&L impact across all 5 RMM levers.

Potential tensions may arise between elements such as changing price points and the associated promotional cadence, making portfolio growth investments and the resulting cost of complexity, or driving margin vs. volume growth. However, by aligning actions to both short- and long-term value creation strategies and expected P&L impact, these tensions can be properly balanced and mitigated over time.

Setting up your operating model to properly manage an RMM strategy



01

ORGANIZATIONAL STRUCTURE

In order to effectively implement a successful RMM strategy, a thorough understanding of a company's organizational structure is critical. Proper incentivization and rewards must be in place to align employees' incentives with the company's goals. Key decisions makers, such as who has the authority to issue markdowns and returns and how this is tied to incentives, must be bought into the RMM strategy.

02

PROCESSES & GOVERNANCE

Prior to implementation, it is critical for a CPG company to have clarity on internal policy, process and compliance. RMM strategy can be complex and requires alignment on a multi-year transformation. Therefore, by understanding process and governance prior to implementation, the process will be executed more smoothly and efficiently.

03

TECHNOLOGY & TOOLS

A successful RMM program will embrace granular data sources and advanced analytics to drive consumer-centricity and be more objectively action-oriented in its decision making. This is vital not only to the implementation but also the design. A solid understanding of available tools for activities such as price optimization are key to maximizing revenue.

Recognizing the Need for RMM

Today's complex environment can leave any CPG flat-footed when trying to respond to dynamically changing factors in inflation, supply chain, competitors, and consumer shopping behavior, among others. Thus, undertaking a comprehensive RMM program has nearly universal applicability.

But what are some tell-tale signs that legacy RMM programs have clear issues and gaps or that opportunities exist for a CPG company to leverage RMM to take it to the next level?

When You Need Help

- **It is difficult for multiple brands to grow share and profit simultaneously.**
- **Promotional activities lack incrementality and penetration.**
- **Price-Pack structure does not align with channel strategy, nor does it unlock incremental margin.**
- **SKU proliferation does not justify its own complexity and incremental costs are not outweighed by business growth.**
- **Product pricing structure does not create requisite value for consumers and/or retailers.**

Action Oriented

We believe in real-time learnings and quickly realized results. At CRG, we do not provide theoretical Excel models and PowerPoint reports. We get our hands dirty by running quick pilots and test-and-learn activities that work in a real-world retail environment to develop actionable consumer insights and feedback. This also allows companies to put points on the board early to fund subsequent waves of investment.

Sustainable Growth

We prioritize long-term benefit over short-term and short-sighted wins. Especially during difficult times and intense external pressures, companies may make reactionary decisions that aid the here-and-now but are value degrading over time. To set up sustainable value growth, companies must have a clear plan with specific outputs that are revenue and margin accretive for the long-term.

Here in the Alvarez & Marsal Consumer and Retail Group, we are helping retailers and consumer products companies be on the front-end of disruption and achieve their highest level of potential impact.

THE RESULT?

An unquestionably different approach and measurable impact for our clients.