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Revenue growth management: The time is now

Market challenges and legacy decisions are forcing consumer-packaged-goods companies to rethink their strategies for revenue growth management.

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Key takeaways

— The pandemic has unleashed a wave of additional complications for consumer-packaged-goods (CPG) industry leaders to understand and resolve.

— Input costs for many products have jumped, and consumer behavior has shifted significantly, intensifying the pressure to rethink revenue growth management (RGM).

— CPGs need a differentiated, three-step approach to become best-in-class. But their window for taking action is narrow.

Three fundamental challenges for CPGs

Consumer-packaged-goods leaders have faced difficult and constrained times over the past decade. Even before the pandemic, growth in the consumer industry was challenging, and margins were sustained primarily through productivity gains to offset the effect of price compression. In this context, CPGs needed to build new capabilities to capture more value from RGM. While 2020 brought volume growth for some CPG categories thanks to pandemic-driven consumption growth, the overarching issues have been exacerbated by the inability to sufficiently leverage RGM. Now, as CPGs look ahead, they are facing three major challenges: to relieve P&L pressure from commodity inflation at a level not seen in over a decade, to address consumer and shopper shifts, and ultimately to develop repeatable ways to align prices with or beyond the consumer price index (CPI).

While the pandemic provided a pause—RGM was understandably not a priority for companies in the past year—it also unleashed a wave of new challenges.

First, there is the return of inflation. Many commodity prices are spiking and are expected to remain high, driven by everything from global supply-chain disruptions when the pandemic hit to the more recent strong rebound in consumer demand with limited capacity to meet it (exhibit). These factors are significantly raising input costs for CPG companies, resulting in greater than double-digit increases in cost of goods sold (COGS) in some situations. Given the extent of inflation, multiple retailers have publicly expressed an expectation for higher CPG prices.

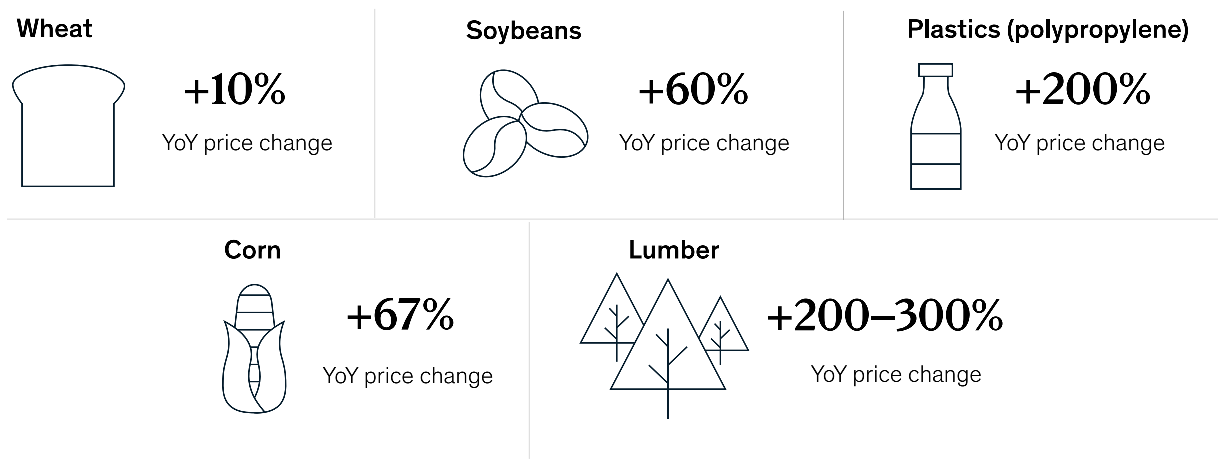
Secondly, there have been unprecedented changes in consumer behavior, shopping habits, and channel dynamics in the past 18 months, which are likely to influence all categories for years to come:

Consumer behavior: declining brand loyalty, increasing at-home needs, and a K-shaped recovery. Across markets, 25 to 40 percent[1] of consumers have tried different brands since COVID-19 started, highlighting the importance of promotions to attract brand switchers. Second, demand has spiked for categories like health and wellness and "at-home" needs, a trend that is expected to persist in the next normal. Third, while our analysis indicates a recovery in consumption, it also anticipates sharp differences geographically and across income segments. In the United States, consumption from high-income households, which accounted for two-thirds of the pandemic-driven consumption drop, will likely determine the economic recovery's magnitude and pace. The demand recovery is thus expected to be K-shaped: rising consumption for high-income households and slower consumption recovery for low-income households, whose incomes have been affected

[1] Tamara Charm, Anne Grimmelt, Hyunjin Kim, Nancy Lu, Mayank, Mianne Ortega, Kelsey Robinson, Yvonne Staack, and Naomi Yamakawa, "Consumer sentiment and behavior continue to reflect the uncertainty of the COVID-19 crisis," October 2020, McKinsey.com.

