THE INNOVATION IMPERATIVE

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by John Grubb, Managing Partner at Sterling-Rice Group

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The food and beverage landscape is shifting materially. Population growth—nominal overall and concentrated in Hispanic and minority cohorts—will not, in and of itself, result in brand growth. Consumers in general, and Millennials in particular, are displaying a very different set of values in making their food and beverage choices. Disruption is often happening on the margins. To understand the latest chapter in the modern food industry, we must now focus less on one titan battling another and much more on dominant category leaders bleeding from 1,000 paper cuts. It's an innovation war on innumerable fronts.

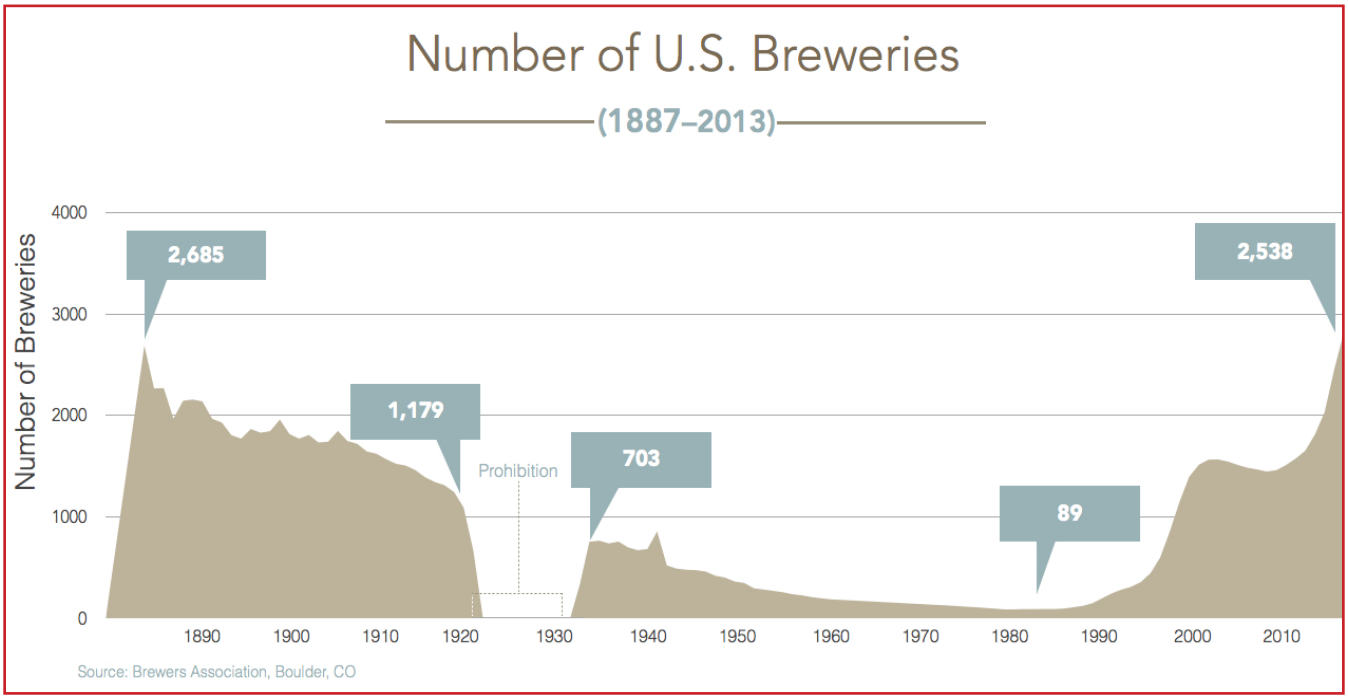
The U.S. beer market is a case in point. After massive consolidation, the industry leaders (Anheuser-Busch InBev and MillerCoors together have 65% market share) have suffered through a slow-motion horror movie as their brands steadily lose share to a largely unseen enemy—craft beer. The U.S. beer market declined 2% in 2013, yet the craft segment of small independents grew 20% in dollars for the same period. With about 8% volume share of the domestic market, the craft segment controls about 14% dollar share of the roughly $100 billion in retail sales.

Compared to the big guys who are already consolidated and optimized for large-scale competitive advantage, craft brewers are winning at the margins, and they are doing so at substantially higher price points with less promotional spending. A localized industry for most of its 500-year commercial history, globalization in beer seems to have exceeded its reach.

THE PACE OF CHANGE

Rapid change is a given in technology. Moore's Law, if anything, appears to be somewhat understated. Most people old enough to remember mainframe computers understand that the computing power of a smartphone now surpasses that of those early, room-sized machines.

With the hyper-connectivity of our world and ready access to virtually unlimited sources of information, it comes as little surprise that the pace of cultural evolution has dramatically accelerated, aided and abetted by social media. The balance of power is, in many cases, shifting in the world of branded products. The old rule book is changing. Case in point: Mass-media "push advertising" to shape consumer demand has real limitations in this new world order. Increasingly, those brands unwilling or unable to listen to and be shaped by their consumers risk losing relevance.



Reprinted from an article that originally appeared in the Nutrition Business Journal, April 2014.

THE PACE OF CHANGE IN FOOD

The obesity crisis in the U.S. and the rise of a range of chronic diseases suggest a significant mismatch between the changes in our dietary and behavioral habits, and our biological ability to rapidly adapt. Add to this the economic crunch in healthcare costs and the lifestyle compromises associated with many chronic diseases and it's not surprising that there is so much conversation and debate around the elements of healthy eating and healthy living.

Big data will be a lead actor in this drama, both in terms of understanding personal genetics as well as the increasingly celebrated role of the microbiome in the complex rubric that is human health. This disconnect between the pace of cultural and technological evolution and the pace of biological evolution is obvious. There is something greatly amiss between our highly engineered and processed staple foods, our overall nutrient intake, and our ability to properly metabolize these in a balanced manner.

Another revision to the USDA dietary standards adds to the debate and confusion. And yet it's those wired consumers who increasingly find the tools and the motivation to crack the code on healthy eating and living. Big CPG needs to wake up to the pace of change and adopt the lean and agile modalities of technological innovation.

CAN BIG FOOD ADAPT?

Whether fads, trends, or megatrends—and it matters greatly which—a large number of characterizations and attributes are central to the conversation on better-for-you foods: natural, organic, local, artisanal, fermented, raw, sprouted, nutrient-dense, high-protein, low-carb, gluten-free, paleo, allergen-free, GMO-free, etc. Demand is being shaped by more subtle ingredient stories, dietary/lifestyle frameworks, authentic brand narratives, less processing, and peer review on preference.

Also worth noting: the longitudinal Gallup survey on Business and Industry Sector Ratings reveals that negative sentiment about Big Ag is growing materially. This sentiment does not yet rival negative sentiment toward Big Banks, Big Oil, and Big Government, but sentiment has clearly shifted over the past 12 years. The GMO debate is shining an unwelcome spotlight on most of industrial food and a supply chain optimized for GMO ingredients in core commodities. Our magnificently efficient production and processing infrastructure brings us food at historically unprecedented economy, but that same infrastructure is poorly configured for flexibility, dexterity, and rapid iteration.

The locus of power has shifted from a manufacturer's narrative to a consumer narrative, and this is reflected in the demand landscape across many grocery categories, including sustained and significant year-over-year declines in such mainstays as carbonated soft drinks, shelf-stable juices, margarine, frozen meals, canned soup, and chewing gum.

HEALTHY CHOICE: FROM INSIGHTS TO DOGMA

The Healthy Choice brand offers an interesting (and not entirely unique) example. It was launched by ConAgra Foods in 1988 as a direct result of a heart attack for then CEO Mike Harper. It became a phenomenal success, growing to $1 billion in sales in about four years. Based on a clear and comprehensible set of heart-healthy macronutrient guidelines (low fat, low sodium, low cholesterol), the brand innovated from the convenience of the frozen food aisle across the grocery store to ultimately realize retail sales approaching $1.4 billion. Yet today that brand has materially contracted and now represents sales just over $500M. It was a great success story, but not an eternal one.

The consumer conversation on weight loss and healthy eating has evolved quite dramatically since the brand's heyday, and the brand's dated thesis about macronutrient regulation (in sometimes marginal-tasting products that derive therefrom) are relics of largely obsolete insights. Weight management could not be more relevant to consumer concerns and the public policy debate today. Yet Healthy Choice, like the other big frozen meal brands in the nutritional segment, has suffered sustained year-over-year declines in the struggle to restore brand relevance in this contracting category. There is growth on the margins of this category—in natural, organic, gluten-free, and other better-for-you products—and it is coming generally at higher price points and with less promotion than the biggest brands.

LEADERSHIP SHIFT

The classic brand leadership paradigm in CPG food over the past 40 years includes some combination of the following strategies:

- Maximize points of distribution and SKUs/facings per shelf-set
- Enhance purchasing and manufacturing scale economies
- "Push" marketing to drive demand
- Establish category leadership with the trade and optimize product assortment
- Utilize consumer and trade promotional dollars to cement leadership position and block competitors

Yet in an odd way, the outcomes of this paradigm help to develop category leadership handcuffs, ways in which the assets of a traditional leadership position can lull a brand to sleep and structurally inhibit innovation. While certainly an advantage in many respects, a major brand manufacturing footprint, infrastructure, and ensuing culture can become significant barriers to innovation. There is evidence of these leadership handcuffs in each of the declining categories referenced above:

- Inflexible manufacturing assets seeking full utilization
- Complex and lengthy supply chains with dependence on specialized, engineered, industrial ingredients
- The tendency to encourage "value engineering" for maximum shelf life and profitability
- A general focus on defense outspending competitors on unproductive promotional dollars and the training of consumers to "buy on deal"
- A focus on close-in product renovation, serving primarily to protect market share

So, while in the short term, market leaders enjoy the profitability associated with incremental share point gains, unintended consequences include gradually erecting cultural barriers to breakthrough innovation that might be dilutive to or threatening of short-term top-line and bottom-line results. Another familiar outcome involves desperate promotional spending that does nothing to expand consumption and ultimately tends to drain the category profit pool for manufacturers and retailers alike.

UNLIKELY WINNERS

With the sands shifting so rapidly, how can big food and beverage brands find the footing to pursue real innovation and keep the 1,000 challengers nibbling their ankles at bay? While some of the nuance varies between categories, we can generalize on an obvious consumer preference for shorter ingredient labels, less processing, micronutrient density, transparency on ingredient sources, less sugar, more taste, and the devil we know (butter versus margarine). Competitive advantage can be very transient. The winning brands emerging from category disruption will scale with flexibility, focus on consumer intimacy and constant consumer engagement, and seek supply chain differentiation based on partnership, quality, and integrity – not just cost.

The beer category example comes back into play as a fascinating illustration of both "relocalization" and the democratization of a major category. In the 1890s, approximately 2,000 breweries served the U.S. population. By 1990 that number dropped all the way to 89. Today there are now over 2,500 breweries again in the U.S., most in the vital, high-growth, microbrew segment.

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Strategic Information for the Nutrition Industry

ABOUT SRG

John Grubb is managing partner at the Sterling-Rice Group. SRG has worked in the world of natural & organic food, functional food & beverage, and ingredients for 30 years with an emphasis on consumer insights, business and brand strategy, product innovation, and communication.

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