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Industry Report: Packaged Foods and Nonalcoholic Beverages

## Recipe for success

By John Jackson, C. Keith Barringer and Jan M. Mueller

This industry's high-performance businesses have turned category focus, incremental innovation, targeted marketing and R&D investment, and ruthless cost control into a formula that delivers tasty long-term shareholder value.

The global packaged food and nonalcoholic beverages industry, with more than 30 distinct product categories, is complex and highly fragmented—and worth about \$2 trillion, or the rough equivalent of the GDP of the United Kingdom. The top 20 players account for less than one-quarter of the market, which is characterized by vast differences in local taste preferences, shelf-life considerations and food technologies.

All of these factors have combined to inhibit consolidation. However, deal activity has picked up in recent years as more companies have sought focus by trying to unravel diverse and undifferentiated portfolios. Yet even with increased consolidation, most companies are struggling to sustain margins.

Rates of growth and profitability vary significantly across the 30 product categories. Sales growth of bottled water far outstrips that of carbonates, for example. And sales of ready-made meals are almost double those of pasta.

Such differences reflect rapidly evolving patterns of consumer demand—a reflection, in turn, of profound changes in demographics and lifestyle. More women in the workforce and increased urbanization have fueled worldwide demand for convenience foods. At the same time, the rates of obesity and food-related diseases like diabetes have skyrocketed, powering a parallel desire for “healthy” food as well as a similarly health-related boom in organic foods, especially in developed countries. Meanwhile, as consumers in many

countries become wealthier, more informed and thus more confident, they have developed an interest in eating for pleasure and have cultivated a taste for exotic, ethnic foods.

There are, to be sure, significant differences globally in these trends. Interest in healthy nutrition rises in line with disposable income, while the growth in convenience consumption is a function of both rising incomes and the increased sophistication of local retail networks. Emerging markets offer sizable growth opportunities, if only because of their relatively low per capita consumption rates.

The bulk of future growth, however, will come from North America, Western Europe and the Asia Pacific region, where the impact of the three new drivers of the demand—convenience, health and pleasure—is the strongest (see chart, page 11). High-performance businesses know this, and they have positioned themselves to take full advantage.

Accenture defines a high-performance business as one that consistently outperforms its peers through economic and industry cycles as well as changes in leadership. Our extensive cross-industry research has identified three building blocks that underpin high performance in any industry—market focus and position; distinctive capabilities; and performance anatomy—and that all high-performance businesses have mastered. Here is what these building blocks look like in the food and nonalcoholic beverages industry (see sidebar, page 3).

### **Market focus and position**

The industry's complexity has led to the evolution of very different organizational models. Many food and beverage companies are still organized along local or regional lines, with a presence in a limited number of categories, often those with a

short shelf life. Other companies have taken a global, multicategory approach, remaining highly diversified in many different categories but with a small number of truly global brands. Only the industry's high-performance businesses have become successful category specialists, with a presence across most geographies but with a limited product portfolio, tightly focused on a handful of categories and power brands.

This strategic category domination is a key element of their market focus and position and also critical to the high-performance status of these companies. While their peers battle to build share and struggle for shelf space, high-performance businesses have successfully leveraged their top brands, targeting categories that have low private-label penetration and the potential to increase both the amount and frequency of purchase.

High-performance businesses in this industry have consistently focused on being either No. 1 or No. 2 in a limited number of high-growth, high-margin categories or niches. Chewing gum giant Wrigley Co., for example, confines itself to the confectionery category. And although PepsiCo plays across numerous soft drink categories, its food presence is limited to a small global portfolio of snacks whose flavors and packaging are adjusted to accommodate local tastes around the world—a natural fit with its carbonates portfolio.

High-performance businesses achieve category domination with a selective approach to acquisitions, which concentrates on reducing portfolio complexity while increasing category domination, distribution power and geographic reach. Witness PepsiCo's acquisitions of Quaker Oats Co. and South Beach Beverages Co. (SoBe), with which the company sought to either gain entry into or reinforce its dominance in attractive, fast-growing categories.