Exhibit

Prices of select commodities have increased in the past year.



disproportionately by the pandemic. In Europe, extensive government support has limited the impact on employment and thus disposable income. However, the resulting higher savings rate has been more elevated among high-income households, and the outlook for low-income-household consumption can be negatively impacted by the labor market.[2] In Asia, the largest drivers of growth are expected to remain the increasing incomes and spend of low-to-mid-income households.[3]

Shopping habits: bigger baskets, fewer trips, and changing preferences. We see shoppers doing more stock-up and fill-in buying than impulse purchasing, although there are important nuances. Additionally, our research [4] shows the shopper base has divided even further. For example, 19 percent of Europeans have already traded down in 2020 and plan to continue doing so.

Channel dynamics: dramatic shift toward online retail and "at-home" channels. Online retail has grown by more than 50 percent in some categories, accelerating a long-term trend, with a high share of consumers expected to continue shopping online. Second, "out-of-home" channels, historically often more profitable for CPGs, have materially shrunk, presenting additional complications. Finally, B2B marketplaces have grown to serve fragmented small grocers, impacting traditional distributors (especially in China, India, and Brazil).

The final factor challenging revenue growth management for CPGs concerns pricing. Historically,

[2] For the full McKinsey Global Institute report, see "The consumer demand recovery and lasting effects of COVID-19," McKinsey Global Institute, March 2021, on McKinsey.com.
[3] Homi Kharas, "Who gained from global growth last decade—and who will benefit by 2030?" Brookings Institute, January 16, 2020, brookings.com.
[4] Claus Gerckens, Franck Laizet, Daniel Läubli, Jean-Albert Nyssens, and Eugen Zgraggen, "The path forward for European grocery retailers," March 2021, McKinsey.com.
[5] Annie Gasparro and Dave Sebastian, "Shoppers start to see effect of higher commodity costs," *Wall Street Journal*, March 31, 2021, wsj.com; Sharon Terlep, "Procter & Gamble will raise prices in September," *Wall Street Journal*, April 20, 2121, wsj.com; Amelia Lucas, "Coca-Cola CEO says company will raise prices to offset higher commodity costs," CNBC, April 19, 2021, cnbc.com.

CPG pricing has trailed inflation, creating margin pressures. For example, US consumer price index (CPI) data show the price of packaged foods increased 12 percent from January 2012 to January 2020, less than the 17 percent increase for all items excluding food and energy. In Europe, pressures on retailers have made net price reductions the norm rather than the exception. CPGs now find themselves needing to catch up to compensate for both the past 18 months and for longer-term behavior.

Driving growth through a differentiated approach

While the outlook remains unclear, we see CPGs shifting from simply meeting demand—the stance for many during the past 18 months—to pursuing margin and growth in this new context. Indeed, companies from food to household and personal care have announced price increases for 2021 in the mid- to high-single-digit range.[5]

While inflationary pressures often cause CPGs to use pricing to support margins (and this is also happening), companies that have successfully navigated such circumstances in the past consider near-term pricing actions strategically, defining a multiyear journey to realize their pricing objectives through a mix of RGM levers, rather than simply using headline pricing across the board.

Indeed, shifting dynamics and the inflationary environment call for an even more comprehensive assessment of the levers available to companies to meet their pricing objectives. CPG leaders need to rethink RGM's main elements— pricing, trade and promotion investment, assortment —and how to combine them to create the necessary "muscle."

— *Pricing.* While it is tempting to move fast to cover 2021 input-cost inflation, CPGs need to set pricing strategy for the long term. It's critical to take a nuanced approach, informed by volume, simulations of the impact of price moves on profits, and measurement of net elasticities, for example. Given the macro-economic dynamics at play, such as the K-shaped recovery in the United States, it will also be important to assess the impact of pricing decisions, across price tiers and income segments, on the affordability concerns of consumers. Taken together, these actions facilitate surgical rather than flat price increases across the portfolio or even in micro-geographies, balancing revenue and profits against volume, penetration, and market share. Finally, it will be important for CPGs to understand the full implications of the evolution to online buying and increased transparency and to adjust their pricing actions appropriately.

