CAGNY 2023

Companies confidently pursuing strategies focused on growth, efficiency and innovation

Senior executives of the market's top consumer product companies assembled recently at the Consumer Analyst Group of New York's (CAGNY) annual conference to highlight their financial performance and operational and business strategies. As is the tradition, this is the opportunity for these leaders to share with top analysts how they plan to outperform the market.

Within a sector that arguably touches consumers' lives more intimately and frequently than any other, the mantra during the pandemic was, "keep as much inventory on the shelf as possible." In the current environment, however, companies are focused on doing things differently. They're exploring new product and packaging solutions, looking to attract new customers, and positioning themselves to enter new markets through new and dynamic partnerships and collaborations. Much of the discussion in boardrooms and C-suites today centers around the investment required to achieve these goals, albeit also doing so with a keen eye toward responsible and sustainable practices.

The big unknown for most companies was understanding the longer-term impact inflation will have on consumer behavior and demand for their products. The vast majority of consumer and retail (C&R) chief executive officers (CEOs) (95 percent) expects the U.S. economy to experience a recession over the next 12 months, with 78 percent saying they have planned for a recession and 88 percent believing a recession will disrupt their business, making a rebound difficult.[1]

Despite these pressures, most of the presenters—particularly those with stronger brand perception and brand equity—are confident that their elasticities will hold, and they will be effective in taking the targeted pricing actions to keep pace with persistent inflation. However, companies that are not the number one or number two player in their categories, and those with less robust brand recognition, are looking to grow market share through product and marketing innovations. In these situations, the risks to meaningful volume declines are too great to continue upward-pricing actions.

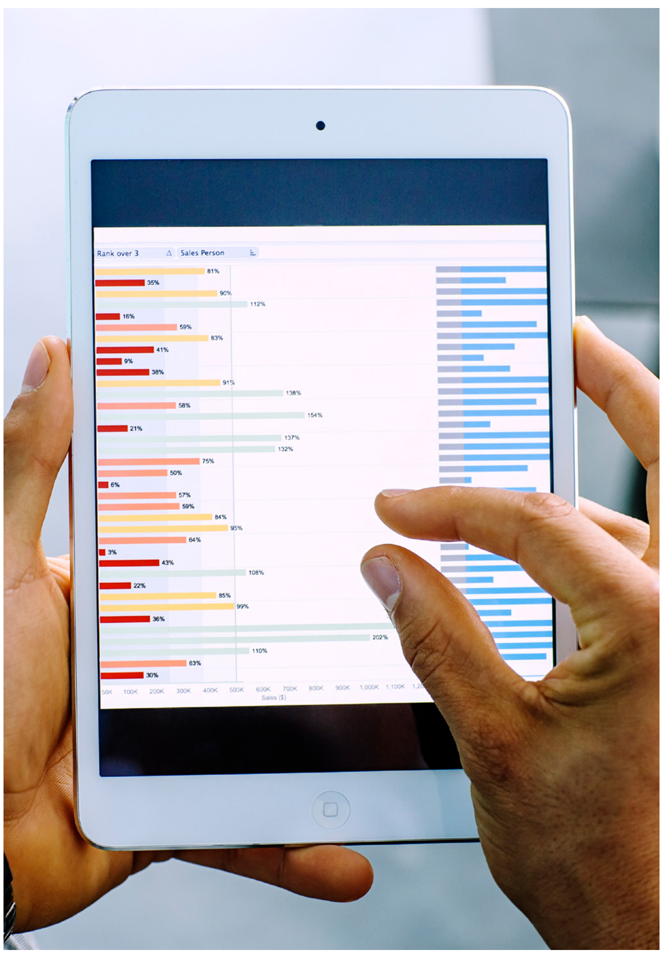
The majority of the participants at CAGNY 2023 were equal parts optimistic and realistic as they highlighted plans for achieving and maintaining competitive advantage. The following are the four top-level strategic themes we heard throughout the conference. In aggregate, company executives were fairly confident about their ability to grow their brands into the prevailing headwinds.

[1] KPMG U.S., 2022 U.S. CEO Outlook - Consumer & Retail (December 2022).

1. Activate all growth levers

The last time the U.S. economy experienced an extended economic downturn in 2008 and 2009 there was a massive trade-down effect, but many companies at CAGNY 2023 reported that they're not seeing that today. Instead, the superiority of core brands, and a focus on premium pricing for premium product, is holding firm for many leading consumer goods companies. With consumers remaining attached to that strength, this is clearly impacting brand performance and leading consumer goods companies to focus investments on these key brands.