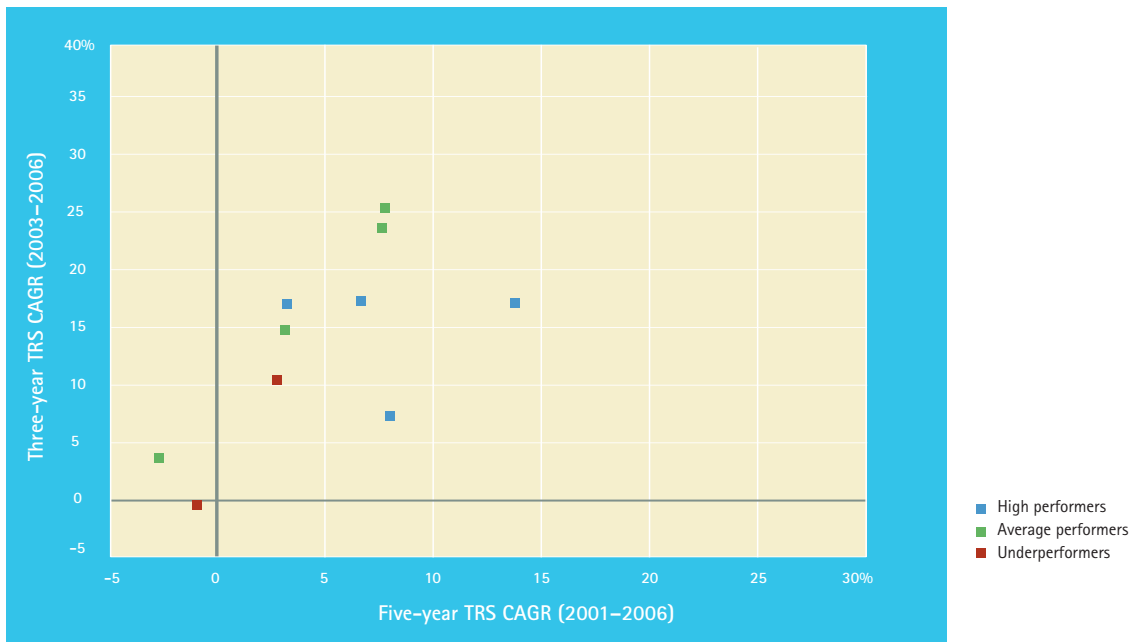
# About the research

The peer group set for the study comprised 13 global, publicly traded companies that all boast worldwide sales of more than \$5 billion annually. In addition, they all derive at least 75 percent of their sales from food and beverages, and 30 percent of these sales are outside their home region. All provide branded packaged products (rather than food or beverage ingredients).

Four companies emerged from our analysis as high-performance businesses. All distinguish themselves on measures of revenue growth, profitability, return on capital and working capital management. They also deliver superior economic profit, which has allowed them to produce consistently superior returns for their shareholders—more than double the industry average over the past five years. More important, their returns on invested capital consistently outstrip those of their competitors, thanks to both higher margins and a higher percentage of sales per invested capital in each of the past three years.

Indeed, high-performance businesses have grown nearly twice as fast as the industry average by focusing on high-growth categories and by implementing selective acquisitions to round out their portfolios and extend channel and geographic reach. However, only two of the four companies have consistently delivered superior returns to shareholders over both long and short time frames, as well as superior revenue growth and profitability and high future value expectations.

Three-year total return to shareholders (CAGR) versus five-year total return to shareholders (CAGR)



Source: Accenture analysis

The Quaker Oats acquisition, which included Gatorade, was designed to bolster PepsiCo's competitive position vis-à-vis the Coca-Cola Co. in the energy drinks category, and SoBe reinforced PepsiCo's position in premium specialty beverages. Both brands are fast-growing, high-margin categories in line with the health trend—helping to counterbalance PepsiCo's traditional carbonates portfolio (see sidebar, page 5).

More average performers, by contrast, still operate according to a global, multicategory model, which dramatically increases their exposure to business complexity and thus inhibits growth. One company has a presence across more than a dozen separate food and drink categories; another has an even more diverse product portfolio that includes a large number of local, often non-scalable and undifferentiated brands.

The strategic category message, however, is clearly catching on. French multinational Groupe Danone, for example, has been systematically shedding noncore businesses while refocusing its portfolio to concentrate on higher-growth regional opportunities and on health-conscious products like pro-biotic yogurt, where it now leads the market. Indeed, Danone is now enjoying its strongest revenue growth in a decade.

### **Distinctive capabilities**

Every high-performance business, in every industry, displays a unique set of connected business processes and resources that create value for its customers. Taken together, these processes and resources make up a company's distinct business formula, or its distinctive capability.

Although these formulas can vary from company to company, there are three business characteristics that are common to the distinctive capabilities of all top performers in the food

industry, which set them apart from their peers and are very difficult to replicate:

- Insight-driven marketing
- Customer and channel management
- Flexible and low-cost operations

None of these characteristics would be as effective, of course, if they did not also rest on the exceptionally robust performance foundations that distinguish high-performance businesses—the sales and marketing, supply chain, finance, IT and HR functions that comprise a sound business infrastructure. Moreover, all three common characteristics work together to help make high performance possible.

Insight-driven marketing, for example, supports superior customer and channel management, and both depend on the flexible and low-cost operations that enable seamless execution. Only PepsiCo can lay claim to outperformance across all three characteristics. Wrigley does well, but its high-performance status is partly due to being “category-advantaged”—the company is focused almost exclusively on the confectionery category, especially chewing gum, which is a high-margin product.

Insight-driven marketing hinges on the ability to spot trends first, before the competition. High-performance businesses can do this because of their superior understanding of both market dynamics and consumer needs.

These companies relentlessly track key consumer trends in strategic geographies by means of exceptionally rigorous, sophisticated and fact-based business analytics that deliver relevant and insightful data. They then use the data to systematically manage the insights they have gained—not just to manage information. What's more, they make these insights accessible right across the organization to facilitate rapid and

## PepsiCo: A discerning eye for acquisitions

Just 10 years ago, it looked as if PepsiCo had lost the so-called cola wars. Its profits lagged those of archrival Coca-Cola by almost 50 percent, and its market capitalization had slumped to less than half that of the Atlanta-based beverage giant.

Since 1996, PepsiCo has turned challenge into opportunity, reshaping its portfolio with an approach to acquisitions that has given the company strategic category domination—the essential element to succeeding at market focus and position, one of the three building blocks of high-performance business, in this industry (see story). So much for history.