— *Trade and promotion investments.* While there may likely be competitive pressure and a tendency to simply revert to 2019 levels over coming months, the 2020 promotion reductions enable re-baselining and "retraining" shoppers. Resetting in the right way requires a clear view of the impact of new consumer behavior during promotions and of the short- and long-term impact of promos. In Europe, the focus on net price management means some reductions will likely need to be shifted to other conditional trade terms to compensate. In the United States, we could see a significant shift to pay-for-performance structures and more conditional trade terms. In growing emerging markets, there's demand for new trade-investment approaches, such as leveraging digital B2B marketplaces. In Asia, a shift in 2020 to modern trade in some markets, at the expense of fragmented trade, requires CPGs, who have historically focused more on route-to-market excellence, to shift toward structured trade investment and promotions. Finally, CPGs need to ensure they are effective in the growing online channels, including personalized promotions.

— *Assortment.* Equally important is resetting the assortment based on true incrementality and cost of complexity. CPGs seek to address the challenges of changing their product mix

[5] Annie Gasparro and Dave Sebastian, "Shoppers start to see effect of higher commodity costs," *Wall Street Journal*, March 31, 2021, wsj.com; Sharon Terlep, "Procter & Gamble will raise prices in September," *Wall Street Journal*, April 20, 2121, wsj.com; Amelia Lucas, "Coca-Cola CEO says company will raise prices to offset higher commodity costs," CNBC, April 19, 2021, cnbc.com.

to offset margin pressure, retail demands for portfolio simplification, and new shopper behaviors. While not returning to the 2019 level of SKU proliferation, CPG companies need to mindfully introduce "good complexity" by selecting innovations and SKUs that are truly incremental.

Additionally, as a result of shifting consumer habits, micropockets of consumer growth (such as shopper type, income level, location preferences) have shifted. Identifying these micropockets and acting on them through a superior understanding of markets and consumers has thus become even more important, and the key to winning them could be getting the above RGM actions right.

Implementing these measures requires solid RGM analytics. The fluid nature of shopper behavior and the supply shortages in 2020 have created noise in the historical data and are making it more challenging to identify relevant data trends. This calls for RGM teams to adapt their data-and-analytics approach to incorporate different consumer-insight sources. These include sentiment surveys to get updates on behavior shifts in time to react, data-set partitioning to isolate temporary effects and train analytical models accordingly, and an increased frequency of data-set updates to be able to monitor changes.

How to approach the opportunity

That's why 2021 is such an important year for RGM in the consumer sector. We recommend three actions best-in-class CPGs should take during the second half of this year as they plan for 2022:

1. *Undertake a comprehensive clean-slate review of RGM.* Given the dramatic shifts in consumer behavior and commodity price pressure, it's time to reevaluate underlying assumptions and rebuild plans thoroughly, based on the differentiated approach described above. It's also an opportunity to "clean the slate" and remediate such historical RGM fundamentals as channel conflicts, poor-performing promotions, everyday low price/cost (EDLP/EDLC) funding, underperforming trade investments, and price points stuck at given thresholds.

2. *Embrace new, granular data sources and advanced analytics to drive consumer-centricity.* The boom in consumer-level data for CPGs can present new possibilities, if CPGs become adept at understanding their consumers and shoppers at granular levels and at translating those insights to tactical execution guidelines. For example, CPGs are now leveraging advanced analytics to tailor their store-level assortment to fragmented trade, often building multiple store segments based on their shopper profiles. This segmentation can be built on consumer traffic and demographics data through geospatial capture and store-shelf data captured automatically through sales-rep handhelds. This enables tailoring assortment and in-store execution to microlocal consumer preferences.

3. *Rebuild your RGM tech for the next normal.* The complexity and increased importance of omnichannel execution, the plethora of data sources, and the ever-faster pace of market change makes rapid and user-friendly RGM tech a critical enabler of effective RGM. We have accordingly seen multiple CPGs advance their tools and analytics suite to support decision making, in particular with automated data-ingestion pipelines, automated visibility tooling, and more integrated, predictive price-promo-pack action simulations, enabling faster and more precise RGM action. These capabilities demand a step up in analytics infrastructure, talent, partnerships, and governance. Typically, it takes companies at least 18 to 24 months—and for some, a multiyear transformation journey—to develop the capabilities required for success.

Market and consumer changes are challenging CPGs to rethink their RGM strategies. Hence, the next normal presents an opportunity for a step-change in RGM's impact. But the window may be narrow, and any delay in mobilization risks leaving CPGs out of the game, failing to keep up with consumer and market dynamics that are fundamentally—and rapidly—changing.

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