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BY STEFFEN LAUSTER, J. NEELY, AND

ELISABETH HARTLEY

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Over the last several years, small consumer packaged goods (CPG) companies in the U.S. have steadily gained market share at the expense of larger competitors. This has been true across a broad range of CPG companies and categories. What's more, upstarts often price their products at a premium. Booz & Company recently completed an analysis of the top 25 food and beverage categories and found that small players (those with sales of less than US$1 billion) are outperforming the competition in 18 of the top 25 categories, including the largest ones.

Several broad forces, most of them peculiar to our times, are combining to create advantageous conditions for small companies. For starters, consumers are demanding broader selection. "Selectionists," who comprise 30 percent of the consumer market, seek greater variety and new tastes—and sometimes care deeply about other factors such as the origins of the food and how far it has been shipped. Selectionists have a stronger interest in local, boutique foods and beverages. Some traditional supermarkets are catering to this trend as a way to differentiate themselves from Walmart and other big price clubs. It's difficult for traditional supermarkets to compete on price, but they can compete by offering a wider assortment of products, which, in turn, creates further opportunities for niche manufacturers.

Several other important factors in the rise of small CPG players are linked to technology. The fragmentation of media and the generally lower cost of digital platforms give small players new outlets to reach customers in more targeted, cost-efficient ways. But what should concern large players the most is how technology is eroding their scale-driven advantages. Small players are increasingly able to outsource invoicing, HR systems, and logistics, as well as other back-office SG&A functions.

Retail consolidation is further chipping away at scale advantage. The preference among bigger retailers is to work with a broad range of manufacturers—both large and small—to keep large CPG companies from gaining too much leverage.

How do large CPG players respond to these changes and the serious threats they contain? Companies begin by developing a better understanding of the strategies that upstart competitors are employing to grab market share. Next, they look at the capabilities underpinning those strategies and consider how they might access these capabilities for their own advantage.

Market Share Growth, Pricing Power

From 2009 to 2012, small food and beverage manufacturers grew revenue about three times faster than the rate of the overall category. In the packaged food category specifically, small players experienced a three-year

Steffen Lauster
steffen.lauster@booz.com
is a partner with Booz & Company based in Cleveland. He leads the firm's consumer and retail practice in the U.S.

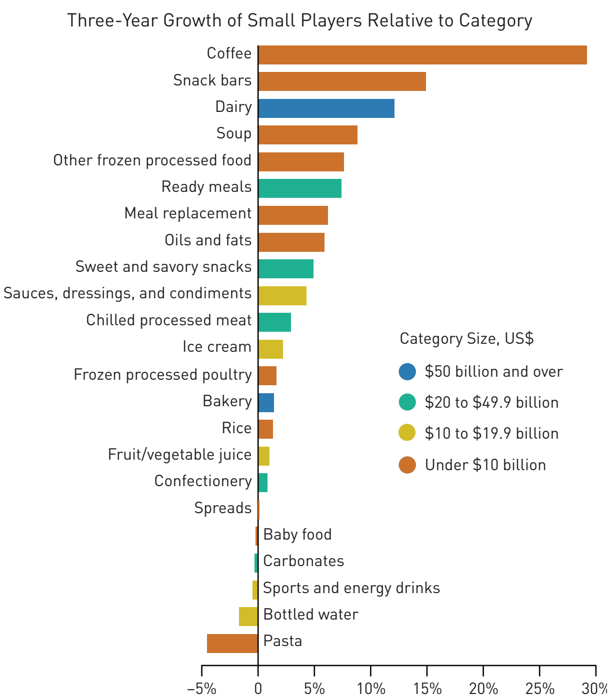
J. Neely
j.neely@booz.com
is a partner with Booz & Company based in Cleveland. He specializes in strategy, mergers, and restructurings in consumer products and retail sectors, and works with publicly traded and privately held corporations.

Elisabeth Hartley
elisabeth.hartley@booz.com
is a principal with Booz & Company based in New York. She specializes in helping consumer-focused companies achieve strategy- and capabilities-based transformation.

compound annual growth rate (CAGR) of 6.2 percent, and gained 1.7 percent of market share. Meanwhile, large players increased sales by just 1.6 percent CAGR and saw market share decline 0.7 percent. In the beverage category, the results were similar. Small companies saw a three-year CAGR of 4.4 percent, compared to just 0.1 percent among large companies. Small companies saw their market share rise 0.8 percent while large companies' market share dropped 2.5 percent. This outperformance occurred even in some of the largest, most consolidated categories, such as bakery, dairy, snacks, and ready meals (*see Exhibit 1*).