Leaders at many companies remain uncertain on the direction of the economy, particularly regarding how persistent inflation will be. Thus, realizing negotiations with retailers may be difficult going forward, many executives expect to price up selectively as needed. These organizations feel they have pricing where they need it to be right now, but if inflation continues at its current pace or spikes later in the year, then the ability to price that move in is going to be increasingly challenging.



That said, most C&R CEOs are confident in the growth outlook for their company (93 percent) and the industry (90 percent) looking out three years.[2] Many companies at CAGNY 2023 expressed a belief that they do in fact have room for pricing, that there is still some elasticity and an opportunity to grow volumes by more consistently hitting fill rates expected by retailers. Fill rates for most consumer goods companies remain in the 80 percent range and very few are operating above the 95th percentile, leaving room for performance and volume improvements. All firms are keeping a watchful eye on inflation, of course, but they still believe that if they continue to see inflationary input costs, then they're going to have to pass that along.

Many executives are confident that, in this inflationary environment, they've figured out how to pass those costs along without seeing their elasticity suffer as much as they originally anticipated. Having eight months of experience from the inflationary peak of 9.1 percent in June 2022[3] has been instructive in how the consumer is responding. But some companies, particularly middle-market and smaller consumer packaged goods companies (CPG), are in fact starting to see an impact to that elasticity to the point where it may become dilutive to their growth strategies. Either way, many companies are planning an increase in advertising and promotional spend to maintain their ability to price and gain share.

With inflation hurting consumers, many companies—particularly those competing in discretionary categories—have seen the consumer spend within their product lines fall in meaningful ways. In certain cases, retailers, expecting that reduction in consumer demand, have been reallocating shelf space to value brands or their own private-label products.

In challenging economic times, we typically expect businesses to pull back on some investments. However, several firms pointed to their CapEx investments as a key element of their drive to increase production capacity. In that vein, one of

[2] KPMG U.S., 2022 U.S. CEO Outlook - Consumer & Retail (December 2022).

[3] Consumer Price Index, Bureau of Labor Statistics (June 2022).

the analyst questions was, “How can you continue to build out capacity if you don’t know where demand is going?” Several companies cited an expectation that this price-volume equation will play itself out in this market. As a result, their strategy is to capture the volume growth they were not able to fill over the last couple of years with the belief that demand increases are structurally permanent and will hold—a confident capacity expansion play.

Other companies, however, are sacrificing volume for pricing, which has still brought a net increase in revenue—but in these situations it was primarily about being late to the party on price increases and now trying to catch up. Even so, the consensus is that gap may narrow going forward and there’s likely to be a more delicate balance between taking pricing and improving volumes and market share.

Regarding China, companies are quite disciplined strategically, targeting consumers who are looking to work their way up the social ladder with higher-end purchases. To that end, many companies are prioritizing high-price, low-volume premium products where they’re getting product placement and media attention. Then, as the brand becomes more established in that important marketplace, companies are actually reducing SKUs and introducing more value-oriented offerings to appeal to mass market.

Merger and acquisition (M&A) pipelines haven’t completely dried up over the last 24 months, but the dynamics have changed. Where many companies might have initiated dialogues with numerous potential partners, those conversations now are funneled down to a smaller group given the increased cost of capital and very slow pace of declining valuations. Today, the M&A temperature has gone from hot to somewhat cool, but with an eagerness to strike when the consumer demand outlook is less cloudy.

There’s a clear gap now between buyers and sellers and their pricing expectations and it’s going to take some time to refill deal pipelines, as those conversations have stalled in recent quarters. Now, the key word is opportunistic—many CAGNY participants suggested that, at the moment, if a prospective deal at a highly attractive or even distressed valuation crosses their desk, then they are prepared to pursue it. Otherwise, the broad sentiment trends toward an inward focus on core operations. If anything, companies are more interested in addition by subtraction through the divestiture of assets that do not align with their overall growth strategy, rather than acquiring new businesses. This would appear to be the expected norm for M&A in this sector for the better part of this calendar year.

In the end, consumer goods companies are seeking to leverage what they see as their improved firmwide capabilities to drive growth. Nearly every participant cited delivering enhanced productivity and cost efficiencies to fund marketing and promotions and drive margin expansion as two key areas of their strategy for FY23. It’s emblematic of how these companies are thinking about growth.

> “Recent divestitures from slower growth categories and brands reflects our commitment to moving away from brands and businesses that are no longer consistent with our long-term focus… Our streamlined portfolio and intense focus on consumer-led STRATEGIES will be the catalyst for future growth in our consumer foods business.”