The key to PepsiCo's success is the selective nature of its M&A strategy. With the purchase of The Quaker Oats Co., South Beach Beverage Co. (SoBe) and Seagram Co.'s Tropicana Products division, the company has made strategic acquisitions in the water, sports drink and juice categories—all fast growing, thanks to the "healthy eating" trend that is one of the factors transforming the industry. PepsiCo also has expanded (again selectively) into the packaged foods sector—more specifically, into snack foods, where its Frito-Lay division now enjoys a 60 percent share of the US market.

By acquiring top regional brands in attractive markets, PepsiCo is also huge—and growing—overseas. In February 2005, it took full control of a joint venture it had established with General Mills (said to be the largest of its kind in Europe) that makes and sells snack foods from Madrid to Moscow. Other recent acquisitions include Sara Lee Corp.'s nuts business in Belgium, the Netherlands and France, and a leading Polish snack foods company.

well-informed decision making. (For more on using analytics to win competitive advantage, see "Winning with analytics," *Outlook*, May 2007.)

There is no direct correlation in this industry between the size of R&D investment and high performance. Instead, high-performance businesses distinguish themselves by rapidly capitalizing on consumer insight to deliver a continuous flow of new products to the market.

### **Incremental innovation**

High performers tend to have strong new-product pipelines to continuously refresh their portfolios. They also derive a large proportion of sales from products launched in the past three years.

Innovations are often incremental rather than spectacular, science-driven or breakthrough in nature. But the continuous refreshment of a company's product portfolio is absolutely

vital to the retention of consumer interest and the maintenance of retail shelf space. These refreshments include line extensions, repackaging and reformulations, as well as genuinely new products. Overall, incremental product innovation accounts for most of this mix and plays a critical role.

Most of Wrigley's new products, for example, are line extensions or new flavors. However, by upgrading its R&D capabilities and restructuring its marketing team to focus on global brands and excellent local execution, the company has leveraged its unified commercial operations and centralized supply chain to consistently deliver innovation rates—measured as the percentage of sales from products launched in the past three years—above 15 percent every year since 2000 (see sidebar, page 6).

High-performance businesses in this industry support their innovation

## Wrigley: Chewing up the competition

The Wm. Wrigley Jr. Co. has come a long way since 1892, when its founder first marketed a primitive form of chewing gum made from spruce gum and paraffin in Chicago. Today, the \$4 billion company sells its popular brands in more than 180 countries. Indeed, with more than 60 percent of sales outside North America, Wrigley reigns supreme as the world's No. 1 maker of chewing and bubble gum.

These are hardly Wrigley's only products. Times have changed for a company that marketed just three chewing gums—Spearmint, Doublemint and Juicy Fruit—for more than 75 years. The growing popularity of sugar-free gum brands that promise to freshen breath, whiten teeth or fight tooth decay have made the gum market a target for candy companies like Wrigley's fast-growing rival, UK-based Cadbury Schweppes, which snapped up Pfizer's Adams confectionery unit, including the Dentyne and Bubblicious brands, in 2003.

Wrigley knows that insight-driven marketing—one of the important elements that distinguish high-performance businesses in this industry (see story)—is the key to sustaining its supremacy. So the company has been busily boosting product development. Its innovation efforts often take the form of beefing up old favorites—pellet forms of Big Red and Juicy Fruit, for example. Wrigley invests heavily in its innovation capability and processes. It spent \$50 million to build a Global Innovation Center—and it is reaping the rewards. Since 2001, the contribution from new products has averaged

15 percent to 20 percent of Wrigley's global sales—a significant increase over the single-digit figures of the 1990s.

Wrigley also has been on the selective acquisition trail—another key characteristic of high-performance businesses in this industry.

Historically, Wrigley focused exclusively on the gum subcategory and relied on organic means to grow the business. However, with increasing consolidation in the confectionery category and growing competitive pressures in the core gum market, Wrigley has responded with a string of acquisitions. In 2001, Wrigley bought Velamints and since then has been steadily adding to its range of non-gum mints, with products like Extra sugar-free mints. In 2002, its \$12.5 billion bid for the Hershey Company floundered when the sale was called off. In 2004, however, the purchase of the Spanish Joyco gum and confectionery business strengthened Wrigley's position in such key confectionery segments as bubble gum, candies and lollipops, and also boosted its presence in Europe and key emerging markets, including China and India. In 2005, Wrigley resolutely entered the US sugar confectionery market with the acquisition of Kraft Foods' LifeSavers, CremeSavers and Altoids brands. Finally, in January 2007, the purchase of an 80 percent stake in Russian premium chocolatier A. Korkunov gave Wrigley an important foothold in a booming consumer marketplace.

capabilities by spending a higher proportion of sales than their peers—between 6 percent and 13 percent, compared with an industry average of 5.4 percent on a three-year average—on innovative marketing, revitalizing their brands through advertising and promotions.

Take, for example, PepsiCo's repositioning of its portfolio on a better-for-you platform through the Smart Spot initiative. Smart Spot labeled products—more than 100 of the company's "healthier" products, including the Tropicana range of fruit juices—meet nutrition criteria based on recommendations from the Food and Drug Administration and the National Academy of Sciences.

Although Smart Spot is currently confined to North America, it is earmarked for European rollout, and the company now devotes half of its media spending to the initiative.

To be sure, not all attempts to capitalize on the health and wellness trend have been successful. For one food giant, an effort to reformulate hundreds of products with nutrition in mind was compromised by the product portfolio itself, which included too many diverse categories.