Exhibit 1: **Small Players Outperform**

In most of the biggest food and beverage categories, small CPG firms are increasing their market share.



Notes: Ready-to-drink tea and frozen processed vegetables are not shown because those categories have no small players. Packaged food categories show 2012 data, beverage categories show 2011 data.

Source: Euromonitor, Booz & Company analysis

Along with market share gains, small players enjoyed price premiums in many categories. A survey of in-store pricing found that Godiva chocolate cost 138 percent more than the Hershey's product of comparable size and flavor, Cape Cod potato chips cost 24 percent more than Lay's, and Amy's Kitchen soups cost 58 percent more than Campbell's. Small players also showed pricing strength over private-label manufacturers. From 2011 to 2012, the price premium for small players over private labels jumped 5 percent for butter, olive oil, and packaged/industrial bread.

Capabilities Underpin Differentiation

Small players don't have a single or consistent approach across all categories to account for their success. They are using a variety of strategies that incorporate brand positioning, pricing, market entry, innovation, route to market, and in-store marketing and merchandising. Within these categories, each carves out distinct positions depending on the product and competitive environment. The overall effect is a patchwork of bespoke strategies. That means one needs to look harder for the lessons—but they are there.

Consider pricing. Although small players generally enjoy premium pricing, such pricing is not a universal strategy. In areas where big players are least capable—such as in organic, artisanal, or regional brands—small players are more likely to take a superpremium position. However, in other categories they may choose a middle tier to be the "attractively priced alternative" to high-end brands. When the large players are perceived by the market as expensive, small players may even take a "value" price position.

Their strategies are diverse and tailored to the category and competitive factors, but several successful small players appear to have an important similarity: They possess a coherent system of capabilities that allows them to focus on a few critical areas where they can most effectively exploit the weaknesses of less-nimble, less-focused large players. A capabilities system is made up of three to six distinctive capabilities, and each capability is ensured through the right combination of processes, tools, knowledge, skills, and organization. This coherence gives its owner the necessary focus to differentiate itself.

Take Cabot cheese, which plays against the corporate stereotype of rivals by highlighting its own cooperative business model and connection to the Vermont dairy farmer. In the same vein, Cabot uses its online presence (Facebook, Twitter, Pinterest, Instagram) to promote community involvement. The company has developed the capabilities to roll out new flavors and specialty aged cheeses that appeal to consumers' desire for variety and homespun creativity: Horseradish Cheddar, Hot Habanero Cheddar, and Tomato Basil Cheddar, to name a few. These specialty cheeses have allowed Cabot to expand its presence in stores to the deli case (with other artisanal cheeses), thus gaining shelf space in a more "premium" section of the store.

Utz Quality Foods is a family-founded potato chip brand in the northeastern U.S. that creates a direct relationship with consumers by offering products online and delivering directly to homes. It also appeals to health-conscious consumers with wheat-free and gluten-free Rice Crisps, non-fried light potato chips, and organic tortilla chips and pretzels. This capability to create healthy innovations is a powerful differentiator for a snack often labeled a junk food.

The Large Player Response

The success of small players and the conditions that have arisen to make them more competitive raise some critical issues for large players about both their organic and their inorganic growth strategies. Large players need to think carefully about how to access the capabilities that small players are using to such advantage. Generally speaking, large players need to tailor product offerings across formats and shopping occasions, drive differentiation through innovation, and reinforce the brand experience through in-store marketing and merchandising.

But at what point should the company respond to a small player's inroads? Should the response be to build or buy? In either case, what new capabilities does the company need to succeed, and how can they be incorporated into existing systems?

Addressing these issues is a tall order, but several large companies are countering the incursion of small players effectively and consistently. Some, such as Coca-Cola, have acquired a long list of high-growth small businesses, capturing their continued growth for themselves. Others, such as Frito-Lay, win by mimicking small players' innovations and then using their scale and brand leverage to compete and drive growth.

Coca-Cola: The Acquirer

Coca-Cola routinely expands its beverage portfolio. More recent acquisitions include Glaceau, an enhanced water; Fuze, a vitamin-enriched beverage; and a handful of other specialty drinks including Odwalla, Honest Tea, Innocent, and Zico. Coca-Cola has learned from experience that acquisitions, rather than new products, are the best way to leverage its impressive and differentiating distribution capabilities. The company has carefully designed six elements to manage acquired brands and build value.

- **Brand positioning:** To keep the new brand distinct and attractive to its established and sometimes devoted customer base, Coca-Cola does not affiliate the acquired brand directly with the Coca-Cola brand.
- **Pricing:** Acquired brands are often positioned as premium brands and priced higher than the competition.
- **Market entry:** Coca-Cola chooses brands that have an established market presence in their niche and that have reached a certain multimillion-dollar revenue threshold.
- **Innovation:** Coca-Cola uses different governance models to oversee acquisitions, but the common priority is to keep the company flexible and innovative.
- **Route to market:** Coca-Cola continues to distribute the acquired brand to specialty retailers, but it also leverages its extensive distribution network to reach more consumers.
- **In-store marketing and merchandising:** Coca-Cola leverages its reach and distribution to merchandise new products. For example, Vitamin Water is now available in numerous convenience stores and kiosks with coordinated displays and in-store support.

Advice for the Upstarts

Even as larger competitors take notice and react to their successes, small companies should keep playing on the strengths that have carried them thus far. Using a variety of strategies that incorporate brand positioning, pricing, market entry, innovation, route to market, and in-store marketing and merchandising, small players are eating into the market share of long-dominant brands. And there are plenty of gains yet to be had. The trick will be continuing to focus on a few critical capabilities where they can most effectively exploit the weaknesses of less-nimble, less-focused large players.

Frito-Lay: The Fast Follower

Frito-Lay's strategy for capturing the high growth of small players is much different from that of Coca-Cola. Consider kettle chips (potato chips cooked in small batches, rather than in the more common continuous-flow machines). Two small players have dominated the category: Cape Cod and Kettle Chips. But instead of acquiring either small player, Frito-Lay leveraged its well-honed capability to mimic market innovations and created Lay's Kettle Cooked. As Coca-Cola does for its acquisitions, Frito-Lay has carefully designed six strategic elements to manage and grow the brand.

- **Brand positioning:** Lay's Kettle Cooked brand is positioned as a value brand in comparison to Kettle and Cape Cod products. Frito-Lay also promotes the healthy aspects of the chip (e.g., "40 percent less fat than regular potato chips").
- **Pricing:** In keeping with its value brand position, Lay's Kettle Cooked is priced below other kettle competitors. A canvassing of supermarkets in 2011 found that a $3.29, 8-ounce bag of Lay's Kettle Cooked was as much as 7 percent less expensive than small player alternatives.
- **Market entry:** Frito-Lay rolls out different flavors of Kettle Cooked chips over time, instead of all at once, all the while pushing them as a healthier way to enjoy Lay's potato chips, which have a long-established brand following.
- **Innovation:** Frito-Lay has developed the ability to rapidly replicate new flavors introduced by Kettle and Cape Cod that it would not have considered offering in the past (e.g., jalapeno and sun-dried tomato and parmesan).
- **Route to market:** Frito-Lay sells primarily through grocery and supermarkets rather than restaurants and boutique markets. Lay's Kettle Cooked leverages Frito-Lay's extensive direct-store-delivery network to penetrate key channels.
- **In-store marketing and merchandising:** Lay's "category captain" position in traditional flat potato chips gives Frito-Lay the power to influence, if not set, category shelf plans. That sway over product placement is a key advantage.

Conclusion

Large companies should view small players not simply as a threat or nuisance, but as valuable working examples of how they might recharge their own growth. Whether a large company decides to acquire small players or to compete with them head on, it needs the right capabilities system. An acquirer must have the people, processes, and tools in place to leverage its scale and strength without snuffing out the new brand's innovative spirit and upstart image. A builder needs the people, processes, and tools in place to innovate quickly in response to small players and to reinforce the new brand through in-store marketing and merchandising.

Careful attention to building or buying the right capabilities will allow large companies to leverage the winning strategies of small players for their own growth ambitions. +

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