—Mark T. Smucker
Chairman, President &
Chief Executive Officer
The J.M. Smucker Company

2. Drive cost efficiency through operational and digital excellence

Few companies at CAGNY 2023 used the phrase "cost savings" or "cost cutting" specifically. Rather, there was talk about transformation offices or centers of excellence that are focused on continuous operational improvement, rather than one-off cost-cutting initiatives. Many referenced distribution and supply chain efficiencies aimed at capturing cost savings, not just broad restructuring programs.

Similarly, in an environment like we are currently experiencing, analysts often expect headcount cuts, but very few participants cited these reductions in force or imminent plans around right-sizing the workforce. Instead, many companies are pursuing operational excellence and leveraging digital technologies and artificial intelligence (AI) to gain efficiencies.

Throughout the conference, we heard companies talk about how they are focusing on the top line and pricing accordingly to cover input costs and combat inflationary pressures, but they're seriously zeroing in on cost efficiency opportunities. This is a recognition that price increases are not forever, and costs and inventory levels must be carefully managed.

From a digital perspective, the broad focus is on better engaging with customers, and using data to draw out the insights needed to develop more effective product innovation, shelf space planograms at the store level, and other customer experience-related initiatives. Nearly a third of C&R CEOs (27 percent) cite advancing digitalization and connectivity across the business as their top operational priority.[4]

Several years ago, there wasn't much conversation at CAGNY around data and analytics. This year, however, virtually every presenter had a perspective around what data and analytics means to them, how they are thinking about data in general, how they are using data to analyze the business, what they are doing with the insights gleaned from data mining, and, ultimately, how they are seeking to monetize data. And they acknowledge they can only do that through greater access to data and extracting actionable insights.

Not surprisingly, many companies talked about efficiencies within their supply chains. Moving beyond the effects of the pandemic, many consumer goods companies have been better able to manage inventory levels and address supply chain capacity issues where they have not been able to hit fill rate targets. As they hit fill rate targets, many executives believe they will be more efficient with their supply chain costs and reap the benefits of relatively lower transportation and logistics costs compared with the last two years. In terms of cost efficiencies, these are the areas where companies feel the market is gradually stabilizing and where they can achieve margin improvement as a result.

Digital investment was another consideration that nearly every organization cited in terms of getting better insights to inform tighter customer connections. Several companies are working to activate new technologies to better manage marketing and revenue management programs at the store level and achieve a higher level of customization, as well as bring increased automation to their manufacturing facilities.

Nearly every company at CAGNY 2023 is planning to increase marketing spend, and especially the more targeted digital marketing efforts. Most are devoting 50 percent or more of these budgets to digital versus TV or other more traditional media.

> "General Mills has expanded or launched a broad and enviable collection of digital platforms through which we are building one-on-one customer relationships. With the rise of e-commerce food sales in recent years, we've invested in capabilities and measurement tools to ensure our leadership at the physical shelf translates to an even stronger position at the digital shelf."
>
> **— Jeffrey L. Harmening**
> Chairman & Chief Executive Officer
> General Mills, Inc.

[4] KPMG U.S., 2022 U.S. CEO Outlook - Consumer & Retail (December 2022).

3. Raise the bar on innovation

Over the past 24 months, the consumer goods sector was singularly focused on the heads-down work of delivery and distribution, stabilizing supply chains, and simply getting product to customers.

In the current environment, many of these organizations are all-in on driving innovation. And it ranges from packaging advances, such as injecting nitrogen into spice bottles to improve freshness and flavor, to practicing connected commerce and leveraging data-driven insights to meet consumers across the physical and digital ecosystems and deliver the personalized convenience features they desire.

Many conference presenters highlighted how they are incorporating technology-driven insights and developing new ways to implement AI and machine learning to formulate predictive assumptions around customer and consumer behaviors, transform marketing, and optimize sales execution. Clearly, innovation as a discipline is much more targeted now than we saw three to five years ago, with companies actively ensuring that R&D and new-thinking initiatives align with their product portfolio, marketing, and overall enterprise growth strategies.

In this environment, more than half of C&R CEOs say the greatest risks to their business transformation include deciding on the right technologies to employ (53 percent) and simply understanding how to keep pace with change (58 percent).[5]

Most companies at CAGNY 2023 didn't quantify their innovation budgets versus prior years, but they didn't back down on innovation in the name of cost cutting either. Virtually no one indicated a moderation of their long-term pipeline of innovation or willingness to mortgage the future for short-term profitability. Importantly, many pointed to keeping the customer at the center of their test-and-learn thought processes and ensuring their innovation plans extended directly from customer needs and priorities.