### Focus on customers, channels

Food and beverages companies must also contend with both the growing power of supermarkets and the private-label penetration this power

reinforces. In addition, they face the challenge of a multichannel selling environment as the share of sales through alternative channels, including kiosks and vending machines, steadily increases. Indeed, customer and channel management is critically important. And with their laserlike focus on key customers and channels, high-performance businesses are well ahead of their competitors in this regard as well.

Witness Kellogg Co.'s purchase of Keebler Foods Co., whose cookies and crackers are available in vending machines across the United States. The acquisition not only gave Kellogg critical mass in US snacks, it also allowed the company to distribute its own Pop-Tarts, Nutri-Grain bars and packaged cereals through many more channels, greatly extending its customer reach.

As with R&D expenditures, simply boosting investment in trade promotions does not guarantee better returns, so high-performance businesses go further. They not only employ integrated commercial planning to maximize the effectiveness of trade investments. They also use sophisticated analytics to evaluate the performance of past promotions, and include the results in the next round of promotional planning—all with an execution mindset worthy of a financial fund manager.

Confronted with the complaints of frustrated shoppers who just could not find enough of its products on supermarket shelves, Campbell Soup Co. used its insights into how shoppers shop and store workers stock shelves to design a gravity-fed shelf system. The system, which shows store workers just which soups are running out and need replenishing, has been installed in outlets throughout the United States, Canada and Mexico. Since its introduction in 2004–05, the so-called iQ Shelf Maximizer has

boosted sales by more than 8 percent in participating stores, and key outlets are performing significantly above the industry average in sales of condensed soups.

### **Economies of scale**

Of course, without flexible and low-cost operations, high-performance businesses would not be able to sustain excellence in their other distinctive capabilities. High performance, after all, is getting harder to achieve as soaring commodity prices and other cost pressures squeeze margins, and as the growth of new, emerging markets extends and globalizes supply chains.

High-performance businesses focus on streamlining and leveraging economies of scale in all key areas of their supply chain—from long-term commodity planning to outsourcing. Thus they create a global operations footprint and increase collaboration with both customers and suppliers. All, moreover, seek relentlessly to drive down costs.

Since 2001, PepsiCo, for example, has cushioned itself from the impact of rising aluminum prices by halving the aluminum content in its packaging. PepsiCo, Wrigley and Kellogg also use financial hedging to try and manage the prices of their key commodities. And all three companies have dramatically upgraded their technology infrastructures (and thus their operational efficiency) with global ERP rollouts.

### **Performance anatomy**

Performance anatomy basically refers to a company's culture—which is, in turn, made up of its leadership values, strategic history and, most important, the winning mindsets that inform an organization's approach to executing its strategy. (For a related story, "The missing link: How employee mindsets can be assessed to improve business performance," *Outlook*, May 2007.)

In the food and beverages industry, a critical mindset is adaptability. High-performance businesses in this industry are just much better—not only than their competitors but also than their peers in related sectors, like alcoholic beverages or home and personal care, that enjoy greater leverage in their retail relationships—at working with and cooperating with their suppliers and customers.

Operating margins are lower than in related industries—a function of a relatively short product shelf life. So whether they like it or not, food and

beverages companies are very dependent on external relationships and hence need to be tightly networked.

High-performance businesses are especially good at third-party manufacturing, distribution and low-cost sourcing, and their relative dependence on their retail outlet customers also has led to close and highly successful working relationships. Some actually have integrated their supply chains with those of their customers so that information about consumption and demand can flow seamlessly between retailer and producer.

This industry's high-performance businesses have turned category focus, incremental innovation, targeted marketing and R&D investment, and ruthless cost control into a recipe that delivers long-term shareholder value. They have achieved this advantageous position by means of rigorous portfolio management and by developing highly flexible organizations with distinctive capabilities that enable them to seamlessly embrace and execute change (see chart, page 3).

However, there are many challenges to the future value of the food industry. While consolidation continues, it is likely to be very gradual, as long as local taste and shelf-life issues limit economies of scale and most producers still juggle with the complexity of managing a diverse and often locally customized brand portfolio.

Accenture research suggests that the key to capturing future growth opportunities will remain a relentless focus on premium product categories—foods and drinks that satisfy at least two of the three big drivers of new demand (convenience, health and pleasure) and ideally all of them. Indeed, the high-performance businesses of the future will stand above their competitors because of their ability to exploit the big trends—for “fast and efficient nutrition,” “guilt-free indulgence” and “quality convenience.”

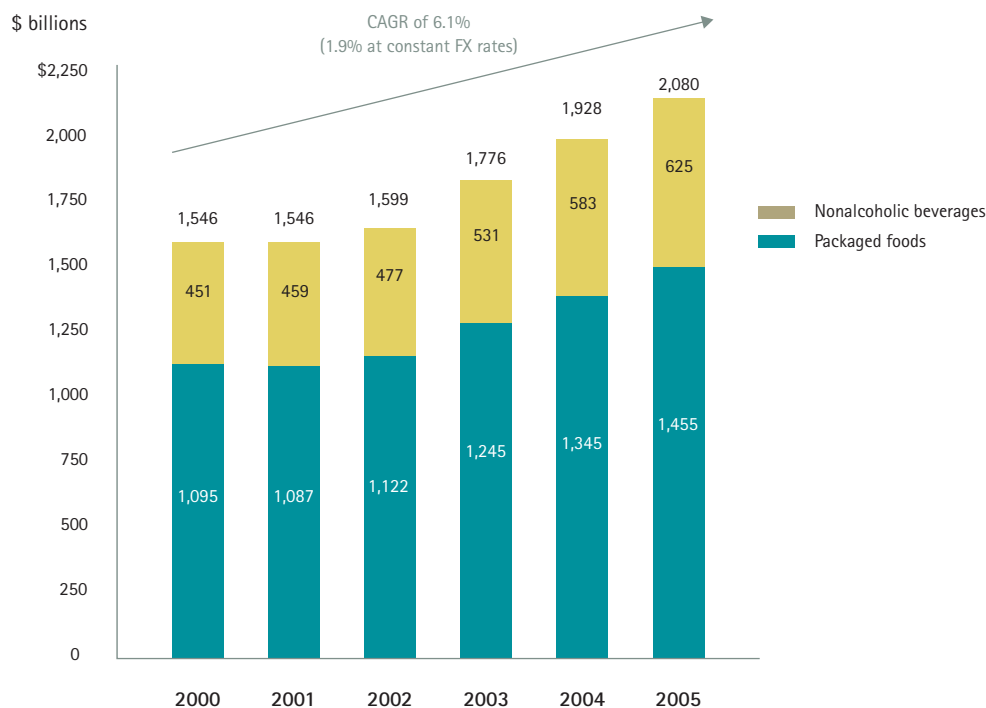
## By the numbers

# A changing business mix

The food and beverages industry is going through changes that are being driven by the new emphasis on convenience and health.

The packaged foods and nonalcoholic beverages industry is a \$2 trillion industry.

### Evolution of global packaged foods and nonalcoholic beverages

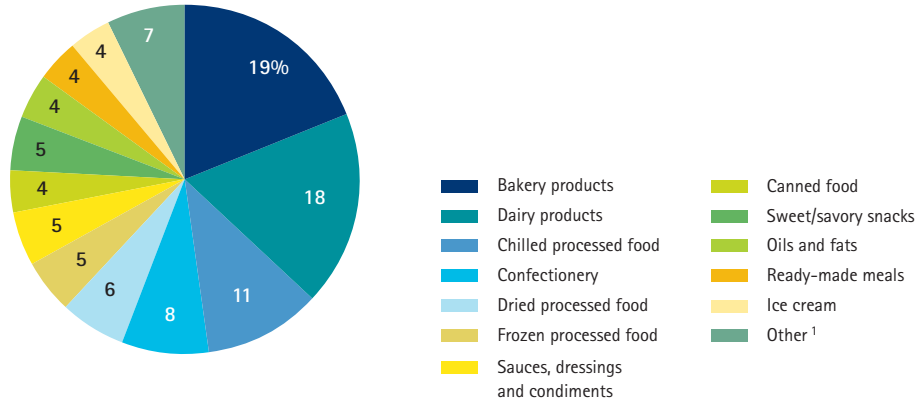


Source: Euromonitor: "The World Market for Packaged Food, June 2006"; "The World Market for Soft Drinks, November 2005"; "The World Market for Hot Drinks, February 2006"

The industry includes 10 distinct sectors, 19 of which are in packaged foods and 11 of which are in nonalcoholic beverages.

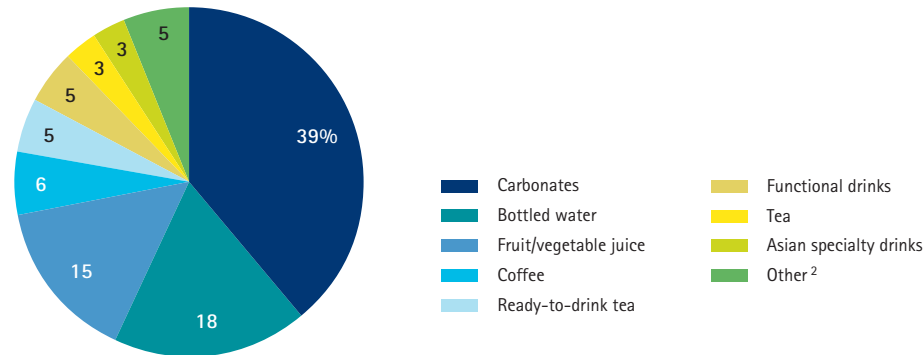
**Packaged foods, 2005**

100% = \$1.455 bn  
 Market growth: CAGR (2000–2005) = 5.8%



**Nonalcoholic beverages, 2005**

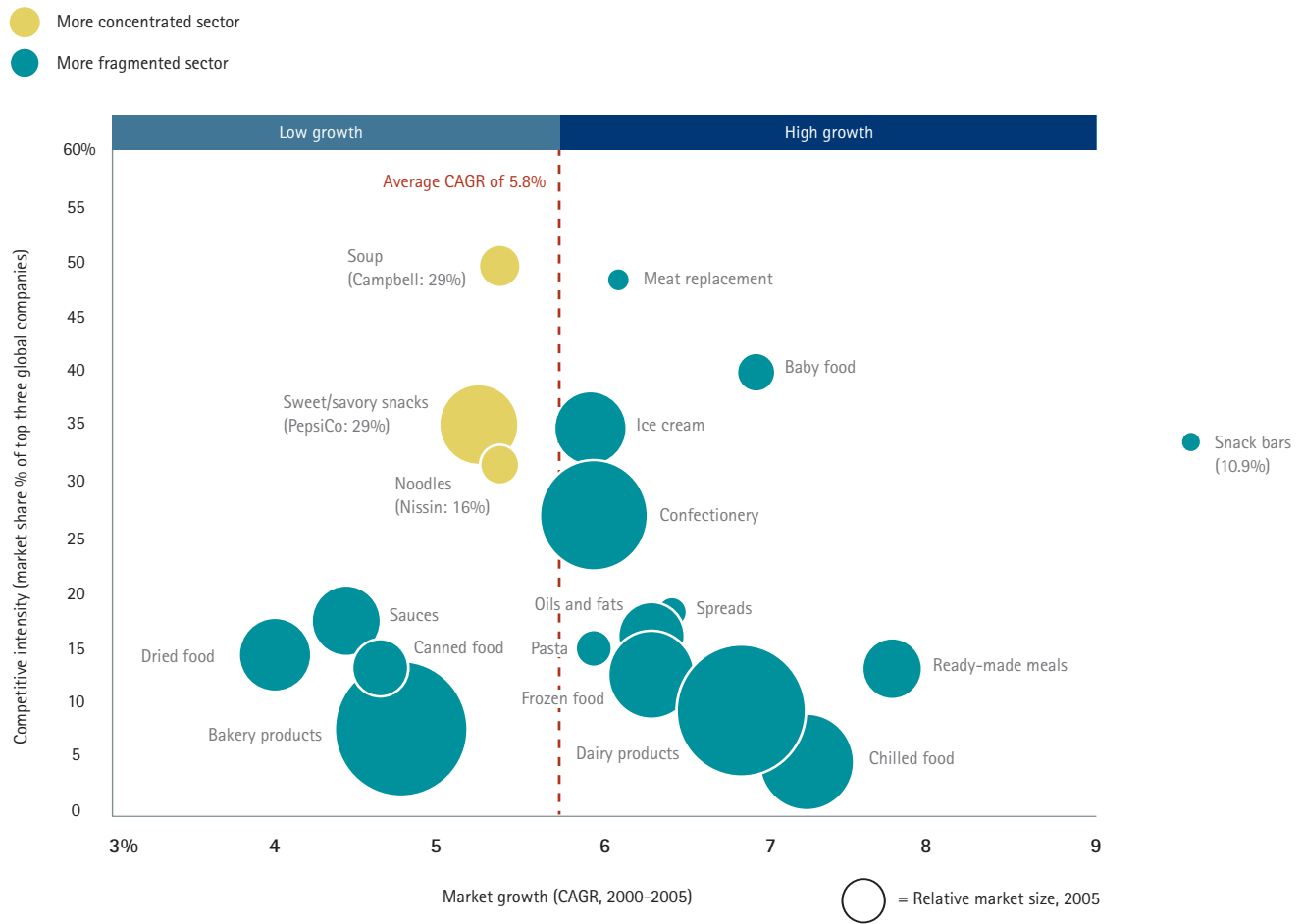
100% = \$625 bn  
 Market growth: CAGR (2000–2005) = 6.7%



1. "Other" contains seven sectors with <2% share, including noodles (1.8%), baby food (1.4%), pasta (1.2%), spreads (1%), soup (0.9%), snack bars (0.5%) and meat replacements (0.3%)  
 2. "Other" contains three sectors with =<2% share, including concentrates (2%), ready-to-drink coffee (2%) and other hot drinks (1%)  
 Source: Euromonitor: "The World Market for Packaged Food, June 2006"; "The World Market of Soft Drinks, November 2005"; "The World Market for Hot Drinks, February 2006"

In packaged foods, growth in the market is driven by categories that emphasize health and/or convenience. In most categories, there is a high degree of industry fragmentation due to local taste differences and perishability issues.

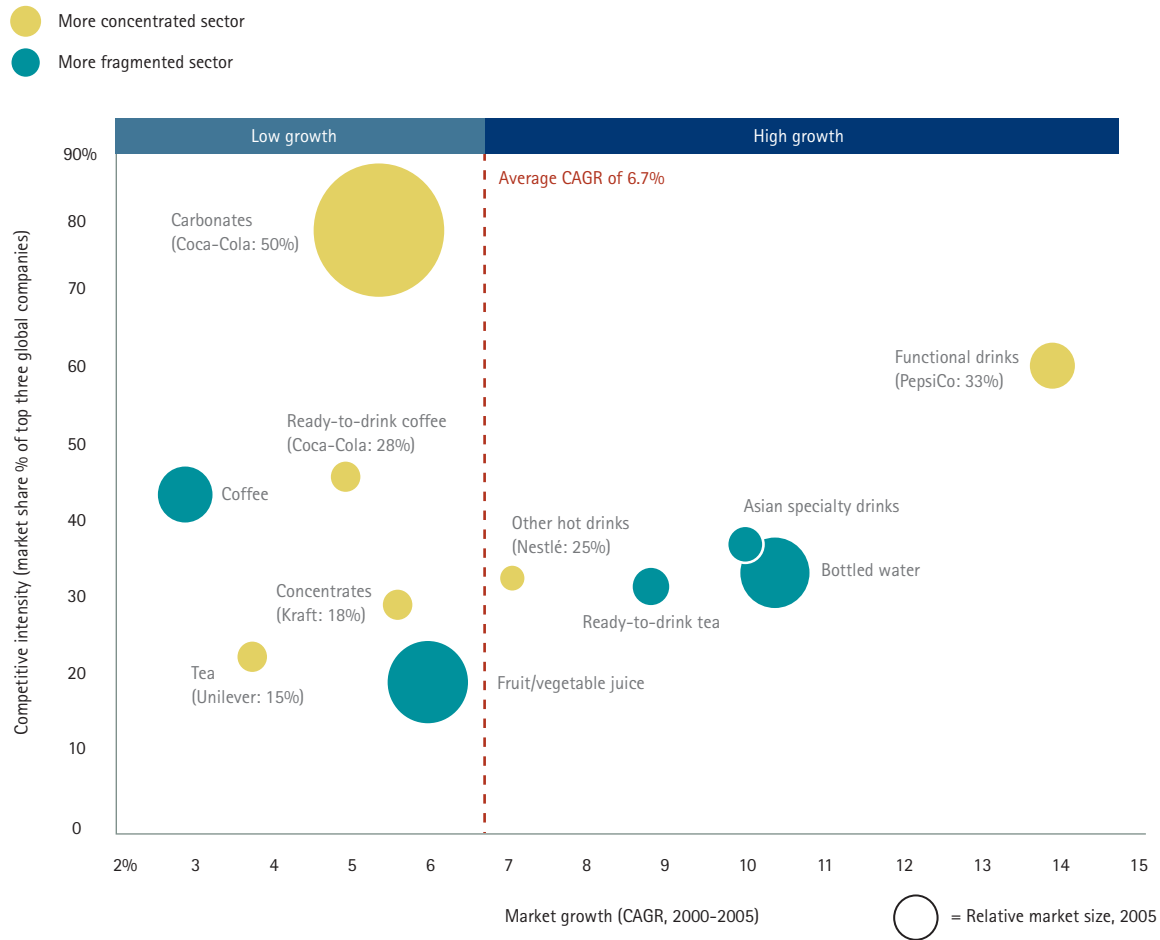
Attractiveness of global packaged foods market—size, growth and competition



Source: Euromonitor, "The World Market for Packaged Food, June 2006"

In beverages, the large carbonates sector is maturing, while the fast-growing water and ready-to-drink tea categories are hotly contested.

Attractiveness of global nonalcoholic beverages market – size, growth and competition

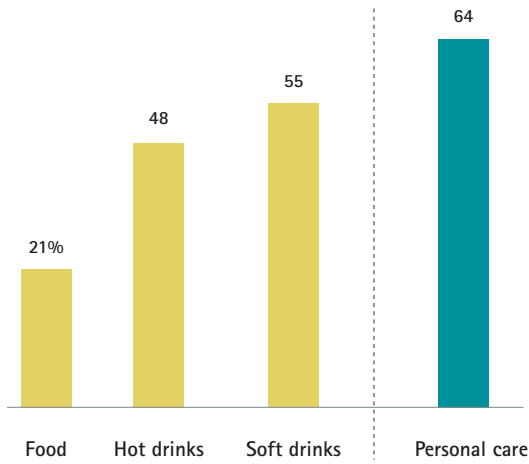


Source: Euromonitor, "The World Market for Packaged Food, June 2006"

Despite its maturity, the food industry still suffers from a high degree of fragmentation and is likely to consolidate only gradually.

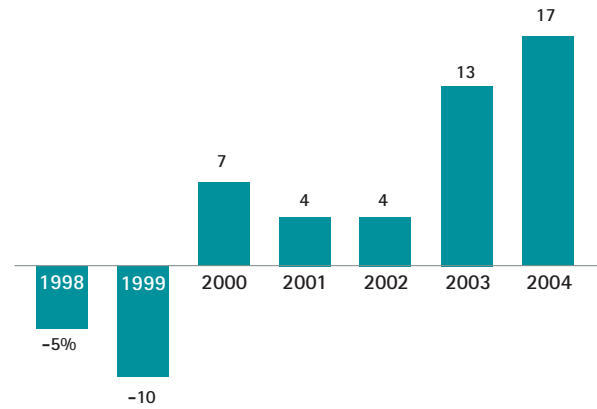
On the supply side, input costs have risen sharply while manufacturers have struggled to pass price increases on to the customer.

Global industry concentration (share top 20 players), 2005



Source: Euromonitor, "The World Market for Packaged Food, June 2006"

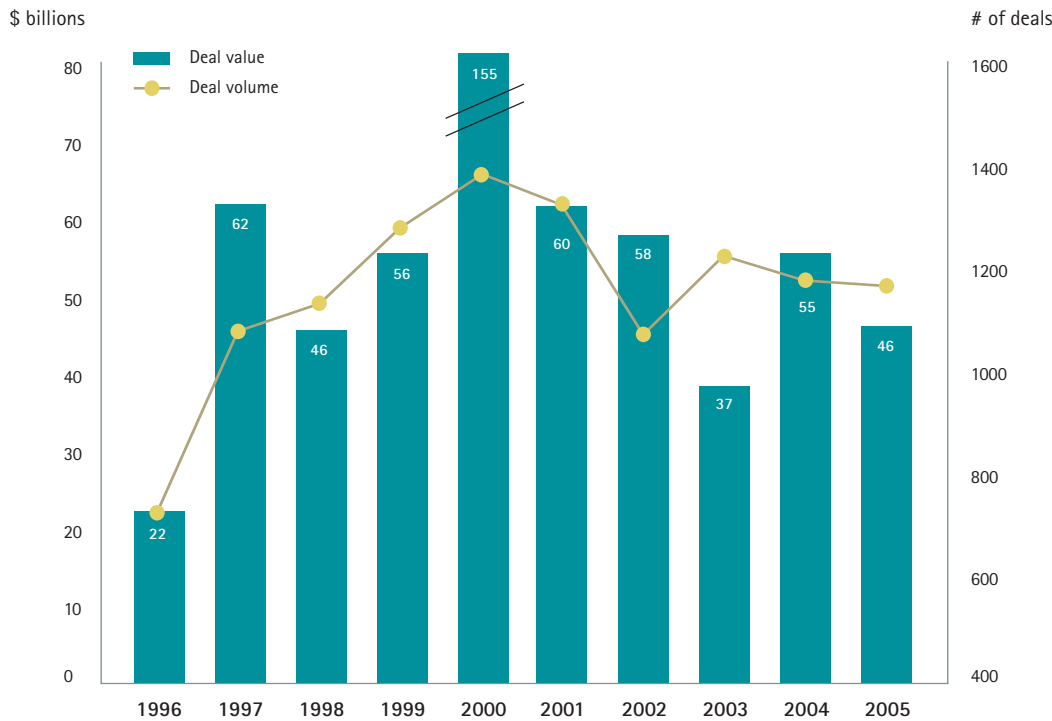
Year-on-year changes in food and packaging input prices, 1998–2004



Note: Index weighted 25:10 food to packaging, where food includes coffee, cocoa, corn, sugar, wheat, oats, barley, rice, butter, milk, soybeans and edible oils; and packaging includes pulp, resin, PET resin, ethylene, natural gas, benzene, aluminum and crude.  
Source: Bernstein Research, "European Food: Quarterly Sector Review," January 2005

Following a glut of large-scale mergers, deal activity has decreased recently as manufacturers have started to focus and unravel their portfolios.

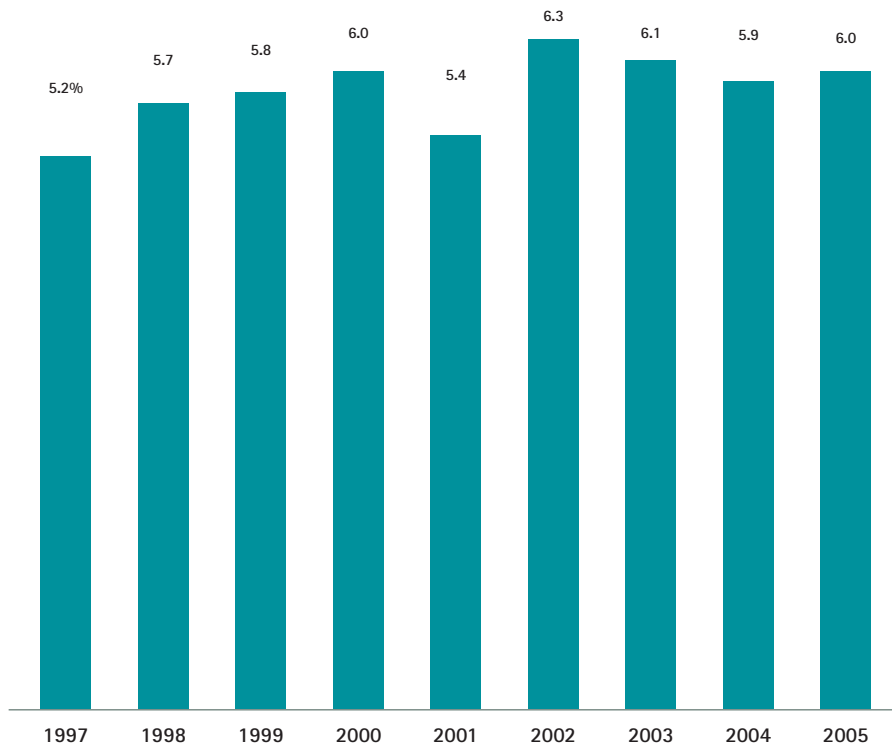
Global deal value, 1996–2005



Source: Accenture analysis

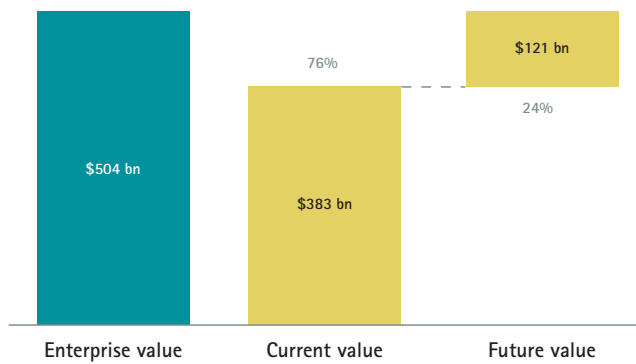
Growing profitability will continue to be a struggle . . .

Industry average economic profitability



. . . and the markets' estimates of future value are relatively low.

Future value



Source: Accenture analysis

## About the authors

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