Whether it's for product development, brand building, or digital advertising, many participants talked about teaming up with third parties that bring differentiated capabilities to the table. These companies are leveraging partnerships and brand collaborations in an effort to get creative around efforts to transform the business that are more organic. Most have discovered the power of social media influencers—particularly with new innovations or product portfolios targeted to younger demographics—and the impact social media can have on brands and campaigns.

> "Transforming the business, unlocking value for the future, and driving margin expansion is going to continue to be about innovation. It's going to be about greater differentiation through our R&D investment… and transforming the catalog into natural products and ingredients—that is going to be a key underpinning for us."

—Franklin K. Clyburn
Chief Executive Officer & Director
International Flavors & Fragrances, Inc.

[5] KPMG U.S., 2022 U.S. CEO Outlook - Consumer & Retail (December 2022).

4. Keep brand purpose as the North Star

Brand purpose and sustainability are subjects every participant cited as major commitments. Across the board, regardless of category, company leaders clearly believe being a good corporate citizen is not only the right thing to do, but it also can generate a good financial return.

To that end, when we surveyed C&R CEOs about their top areas of environmental, social, and governance (ESG) focus, the top two responses were taking a more proactive approach to societal issues and increasing measurement and governance to ensure greater environmental, social, and governance (ESG) transparency.[6]

Nearly all had examples of key priorities in areas including scope 1 and 2 carbon emissions, water consumption, regenerative agriculture, recyclable packaging, zero waste to landfill, food waste, animal welfare, renewable electricity, sustainable sourcing, and human rights.

Companies also are focused on transforming their organizations—including senior management positions—from a diversity, equity, and inclusion perspective. Boards are similarly evolving with materially higher percentages of directors who are women and from historically underrepresented groups.

A case in point is the diversity of the CAGNY 2023 participants and audience. In prior years, it was not a diverse conference, but there has been considerable progress. There were many more women and people of color present. As Linda Rendle, CEO of The Clorox Company, commented, "As an industry, this is great to see, but we have to do more. And as we look at our business, it's very much the same. We've come a long way, but we can do more; we've got to match our clients in this way."

These companies have more meaningfully embraced where the market is headed and recognize that they must not only seek to delight customers with technology-based product innovation and experiences, but they also must reflect their customers culturally and demographically.

Leading consumer goods companies, like those across all industries, are publishing corporate social responsibility reports outlining the actions they are taking to incorporate ESG into their business practices and investment decisions. The reports are focused on a broad array of topics, including a company's management of its operational impact to the environment, financial investments that generate positive environmental and social impacts, and partnerships with organizations to advance sustainable development.

These topics represent a broad spectrum of factors that traditionally have not been part of a company's financial analysis. However, as investor and customer awareness of these issues grows, sustainability-related risks are evolving from emerging to foundational factors that companies should embed in their long term strategy and across their operations at all levels of the organization.

> "Our approach to sustainability is very simple. We aim to lead in the areas where we matter most, like sourcing our key ingredients and protecting human rights across our value chain and to help drive change where the world needs it most, like reducing our carbon emissions and packaging waste."
>
> **—Dirk van de Put**
> Chairman & Chief Executive Officer
> Mondelez International, Inc.

[6] KPMG U.S., 2022 U.S. CEO Outlook - Consumer & Retail (December 2022).

KPMG can help

We help consumer and retail companies, from small start-ups to large multinational operations, navigate the changing marketplace and improve top- and bottom-line results. With client-centric, industry-focused advisory, tax, and audit services, we work with clients to drive greater shareholder value and embed and sustain positive change across numerous areas, including:

- Enterprise performance improvement
- Technology-enabled transformation
- The future of finance
- Workplace of the future
- Supply chain
- Mergers and acquisitions
- Environmental, social, and governance
- Risk and compliance

Contact us

Matt Kramer
National Sector Leader, Consumer & Retail
mattkramer@kpmg.com

Duleep Rodrigo
National Advisory Leader, Consumer & Retail
drodrigo@kpmg.com

Sam Ganga
National Consulting Leader, Consumer & Retail
sganga@kpmg.com

Asad Chaudry
National Audit Leader, Consumer Goods
achaudry@kpmg.com

Brian Campbell
National Tax Leader, Consumer & Retail
bcampbell@kpmg.com

Frank Petraglia
National Deal Advisory Leader Consumer & Retail
fpetraglia@kpmg.com

Additional contributors

Allan Colaco
Office Managing Partner, Stamford

Kevin Martin
Partner, Advisory

James Czarnecki
Principal, Advisory

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia