Brand new order

Disrupt or be disrupted

Creating value in the consumer products brand new order

Ernst & Young
Quality In Everything We Do

Our thanks to the 285 C-suite executives and analysts who participated in the study, and in particular, to those who shared their insights and personal experience in a series of in-depth interviews:

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Foreword

Welcome to *Disrupt or be disrupted,* the first in a series of our *Brand new order* publications, which explore how consumer products companies are addressing today's highly complex, fast-changing environment.

We believe consumer products is a great sector, but the macroeconomic environment is tough and isn't about to change. It has also become increasingly clear that the traditional consumer products operating model is, if not broken, no longer fit for its purpose. Companies cannot be complacent. Incremental optimization is no longer an option.

At the same time, this is an environment of considerable opportunity, including an explosion of demand in rapid-growth markets and the potential for new technologies such as mobile and social media to create new conversations and routes to market. Our work has led us to conclude that consumer products companies are facing a "brand new order" — an unprecedented environment of constant change and spiraling complexity. We believe that winning in the brand new order requires companies to take action on many fronts. They need to challenge accepted ways of thinking and adopt a highly disruptive approach to managing almost every aspect of their business. And above all, they must execute flawlessly.

To help us understand how the brand new order is affecting consumer products companies, we commissioned a survey of 285 senior executives from across the sector and around the world that took place between February and May 2012. We also spoke to CEOs, CFOs and other top executives from many of the world's leading consumer products companies as well as leading analysts focused on the sector. We are very grateful for the time and valuable insights that these individuals provided.

This report presents the findings from our research, along with our view of what companies need to do to respond to the brand new order. We hope you find it interesting and valuable reading.

Howard

Howard Martin

Pat

Patricia Novosel

Key takeaways

The brand new order is an environment of continuous, accelerating change and spiraling complexity. It is transforming and disrupting the business landscape for consumer products companies and presenting them with huge opportunities and risks.

Two-thirds of companies we questioned said they are under pressure to reappraise their operating model. Almost three-quarters said they need to make significant changes in order to sustain historic margins. Addressing this highly uncertain environment requires disruptive thinking, a willingness to change and a rejection of some tried-and-tested ways of creating value.

Companies operating in the brand new order must come to grips with:

- Uncompromising stakeholders who present companies with dilemmas
- Consumers taking hold of the conversation and demanding greater value
- The need for an entirely revitalized approach to brand management
- The need to maximize flexibility of supply to meet consumer and customer expectations
- The requirements for a new style of leadership fit for a fast and constantly changing world

Winning in the brand new order will require more than just incremental improvements. It will demand new ways of thinking and disruptive approaches. Leaders will have to take value creation to the most granular level across their organization in order to succeed. They must:

Reframe strategic choices

- Choose where and how to compete
- Set a clear long-term vision and purpose
- Strike a careful balance between global and local

Realign the value chain

- Harness social media to hold profitable conversations with consumers
- Develop a multi-channel strategy that is customized to the needs of the consumer and customer
- Maximize flexibility in the supply chain to create both efficiency and security of supply

Ruthlessly execute to capture value

- Create strong alignment between strategic vision and the resources and capabilities required for implementation
- Maintain a focus on efficiency but prioritize value creation
- Empower talent to make the right decisions in a data-rich world

Consumer products companies that fail to respond to the brand new order will leave significant value uncaptured. They risk declining volumes and margins, and consumer irrelevance. This will lead to increasingly intense scrutiny from investors and analysts, who may start to question both their strategy and long-term viability.

74% need to make significant changes in order to sustain historic margins

68% are under pressure to reappraise operating model

37% say they are poor at increasing the pricing power of brands

Key challenges identified by senior executives

Reframe strategic choices

Unprecedented complexity and dynamic change are forcing companies to disrupt themselves.

- 74% agree that significant changes are needed to sustain historic margin levels.
- 74% agree that their market share is under pressure from intense competition by current and new competitors.

Few companies are confident that they can make the right decisions against a backdrop of continuous change.

- Only 29% say that their company is very good at choosing where to compete; among respondents from Europe, that figure falls to 20%.

Striking the balance between global and local remains a key challenge.

- Only 16% say that their company is very good at balancing global control with local entrepreneurialism.
- More than 25% admit that they are poor at it.

Realign the value chain

Social media is shifting control of brands to consumers, but companies have not yet adapted to this transition.

- Just over half think that social media is transforming the relationship between manufacturer and consumer.

Shortages of key commodities will require companies to rethink their sourcing strategies.

- Availability and cost of raw materials is rated as the No. 1 risk.
- Six out of ten agree that it will become increasingly necessary to secure long-term supply of critical resources and commodities, including water.

A multichannel world poses unprecedented supply chain complexity.

- Almost two-thirds agree that routes to market are becoming more complex.
- Only just over one-quarter say that their company is very good at creating a lean and agile supply chain.

Ruthlessly execute to capture value

Aligning execution with strategy remains a major challenge.

- Just 30% say that they are very good at making sure that there is a clear strategy and that resources are aligned behind it.
- Just 25% think they are very good at making sure the company's strategy is understood internally.

Maintaining margins demands a continuous focus on cost and efficiency.

- Almost 50% say that they spend more than 25% of their time on margin improvement.
- 37% say they are poor at increasing the pricing power of brands.
- Efficiency and productivity programs are expected to deliver the most positive margin improvement in their company over the next 10 years.
- Just under 33% say that their company is very good at increasing efficiency or productivity, although only one-quarter offer the same assessment of their ability to reinvent processes to reduce cost.

Talent remains the key barrier to effective execution.

- Talent and capabilities are considered the most significant barriers to executing strategy.
- Just 20% say that they are very good at attracting and optimizing talent and resources.

Understanding the brand new order

brand new order *[brand-nü ör-dər]*

The level of complexity and pace of change feels unlike anything that consumer products companies have ever previously experienced.

Five characteristics of the brand new order

1. Uncompromising stakeholders present companies with dilemmas.
2. Consumers take hold of the conversation and demand greater value.
3. The new age of the consumer demands a revitalized approach to brand management.
4. Unprecedented complexity demands greater flexibility of supply.
5. The fast-changing environment requires a new style of leadership.

Understanding the brand new order

We believe consumer products companies are facing a brand new order of spiraling complexity and a dramatic pace of change in which many tried-and-tested ways of creating value are no longer fit for purpose. This highly disruptive environment presents companies with huge opportunity but also heightened risk. Coming to grips with the brand new order requires companies to constantly challenge their thinking and disrupt their own ways of working.

For a sector that has a reputation for being stable, this environment of constant disruption may be difficult to accept. Some of the largest companies in the sector have been in business for more than 100 years. They may not always be the fastest-growing companies on a stock exchange, but they have predictable earnings, strong cash-flow generation and regular dividends. Despite the financial crisis, the global consumer products market grew at a very steady average compound annual growth rate of more than 3% over the past decade.[1]

This stability and consistency that attract investors to the sector can no longer be taken for granted. Disruptive shifts are taking place on almost every front. The global economy is being reshaped as the center of gravity shifts to the east and south. Technology is dramatically changing the relationship between brands and consumers. Routes to market are becoming more complex. And different stakeholder groups are making demands on companies that sometimes converge, but often conflict. The speed with which consumer companies need to change is breathtaking. The old models and structures that served them so well in the past are being stretched to the breaking point.

[1] Datamonitor Consumer Packaged Goods Market Data Analytics, database, (accessed 5 May 2012).

> "It's hard to feel confident about the numbers unless you've got a good understanding of corporate culture, where management's going and what lies beneath those numbers. We need to know that management is being realistic."
>
> **Andrew Lazar,** Investment Analyst at Barclays Capital

It is imperative that consumer products companies address each of the following five disruptive characteristics that define the brand new order.

1. Uncompromising stakeholders present companies with dilemmas

Business leaders must manage a more diverse, complex stakeholder universe and satisfy multiple sets of demands. Investors expect clarity around margin improvement, yet companies are facing pressure on margins and finding it more difficult to provide clarity given the pace of change. In addition to meeting the needs of investors, companies must also address the expectations of regulators, governments, employees, customers, suppliers and communities. Investors want stability and consistency and will not forgive management for lapses in performance. Governments and regulators are placing companies under tighter regulatory control, while consumers expect them to act responsibly in their stewardship of resources and communities.

Although the demands of different stakeholders may sometimes converge, on other occasions they will, on the surface, appear irreconcilable. For example, investors may want short-term returns, which could be achieved by shrinking the workforce or increasing prices of products. Yet both these approaches would conflict with the needs of other stakeholders, such as employees or customers.

Satisfying the demands of different stakeholders under conditions of extreme uncertainty is now a major management challenge, and it demands a strong management team, clarity of purpose and consistency in approach. Transparency is no longer an option in terms of reporting and communicating — it is an essential part of business life.

2. Consumers take hold of the conversation and demand greater value

Consumer products companies no longer 'own' their brands. When consumers are seeking recommendations or advice on what to buy, they will turn not to the producers of those goods but to third-party advisers, such as their peers, social leaders or experts found on digital channels, such as Facebook or Twitter. Brands are now becoming a cloud of interactions that are shaped by consumer comments not just companies or partner organizations.

Without control over the conversation, business leaders must determine how to participate and engage with these third parties so that they can build and maintain trust among a fast-changing and demanding consumer base. Channels such as Facebook and Twitter are evolving at an incredibly rapid rate and will probably be joined or even overshadowed by new technologies in the next few years. Companies must also understand the equivalent channels in other markets, such as Renren in China and VK in Russia. This means that companies must learn incredibly quickly how to use a large variety of channels and perform multiple experiments at any one time to determine which approaches work and which should be discarded.

> "It's important for companies to have a values-based message, but it's also important for them to make money. Telling stakeholders that you want to improve lives or reduce poverty around the world is great because it's something that people can rally around, but you need to be able to execute on it properly. You can't have one without the other."
>
> **Nik Modi,** Investment Analyst at UBS

> "There are layers of bureaucracy in many of these companies that could easily be slimmed out, but it will take a new way of working that will require a different mindset."
>
> **Tracey Campbell,** Founder of SalientBrief

3. The new age of the consumer demands a revitalized approach to brand management

In a consumer-centric world, the brand is king. With consumers now controlling the conversation around brands, the traditional approach to category management is not fit for purpose. In order to compete effectively, consumer products companies must adopt a highly shopper-centric approach. Consumers have more influence than ever, and retailers will respond to their needs, stocking the brands that consumers say they want, not those that companies want to sell.

This renewed focus on brands requires consumer products companies to relearn the capabilities of managing brands and swing the pendulum away from centralization and back towards local execution. Rather than aggregate brand management at the global headquarters, companies need to give profit and loss accountability for brands to local managers so that they can make marketing decisions based on their knowledge and understanding of the local market. This will require a major shift in power and accountability for some companies, but local execution will be critical to create differentiation in a highly competitive market.

4. Unprecedented complexity demands greater flexibility of supply

Companies have long sought ever-greater economies of scale by integrating supply chains at a global level. They have tried to reduce the number of SKUs, harmonize manufacturing and standardize their product offerings as much as possible. If companies offer consumers "any color … so long as it is black" — as Henry Ford did with the Model T car in the early 20th century — they are merely superimposing simplicity on a world that is becoming more complex by the day.

Companies need to embrace good complexity that creates value and reject the bad complexity that creates unnecessary cost. Consumers want choice and companies need to find a way of delivering it using techniques that create uniformity where possible but enable customization where it is needed. Stripping out nonperforming SKUs and figuring out how to offer choice without creating unmanageable complexity have become key capabilities for leading consumer product companies.

5. The fast-changing environment requires a new style of leadership

The speed of change and scale of complexity have rendered traditional methods of management obsolete. Command-and-control approaches cannot keep pace with a dynamic business environment. Instead, leaders need to give greater autonomy to local managers, but provide a clear framework so that decisions take place within certain parameters and are aligned with the overall long-term vision of the company.

Business leaders must embed a more facilitating, enabling style of management with clear accountability for outcomes. It will also require a new generation of entrepreneurial local managers who are comfortable with making decisions independently of headquarters. These managers must adopt the skills of the "herd." This means that they must be aware of a common purpose, have the ability to sense both risk and opportunity — and respond accordingly. This new generation of managers will know instinctively how to do what is right for the organization within the context of the local environment.

> "If your business is skewed towards the mature markets of the US and Western Europe, then you're growing volumes in line with population growth. You may never get to a scenario where you could have sustainable double-digit earnings."
>
> **Sandra Salas,** Senior Consumer Specialist, Merlin Securities

The pace of change

Measuring the pace of change is notoriously difficult, but many indicators point to a dramatic acceleration of change over the past few years. Looking to the next few years, there are few signs that this pace of change will slow. Below are a number of statistics that hint at this acceleration in the pace of change:

- Between now and 2050, the population of the world will grow from 7.1 billion to 9.3 billion. Almost all of this growth will come from rapid-growth markets.[2]
- In 2009, the number of people living in urban areas surpassed the number living in rural areas for the first time. By 2050, the global level of urbanization is expected to reach 67%.[3]
- By 2030, global water demand is forecast to exceed supply by 40%.[4]
- There was a 24% change in the composition of the Global Forbes 2000 between 2007 and 2011.[5]
- The quantity of data in the world is doubling every two years. Wal-Mart Stores alone handles 1 million transactions every hour, creating databases estimated at more than 2.5 petabytes.[6]
- In 2001, it took Apple more than 360 days to sell 1 million units of its first-generation iPod. In 2012, it took just three days to sell 3 million units of its latest iPad device.[7]
- There are now almost 6 billion mobile phone subscriptions in the world.[8]

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[2] *World Population Prospects, the 2010 Revision,* United Nations, Department of Economic and Social Affairs, Population Division, April 2011.
[3] *World Urbanization Prospects, the 2011 Revision*, United Nations, Department of Economic and Social Affairs, Population Division, March 2012.
[4] United Nations, Department of Economic and Social Affairs, Water Division, The 2030 Water Resources Group, 2009.
[5] Ernst & Young research, based on analysis of the FORBES 2000 list.
[6] "Data, data everywhere," *The Economist*, 25 February 2010 (www.economist.com/node/1555744).
[7] "Apple sells 3 million iPads in 3 days," *Los Angeles Times*, 20 March 2012, via Factiva, © 2012. Calkins Media, Inc.
[8] www.themobileworld.com, (accessed 1 June 2012).

Addressing the brand new order

Winning in the brand new order requires companies to make far-reaching changes to their business. We believe that these changes fall under three key categories. Companies need to:

Reframe strategic choices
Realign the value chain
Ruthlessly execute to capture value

In the rest of this section, we explore these choices in more detail and provide a set of recommendations to help companies address the brand new order more effectively.

Reframe

Reframe strategic choices

Key challenges identified by senior executives

Unprecedented complexity and dynamic change are forcing companies to disrupt themselves.

- 74% agree that significant changes are needed to sustain historic margin levels.
- 74% agree that their market share is under pressure from intense competition by current and new competitors.

Few companies are confident that they can make the right decisions against a backdrop of continuous change.

- Only 29% say that their company is very good at choosing where to compete; among respondents from Europe, that figure falls to 20%.

Striking the balance between global and local remains a key challenge.

- Only 16% say that their company is very good at balancing global control with local entrepreneurialism.
- More than 25% admit that they are poor at it.

35% say they are poor at reducing bureaucracy and complexity

Just **29%** of respondents say that their company is very good at choosing where to compete

Only **16%** say that their company is very good at balancing global control with local entrepreneurialism

Business leaders of consumer products companies have always faced difficult decisions, but in the current environment, these choices have become even more complex and multidimensional. Strategies that worked consistently in the past are no longer reliable. Markets that have shown growth for decades are under threat. And consumers and customers who have always been dependable are evolving beyond recognition. Managing in this environment requires companies to shed legacy ways of thinking and embrace disruptive solutions.

The scale and the pace of change creates what appear to be paradoxes for decision makers. Companies must invest to maintain market share in sluggish mature markets, but also allocate funds and resources to capture growth in rapid-growth economies. They must get closer to consumers in specific markets — even at a city level — but also figure out how to derive economies of scale at a regional or global level. And they must serve the needs of different stakeholders who may each have a very different expectation of how the company should behave.

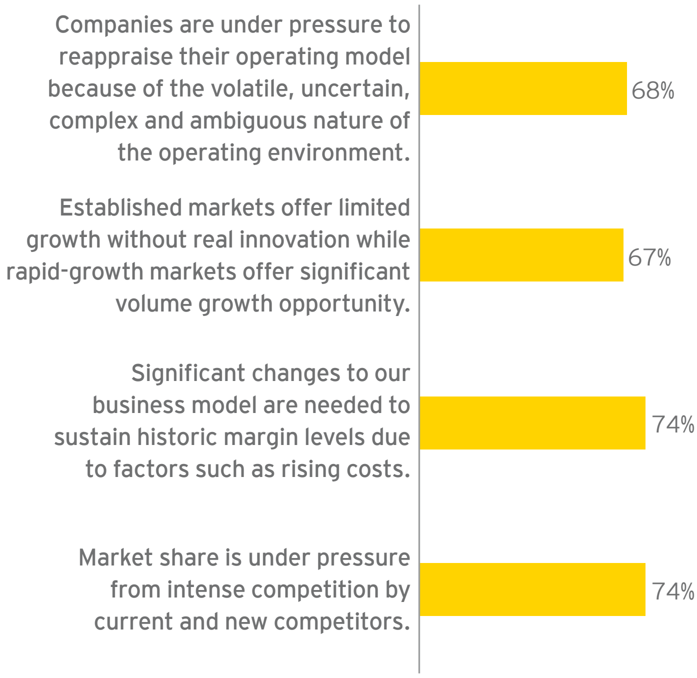
Setting long-term strategy against a backdrop of extreme volatility poses significant challenges. On one hand, leaders must determine a long-term vision and purpose for the company that serves as the guiding star for business decision-making. Yet at the same time, they must be able to react to sudden shifts in the business environment that may render strategic choices less relevant than they were in the past. "We live in a world that is more volatile and less predictable and we have to accept that," says Jean-François van Boxmeer, CEO of Heineken. "Managing in this environment requires the tenacity to stick to long-term goals and the flexibility to adapt to a changing environment."

Resolving these paradoxes lies at the heart of strategic decision-making today. In a volatile, uncertain, complex and ambiguous world, companies must consider how multiple variables of change might affect the decisions that business leaders make. "The biggest challenge of leadership today is resolving what appear to be dilemmas or trade-offs," says Bob McDonald, President and CEO of Procter & Gamble.

Choose where and how to compete

Most senior executives in the industry recognize the need for disruptive change. Almost three-quarters of respondents agree that significant changes are needed to sustain historic margin levels, and a similar proportion agree that market share is under pressure from intense competition by current and new competitors (see Chart 1).

Chart 1: Percentage of respondents agreeing with statements



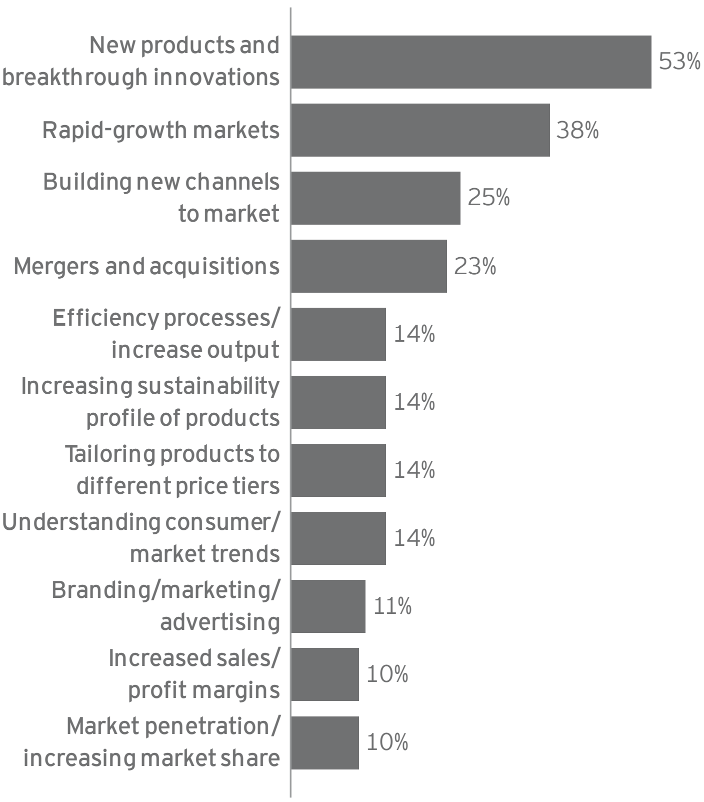
Reframe strategic choices

"The biggest challenge of leadership today is resolving what appear to be dilemmas or trade-offs."
Bob McDonald, Chairman and CEO, Procter & Gamble

Deciding how and where to compete, and where to focus in order to create the most value, is increasingly difficult. Respondents to our survey say that new products and breakthrough innovations have the most potential to create value, but they also point to investment in rapid-growth markets and building new channels to market as key activities (see Chart 2).

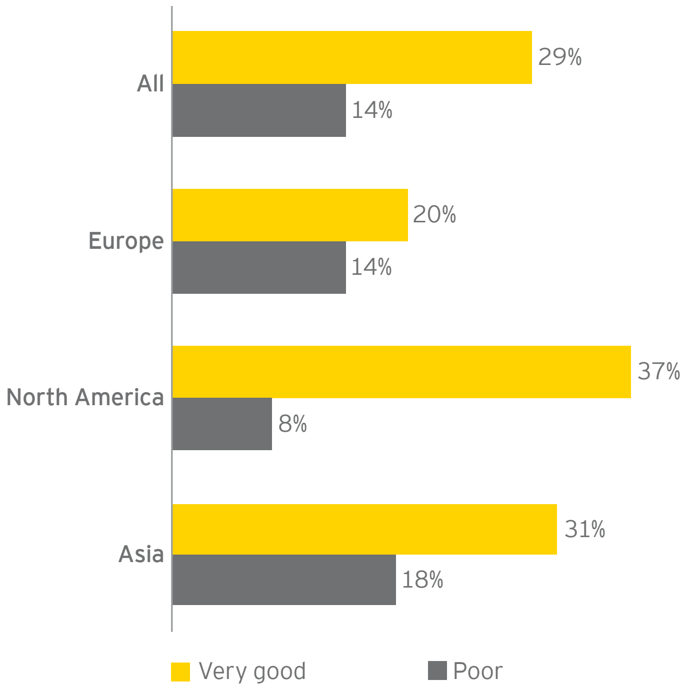
Given the scale of complexity and change in the external environment, incremental shifts are unlikely to be enough. Instead, companies need to revisit their entire operating model and strategy to determine whether it remains fit for purpose in the brand new order. Only by creating value at the most granular level can they succeed.

Chart 2: Which three activities would you say have the highest potential to create value in your business over the next five years?



Making the right choices is perhaps the most fundamental determinant of long-term success, yet this is an area where many senior executives in the industry say that they struggle. Just 29% of respondents say that their company is very good at choosing where to compete, and among respondents from Europe, that figure falls to just 20% (see Chart 3).

Chart 3: How would you rate your company's performance on choosing where to compete?



"With finite resources to allocate, companies must make difficult choices and trade-offs over where they should focus their attention and capital," says Howard Martin, Global Consumer Products Leader at Ernst & Young. "These decisions are extremely complex, and business leaders must increasingly rely on data and analytics to give them the support they need and the confidence to make choices under extreme uncertainty."

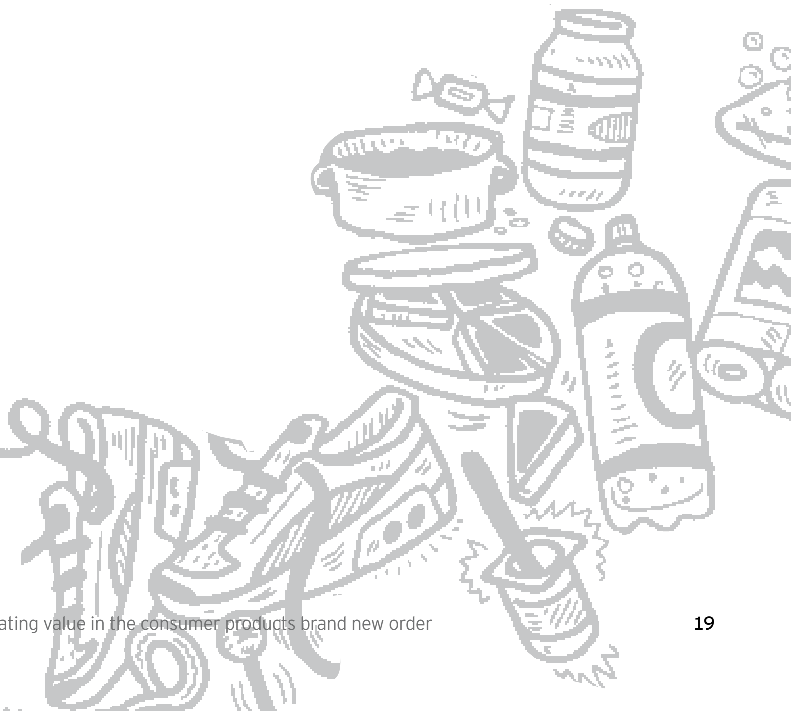
This analytics capability will increasingly be a critical source of competitive advantage. Companies that have it and act upon it are likely to make the right decisions. Those that do not and that cannot separate data from noise, will find it difficult to choose where to compete. Despite its importance, many companies admit that this is an area where they struggle. In a recent research report from Ernst & Young,[9] two-thirds of CFOs agreed that inadequate data or lack of transparency in data means that it can be difficult to build a robust evaluation model for investing in rapid-growth markets.

Companies should look across their portfolio and take a ruthless approach to selecting which markets, products or brands will make the best candidates for investment. Identifying and stripping back layers of complexity that do not add value is essential. "You need to figure out how to take the nonperforming or under-performing variants, SKUs and brands out of your portfolio," says Jesse J. Wu, Worldwide Chairman of the Consumer Group, Johnson & Johnson. "Doing that will help to keep your world simple."

A key decision for many consumer products companies involves the timing, extent and speed with which they reallocate resources to rapid-growth markets. These markets offer huge opportunities because 97% of the growth in population from 7 billion to 9.3 billion between now and 2050 will take place there.[10] In the nearer term, GDP growth rates are expected to be 50% greater than those in mature markets between 2011 and 2016.[11] This economic growth will push up per capita incomes, increasing the share of household spending that can be allocated to discretionary items.

"The decision to invest in rapid-growth markets is not straightforward. Companies must decide not only which markets should be prioritized but, within those markets, which cities will be the best investment destinations," says Emmanuelle Roman, Global Consumer Products Markets Leader at Ernst & Young. "Leaders must be careful to select the right mode of entry, and decide whether the investment should be made to acquire brands, factories, distribution channels or some combination of these. Once in market, companies must decide how quickly to ramp up investment. Building scale at speed is seen by many as a pre-requisite."

Greater investment and a focus on rapid-growth markets also mean that companies may need to decrease resources that are allocated to mature markets. Often, companies may find that the level of investment required in mature markets to make a material difference may be considerably greater than what would be required in a rapid-growth market to achieve a similar outcome. A recent research report from Ernst & Young found that 87% of CFOs agreed that it is difficult to build a rationale for increasing resource allocation to developed markets when other parts of the world are growing so much more quickly.[12] "We could decide that we want to move the needle in Europe, but that's a very expensive battle, and the question is whether that is sustainable," says Cees 't Hart, CEO of FrieslandCampina.



[9] *A tale of two markets*, Ernst & Young, 2012.
[10] *Ernst & Young Rapid-Growth Markets Forecast* — Winter edition — January 2012
[11] *World Population Prospects, the 2010 Revision*, United Nations, Department of Economic and Social Affairs, Population Division, April 2011.
[12] *A tale of two markets*, Ernst & Young, 2012.

Reframe strategic choices

> "Half of worldwide growth over the next ten years will come from mature markets."
> **Paul Bulcke,** CEO, Nestlé

However, even mature markets offer good growth prospects for those companies that can create the value that consumers demand. These economies may be debt-ridden, have high unemployment, aging populations and low rates of economic growth, but they have millions of consumers who will reward companies by paying a premium for products that meet their needs. "Half of worldwide growth over the next ten years will come from mature markets, so we really need to keep perspective on this," says Paul Bulcke, CEO of Nestlé. "There is so much value to be created in these countries."

Getting this balance right is challenging, but part of the solution seems to be having strategic options, which enable companies to respond quickly to a fast-changing, volatile environment. By having a foothold in multiple markets, companies can derive benefits and minimize risks through diversification. "We know that the evolution of these markets will not be in a straight line, and there will be a degree of volatility that we have to manage and communicate to shareholders," says Paul Walsh, CEO of Diageo. "We don't want all our eggs in one basket, and we like breadth."

Set a clear long-term vision and purpose

You can't predict the future, but you can prepare for it. An essential part of this preparation is a long-term vision and purpose that unites the entire workforce behind a set of common goals and provides a clear framework to enable consistency of decision-making. A long-term view helps executives manage turbulence because they know that, while they may face any number of issues that will dictate their agenda on a day-to-day basis, the decisions made can all converge in a global strategic direction.

In a world where disruptive change is key to survival, having a long-term vision provides the necessary consistency so that the organization understands the long-term goals. Without a long-term vision, constant disruptive change can appear unplanned or destabilizing, and that can breed cynicism among the employees and "change fatigue." But if there is a clear long-term vision, and an understanding of the need for disruption then employees will be more likely to accept it.

The pace of change means that companies must not only invest for today, but also position themselves for tomorrow as well. This requires constant reinvention because every few years, the environment will be completely transformed. "If you don't find a way to reinvent yourself and predict what the future is going to look like, you're just not going to win in the market," says Patricia Lopez Perez-Ayala, Vice President and General Manager for Eastern Europe at Procter & Gamble.

This balance between short-term decision-making and long-term vision is a critical management capability at a time when the external environment is so uncertain. The rapid pace of change means that companies need to operate in real-time, collecting information constantly, analyzing it and using it to inform their decision-making.

Yet at the same time, these rapid decisions need to be consistent with the longer-term purpose of the company. "We need to respond every nanosecond to issues that affect our business, yet we must also remain focused on the purpose and long-term strategy of our organization," says Bob McDonald of Procter & Gamble. "You can't swing the pendulum too much to one side or the other; you have to stay centered."

Meet the needs of a diverse set of stakeholders

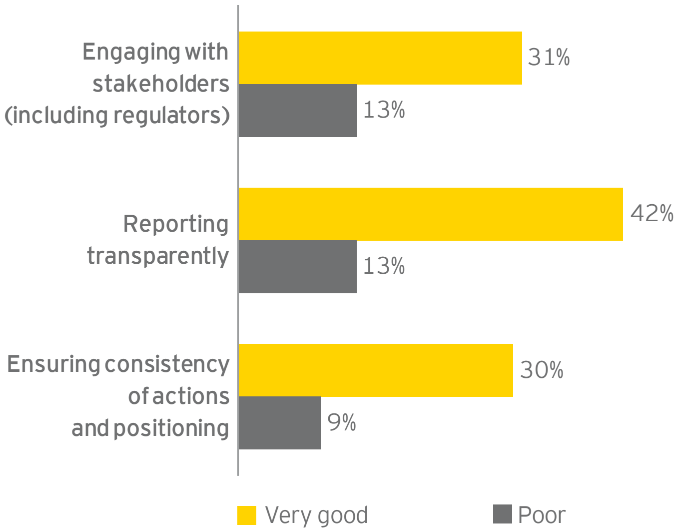
In the brand new order uncompromising stakeholders increasingly present companies with dilemmas. The days when consumer products companies could put the needs of shareholders above all others have long gone. Today, business leaders must balance demands from a variety of different stakeholders, including customers, consumers, regulators, pressure groups, local communities and partners, in addition to their investors.

While the expectations of stakeholders may sometimes converge, at other times they may not. This means that decisions may at times favor one stakeholder over another, and the role of the business leader becomes one of ensuring that strategic decisions do not disproportionately impact one stakeholder over another.

Reframe strategic choices

Our survey respondents admit that this is a tricky balance to get right. Just under one-third say that they are very good at engaging with stakeholders (see Chart 4). But this figure varies significantly from region to region and among companies of different sizes. Almost one-half of respondents from North America say that their company is very good at engaging with stakeholders, but among those from Europe and Asia-Pacific, this proportion falls to 25% and 23% respectively. Larger companies also say that they are much better at stakeholder management, with 41% of those from companies with annual revenues of greater than US$1 billion rating themselves as very good compared with just 24% among those with revenues below that threshold.

Chart 4: How would you rate your company's performance in each of the following areas?



Across every stakeholder relationship, the critical component is trust. "We live for our consumers, so we need constantly to be building levels of trust everywhere where we operate," says Paul Bulcke of Nestlé. "We do that every day through the 1.2 billion products that we sell, but we also build trust with other stakeholders by engaging them in discussion and ensuring that we are part of the fabric of society. The most dangerous thing for a company like ours is to lose trust."

Building and maintaining trust requires a high degree of transparency. Companies must be absolutely clear with investors and other stakeholders about the key opportunities and risks facing the business, and be entirely consistent in how they report these. They must also make sure that the impact of strategic choices on different stakeholder groups is clearly communicated. A recent study from Ernst & Young on how organizations manage stakeholder confidence found that high-performing companies are those that talk in specific terms to their stakeholders.[13]

A greater focus on rapid-growth markets as a source of growth creates different dynamics in stakeholder management. Before selling anything at all, companies must earn their "license to operate," which may involve building relationships with local communities and assuring governments that the investment that the company is making will be good for society and the economic development of that country, not just the company's share price. "Connecting with society at large requires us to take a long-term perspective," says Bulcke. "When we go into a country, we don't go in there and only stay through good times, we stay through both good times and bad."

[13] *Stakeholder Confidence: telling the right story, the right way, at the right time,* Ernst & Young, 2011.

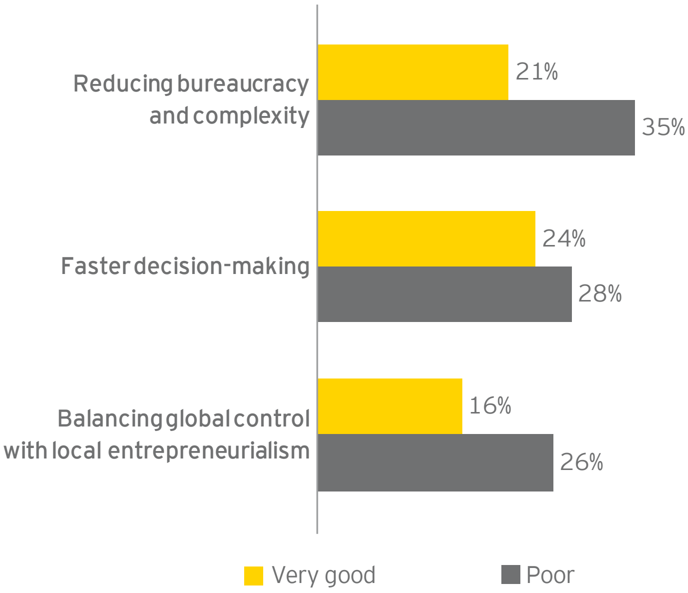
"A disruptive environment forces companies to question legacy approaches to operating models."

Andrew Cosgrove, Global Lead Analyst for Consumer Products at Ernst & Young

Companies must strike a careful balance between global and local

Deciding where to localize and where to centralize has become one of the key decisions for business leaders in the industry. But for many companies in the sector, this remains a challenge. Just 16% of respondents say that their company is very good at balancing global control with local entrepreneurialism, and more than one-quarter admit that they are poor at it (see Chart 5).

Chart 5: How would you rate your company's performance on each of the following factors?



On one hand, companies need to tailor their offering to make sure that products meet the nuances of the local market. A cookie-cutter approach of transplanting products from one part of the world to another is unlikely to work. "We believe that customization is key and a source of competitive advantage to us over the long term," says Sunil Duggal, CEO of Dabur. "For that to happen, we need a local supply chain because you can't have a global supply chain with highly customized local offerings."

At the same time, companies need some degree of standardization, both to make sure that their overall purpose is consistent across markets and to derive economies of scale where they are available. Companies like Heineken have shifted over the past few years from being fully decentralized to considering how and where certain activities can be aggregated and run from headquarters. "Ten years ago, we were totally decentralized," explains Heineken CEO Jean-François Van Boxmeer. "Today, purchasing, IT, accounting, treasury management and management of the global brand Heineken is done centrally. But this centralization does not imply bureaucracy. Technology allows you to do things in a more global way. Everything that is not global is local by definition. If you give clarity to people, then it can work."

Reframe strategic choices

Finding ways of capturing the benefits of decentralization and local execution within the parameters of a unified purpose has become essential to success. Consumer products companies need to combine the dynamism of a start-up in the local markets with the capabilities of a large company. "With the right people in place, who are encouraged to think creatively, we can have a company that is sizeable and complex but still benefits from a lot of individual initiatives and entrepreneurship," says Nestlé's Bulcke. "At the same time, we have a set of common tools that are used worldwide to build the best brands and drive waste out of the system. These common tools and our single strategic 'road map' are what makes the complexity manageable."

Whatever approach a company takes, it is vital to be clear and consistent about where responsibility for decision-making rests. Everyone in the organization must understand where accountabilities lie, and there must be a consistent approach to determining which activities should be conducted locally and which should be the responsibility of the headquarters. "Received wisdom about the pros and cons of local versus global should be challenged," says Andrew Cosgrove, Global Lead Analyst for Consumer Products at Ernst & Young. "A disruptive environment forces companies to question legacy approaches to operating models, and although change is never easy, it may help to simplify decision-making in a complex world."

A greater shift toward local execution will require an evolution of the capabilities required to be a successful manager. One of the key characteristics of the brand new order is the need for a new style of leadership to respond to a fast-changing environment. Companies need managers with the agility to make decisions in response to local stimuli but who are also aligned with the broader purpose and vision of the organization.

"Increasingly, the need to respect variations in local execution is causing consumer products companies to re-examine the role of the corporate centre," says Oliver Wright, Advisory Partner at Ernst & Young. "Companies should focus corporate resources tightly on the areas where they can add distinctive value such as coordinating and orchestrating resources globally, ensuring that local managers have the right capabilities to meet the needs of local consumers and customers, and facilitating the free flow of best practice from one market to another."

"Increasingly, the need to respect variations in local execution is causing consumer products companies to re-examine the role of the corporate centre."

Oliver Wright, Advisory Partner at Ernst & Young

Questions for management:

- How can we ensure we have both the appetite and ability to disrupt entrenched ways of working?
- Are our management reports and forecasts providing insights into "why" and not just "how, what, when and where"?
- Which markets, customers and segments do we need to invest in now to position ourselves for the future?
- How can we leverage global scale and scope while ensuring in-market execution is uncompromised?
- How do we take into account the needs of all stakeholders as part of the strategic decision-making process?

Realign the value chain

Key challenges identified by senior executives

Social media is shifting control of brands to consumers, but companies have not yet adapted to this transition.

- Just over half think that social media is transforming the relationship between manufacturer and consumer.

Shortages of key commodities will require companies to rethink their sourcing strategies.

- Availability and cost of raw materials is rated as the No. 1 risk.
- Six out of ten agree that it will become increasingly necessary to secure long-term supply of critical resources and commodities, including water.

A multichannel world poses unprecedented supply chain complexity.

- Almost two-thirds agree that routes to market are becoming more complex.
- Only just over one-quarter say that their company is very good at creating a lean and agile supply chain.

1/2 think that social media is transforming the relationship between manufacturer and consumer

6/10 agree that it will become increasingly necessary to secure long-term supply of critical resources

2/3 agree that routes to market are becoming more complex

As companies expand their geographical footprint and manage a proliferation of channels across retail, digital and direct-to-consumer, they inevitably face a dramatic increase in complexity across the value chain. Companies must create and manage demand for a huge number of products, brands and SKUs across multiple markets. They must work with a complex network of external suppliers, who may themselves depend on a web of second-tier suppliers. And they must make sure that they build strong collaborative relationships with consumers, suppliers and customers.

Value chains must be resilient enough to withstand shocks but agile enough to respond quickly to sudden or unexpected change. And with margins under pressure, companies must also make sure that their value chains operate efficiently. Respondents to our survey recognize the need for improvement in the management of their value chain. Almost two-thirds agree that routes to market are becoming more complex, but just 26% say that they are very good at creating a lean and agile supply chain (see Charts 6 and 7).

Chart 6: To Percentage of respondents agreeing with statements

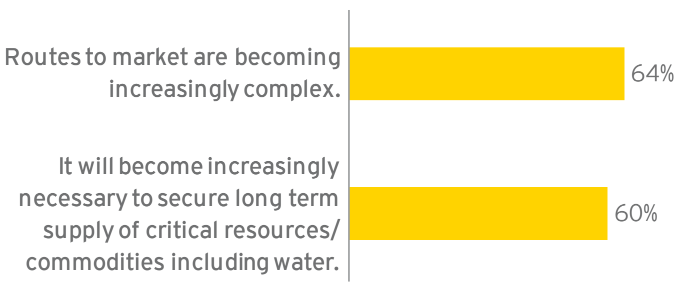


Chart 7: How would you rate your company's performance in each of the following areas?

The increasing cost and scarcity of natural resources adds to the challenge. Wealth expansion in rapid-growth markets will create significantly greater demand for oil, water and other commodities. As this demand grows and supply struggles to keep up, the price of many commodities will soar, leading to greater competition for available resources and placing an even tighter squeeze on margins.

Realign the value chain

Within the next five years, increased cost and scarcity of resources will stretch many operating models in the industry to their breaking point. Asked where they see the biggest increase in risk profile across their organization over that period, the senior executives from the consumer products industry questioned for this report, point to the availability and cost of raw materials as their primary concern (see Chart 8). With operating models under threat, companies may need to adopt radical approaches to the supply chain to make sure that they retain access to key resources.

Chart 8: Top seven risks

1	Availability and cost of raw materials
2	Changing and evolving markets and economies
3	Strong competition
4	Government policies, rules and regulations
5	Decreased profit margins
6	Evolving consumer expectations
7	Access to finance and investment

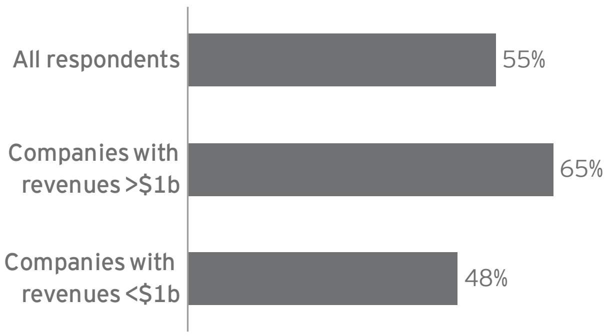
Harness social media to hold profitable conversations with customers

As part of the brand new order, consumer products companies are no longer in control of their brand. The days when marketing managers could pinpoint a brand's product positioning using a series of carefully targeted television and radio advertisements are over.

While companies must continue to seek to determine the positioning of their brands, they must be willing to adapt their messaging based on consumer reaction. "Previously companies could rely on a level of control in the way they pushed messages out to consumers through static mediums such as TV and print. Today, as a result of the rise of social media, the way messages are received and subsequently perceived by consumers is far harder to control," says Joanna Henderson of Ernst & Young's Global Consumer Products Advisory practice. "Marketers have to continuously monitor how their consumers are engaging with their brand, and based on these reactions, fluidly adapt their messaging across all media."

Social media channels are having an increasingly important impact on the consumer goods industry. Just over half of respondents agree that it is changing the traditional relationship between manufacturer and consumer (see Chart 9). Respondents from companies with revenues in excess of US$1 billion are particularly likely to agree with this statement.

Chart 9: To what extent is the traditional manufacturer/ consumer relationship changing due to social media?



Social media outlets offer instant feedback when consumers express their approval, or displeasure, with a brand. The collective power of these channels gives consumers much greater influence over brand decisions than was possible in the past. This can be very advantageous to those companies able to leverage engaged consumers as brand ambassadors and contributors to product development. However, social media can also be very dangerous as problems can be magnified and go viral very quickly.

Rather than view social media as an unstructured "Wild West" where brand managers have no control over what is expressed, consumer products companies should see these new media channels as a powerful opportunity to embed entirely new marketing approaches that allow them to conduct conversations with consumers and harness that information to improve their products.

In the United States, consumers already spend more time using the internet than they do watching television. And yet the marketing budgets at consumer products companies have not evolved with this shift. Companies spend just 14% of their advertising budget on the internet and 34% on television advertising.[14] Traditional marketing channels may still be important, but they are losing their potency, and consumer products companies need to entirely reframe their thinking to keep pace with the disruptive changes taking place in the media landscape.

Part of the problem may be an innate conservatism. If something has worked in the past, such as television commercials, then marketing departments have an in-built reluctance to try something new. The upshot of this conservatism is that marketing departments are at times no longer leading consumers, but following them. "Marketers may worry that something like social media, while exciting and new, might not deliver the results," says Achal Agarwal, President of the Asia-Pacific region at Kimberly-Clark.

This resistance to change highlights the importance of tools that can track the performance of social media and determine return on investment. "By quantifying the impact of social media and other channels, marketing departments will have greater confidence to reallocate and justify their budgets," says Mike Sills, EMEIA Consumer Products Leader at Ernst & Young. "Companies need to understand the extent to which social media referrals lead to revenues and how the value of conversations on channels like Facebook contribute to their brand equity."

Consumers clearly want to have a conversation with brand owners, but there are no hard and fast rules about how brand owners can leverage social media. Constant experimentation and an ability to learn quickly from mistakes are essential. Companies should be ruthless in canceling ideas that do not work and building on those that do.

[14] US Interactive Marketing Forecast, 2011 to 2016, Forrester, August 2011.

"Today, as a result of the rise of social media, the way messages are received and subsequently perceived by consumers is far harder to control."

Joanna Henderson, Global Consumer Products Advisory at Ernst & Young

Realign the value chain

The successful deployment of social media will also depend on building the capabilities and making sure that marketing teams around the world are equipped with the right skills and resources. Rather than enabling local teams to adopt their own approaches, some leading consumer products companies are developing these capabilities centrally. Local managers can then draw on this knowledge to execute their own market-specific campaigns.

For example, on digital Nestlé has set up an acceleration team to build capabilities and provide a platform to establish leading practices around the world. "We don't want to have to reinvent the wheel in every market, so it makes sense for us to develop this centrally and then bring that expertise to markets with the knowledge that they have acquired," says Nestlé, CEO Bulcke. "The markets then can tap into that best-practice library or consult with people who can help them."

Develop a multichannel strategy that is customized to the needs of the shopper and customer

The trade landscape is changing. In mature markets, the hypermarket model is in decline, and there is a steady shift toward smaller convenience stores. In the past three decades, for example, the number of convenience stores in the United States has more than doubled from just over 70,000 to almost 150,000.[15] But despite these headline trends, the underlying picture is one of complexity, with different retail chains adopting divergent approaches to the composition of their store formats.

"It's hard to predict where retailers will go," says Enrique Calvo, CFO for Brazil at Procter & Gamble. "In the past we have expected them to go one way and then they veer in another direction, so the key is to be strong and win across all channels. Our vision is to spread strength and balanced growth in all areas. We cannot forget any angle."

In addition to dealing with a complex bricks-and-mortar retail infrastructure, companies must also manage other fast-growing channels, including e-commerce, direct-to-consumer and mobile. Managing these channels, which all have different dynamics and characteristics, introduces new layers of complexity in trade fulfillment. As new retailers emerge or expand their business, consumer products companies need to follow and make sure that they remain relevant to those customers despite their changing focus and priorities. "We've got to figure out ways to remain ubiquitous in distribution," says Jim Dwyer, CEO of Michael Foods.

The growing complexity of the trade environment emphasizes the need to focus on the brand, not the category. Shoppers are increasingly influenced through word of mouth or social media recommendations, and then they locate that product across a proliferation of both online and offline channels. In category management, growth is achieved through pricing and promotions, but in a world where the brand is king, companies can achieve more sustainable growth by building brand equity and optimizing price management.

[15] National Association of Convenience Stores (NACS), 2012 http://www.nacsonline.com/NACS/News/FactSheets/Pages/default.aspx, (accessed 1 June 2012).

"Segmentation of the supply chain provides an important means of managing channel complexity. By splitting the portfolio into products with low-, medium- and high-value margins, companies can create differentiation in the supply chain and routes to market that are appropriate for each type of product."

Mark Yeomans, EMEIA Supply Chain Strategy Leader at Ernst & Young

As companies respond to changing consumer preferences, they need to reconsider how they manage their supply chain. It is clear that a one-size-fits-all approach to managing the customer will no longer be appropriate. Companies should tailor consumer propositions by store format and measure performance across these channels. Because different channels are not created equal, companies should differentially invest with customers that have the most room and means to grow. Collaboration with customers can also be a powerful tool to achieve mutual benefits. For example, consumer products companies can share insights about how shoppers purchase and use their products, allowing retailers to position and sell them in the most effective way. Lessons from one retailer relationship can often apply to another, so companies can adapt successful models across different markets where there may be customers with similar characteristics.

Segmentation of the supply chain provides an important means of managing channel complexity. "By splitting the portfolio into products with low-, medium- and high-value margins, companies can create differentiation in the supply chain and routes to market that are appropriate for each type of product," says Mark Yeomans, EMEIA Supply Chain Strategy Leader at Ernst & Young.

For example, low-value products may have a higher degree of standardization, high-speed lines and an increased focus on efficiency. Higher-value products may require a more tailored approach to suit the expected degree of customization and specialization. In this manner, supply chain resources are allocated to the products and channels that matter most.

Maximize manufacturing flexibility to achieve both efficiency and security of supply

Globalization and technology have enabled companies to drive economies of scale. Many large companies have sought to gain cost advantages by centralizing procurement globally or reducing the number of suppliers. This reduces complexity, but it also exposes companies to greater risk and potential supply interruptions.

Rising oil prices are a key factor because they make it much more expensive to transport goods over long distances. Increased shipping costs can quickly erode the savings that may be generated by manufacturing in a low-cost jurisdiction, such as China. According to one estimate, if China's currency and shipping costs were to rise by 5% annually and wages were to go up by 30% a year, then by 2015, it would be just as cheap to make products in North America as to manufacture them in China and ship them to North America.[16] And as demand for oil increases against a backdrop of rising concern about climate change, companies will increasingly start to question both the economics and ethics of their global supply chains.

More broadly, security of supply will become an increasingly important factor driving sourcing decisions because commodities, including water, will become increasingly scarce and unevenly distributed. Six out of 10 respondents agree that it will become increasingly necessary to secure long-term supply of critical resources and commodities, including water (see Chart 6).

Shifting to a regional supply chain model can help to offset rising shipping costs and enable companies to react more quickly to changes in consumer demand. It means that they are better able to customize products locally so that they are tailored to specific markets. It increases security of supply because companies are less dependent on a more concentrated supplier base.

[16] "The end of cheap China," *The Economist website,* www.economist.com/node/21549956, (accessed 1 June 2012).

Realign the value chain

> "Nano-factories give us flexibility to start operating in these markets without the need for large capital expenditure."
> **Pierre-André Térisse,** CFO, Danone

There may be tax advantages, too, because there is less need for components or commodities to cross borders and incur customs duties. "Companies with complex supply chains that have components crisscrossing borders multiple times can incur significant tax liabilities," says Julia Maximovskaya, Global Consumer Products Tax Leader at Ernst & Young. "This highlights the importance of considering the tax implications of supply chain management and making sure that these are regularly revisited to take into account legislative and regulatory changes."

In rapid-growth markets, there may be a requirement for greater vertical integration because the supplier network may be less developed. Heineken, for example, is much more involved in the upstream agricultural aspects of its supply chain in a market like Africa than it would be in Europe, because the agricultural supply is less developed. "In this way, we make a contribution to the development of that country as well as to our own company," explains Heineken CEO Mr. Van Boxmeer.

The size of the potential market will make a big difference in how a company customizes its supply chain to meet local market needs. For example, Danone has created small "nano-factories" in some rapid-growth economies that are designed to reduce the entry costs in markets where it may not make sense to invest in large-scale manufacturing capacity. This enables the company to serve markets where there are consumers with very low purchasing power and where the economics would preclude the construction of a large factory. "Nano factories give us flexibility to start operating in these markets without the need for large capital expenditure" says Pierre-André Térisse, CFO for Danone.

Another factor is the availability and scale of potential partners to collaborate with. Consumer products companies are increasingly looking for collaborative opportunities that create win-win outcomes for both parties.

Questions for management:

- How can we ensure we keep pace with the rapid expansion of digital marketing and the social media revolution?
- How are we turning shopper data into insights and shopper insights into practical actions?
- How will increasing competition and cost of natural resources affect our margins and business?
- How are we exploring potential synergies with other players in the value chain to create value?
- How could a segmented supply chain help us manage complexity?

Ruthlessly execute to capture value

Key challenges identified by senior executives

Aligning execution with strategy remains a major challenge.

- Just 30% say that they are very good at making sure that there is a clear strategy and that resources are aligned behind it.
- Just 25% think they are very good at making sure the company's strategy is understood internally.

Maintaining margins demands a continuous focus on cost and efficiency.

- Almost 50% say that they spend more than 25% of their time on margin improvement.
- 37% say they are poor at increasing the pricing power of brands.
- Efficiency and productivity programs are expected to deliver the most positive margin improvement in their company over the next 10 years.
- Just under 33% say that their company is very good at increasing efficiency or productivity, although only one-quarter offer the same assessment of their ability to reinvent processes to reduce cost.

Talent remains the key barrier to effective execution.

- Talent and capabilities are considered the most significant barriers to executing strategy.
- Just 20% say that they are very good at attracting and optimizing talent and resources.

Only **25%** think they are very good at ensuring the company's strategy is understood internally

37% say they are poor at increasing the pricing power of brands

Just **20%** of respondents say that they are very good at attracting and optimizing talent and resources

Meeting the needs of uncompromising stakeholders against a backdrop of proliferating channels, rising costs and constant change requires a laser-like focus on execution. With competition becoming more acute across both mature and rapid-growth markets, the difference between success and failure frequently comes down to how a company implements its strategic vision.

Business leaders must make sure that strategy and implementation are completely aligned, establishing resources that will enable strong performance to be delivered consistently. Companies need an operating model that will support agility, a ruthless approach to costs and a strong focus on continuous improvement so that the organization is constantly learning and evolving. "You can get all knotted up and try to get a perfect strategy but then forget that there's very rarely perfect execution," says Michael Foods CEO Dwyer. "A good strategy executed in a great way is really much more effective than a great strategy with good execution."

Great execution starts with a clear strategy that is communicated consistently across the organization. It also depends on having the right people in the right roles, rigorous controls frameworks and robust performance management processes so that decisions are aligned with the company's overall goals. "Execution is the only strategy that the consumer and the competition see," says Procter & Gamble's McDonald. "It starts with strategy, systems and culture, and if you get those things right, that will go a long way towards helping with your execution."

Strongly align the strategic vision with the resources and capabilities required for implementation

A management team can spend weeks or months formulating strategy and considering how key decisions should be made in the face of significant uncertainty. At that point, it's up to the business to implement that strategy and make sure that day-to-day decisions are aligned with the organization's overall goals.

Every day, managers make thousands of decisions in markets around the world that may have very different business environments and dynamics. These decisions must be appropriate for the market and conditions, as well as consistent with the company's long-term goals. The rapid pace of change exacerbates the problem because it demands quick responses from managers who may be many thousands of miles away from the corporate headquarters.

This need for agile decision-making requires a new set of capabilities from local managers. Rather than respond to a top-down approach to management, they must operate more autonomously but within parameters set by the corporate headquarters. In much the same way as a herd, managers around the world must operate with a shared purpose and be able to sense and respond to danger instinctively.

In large global companies, enforcing consistent strategic alignment is a major challenge. Among our respondents, just 30% say that their company is good at creating a clear strategy and aligning resources behind it (see Chart 10). Making sure that there is a common understanding is even more problematic, with just 23% agreeing that their company's strategy is understood internally and that behavior across the business reflects it.

Ruthlessly execute to capture value

"A good strategy executed in a great way is really much more effective than a great strategy with good execution."

Jim Dwyer, CEO, Michael Foods

Chart 10: How would you rate your company's performance with regards to each of the following statements?

The communication of strategy throughout every layer of the company is an essential first step toward alignment. Richard Smucker, CEO The J.M. Smucker Company, explains that his company has a strategy book that is shared with every employee in the company and updated annually so that everybody fully understands the company's strategy for the year and its long-term goals. "You can have a great strategy and a great group of people, but you've got to implement on a day-to-day basis," Smucker says.

Clear communication helps to establish common goals for managers around the world to work collectively toward. Often, the barriers to execution come down to simple miscommunication issues. "If you have one team working on one project and another working on something similar but slightly different, then you haven't got the full power of the organization behind you," says David Haines, CEO of Grohe. "Once you have complete alignment, then there is no obstacle that you can't unblock."

Business leaders need to be visible and available to managers around the world. This often means a huge amount of travel, but it is only by visiting markets that senior management can gain confidence that what is being implemented makes sense. "We spend a lot of time visiting markets and talking to our managers around the world," says Jean-Jacques Guiony, CFO of LVMH. "This helps us to get local feedback quickly so that, if we do need to change our policy or strategy, we have the information to support that decision."

Even if some aspects of the strategy need to be changed in response to an unexpected shock or event, consistency remains critical so that managers understand the behaviors that are expected of them. "Consistent communication is essential," argues Kimberly-Clark's Agarwal. "When our CEO stands on stage and talks about initiatives, there's no element of surprise. It's exactly what you expect to hear, but each time we take a big step forward. People realize that this is the way that we manage, and they get used to operating in the same way."

Although the soft side to alignment is essential, companies must also rely on data and information to make sure that the right day-to-day decisions are being made. "Business analytics can help to support decision-making and give managers confidence that their choices are both appropriate and aligned with the overall strategy," says Patricia Novosel, Deputy Global Consumer Products Leader at Ernst & Young. "But increasingly, companies need to look beyond the internal data generated by their enterprise resource planning systems to data that originates from external sources, including electronic point-of-sale systems and the unstructured information that populates social media."

In a highly complex, fast-changing world, this may be more valuable than data that is stored internally because it can provide earlier warning of important trends or changes in consumer or customer behavior. "You can't forecast the future with certainty, but what you can do is create a learning organization that operates in real time using digital technology that can react to changes with greater efficacy and greater efficiency than an organization that doesn't," says Procter & Gamble's McDonald.

But given the massive expansion in data being created, focusing on the right information is a significant challenge. Albert Einstein once said that "not everything that counts can be counted — and not everything that can be counted counts." This remains as true today as ever, but for consumer products companies that find the tools to analyze this proliferation of data in a way that supports their decision-making, the outcome will be much stronger alignment between strategy and execution.

Performance management systems are also essential to set the parameters for decision-making. By putting in place key performance indicators that measure progress toward achieving strategic goals, business leaders can set expectations, measure progress and identify problems with execution. "Everybody involved in a project needs a common language and identifiable goals," Smucker says. "It's important to be very disciplined about tracking performance toward those objectives using red, green and yellow indicators. If somebody misses a deadline or misses a goal, we learn from our losses, but we also celebrate our successes."

Maintain a focus on efficiency but prioritize value creation

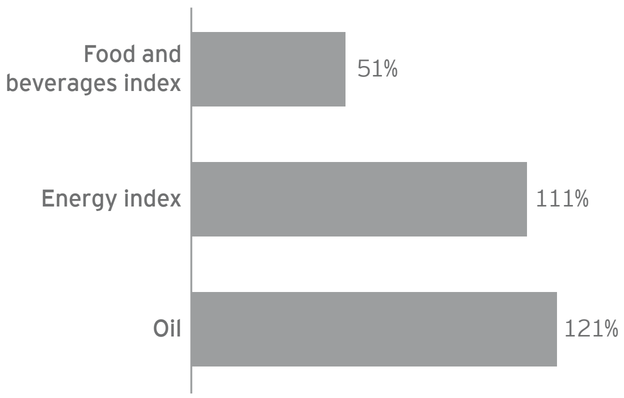
Consumer products companies remain under strong pressure to improve efficiency and productivity. Structural cost increases are placing significant pressure on historic margin levels. Since January 2007, the cost of food and beverage commodities has increased by 51%, energy by 111% and oil by 121% (see Chart 11). At the same time, companies face downward pressure on prices from more value-conscious consumers who have become more resistant than ever to price increases.

Ruthlessly execute to capture value

"Every single consumer products company has potential to take cost out."

Ed Hudson, UK and Ireland Consumer Products Leader at Ernst & Young

Chart 11: Percentage increase in commodity prices since January 2007

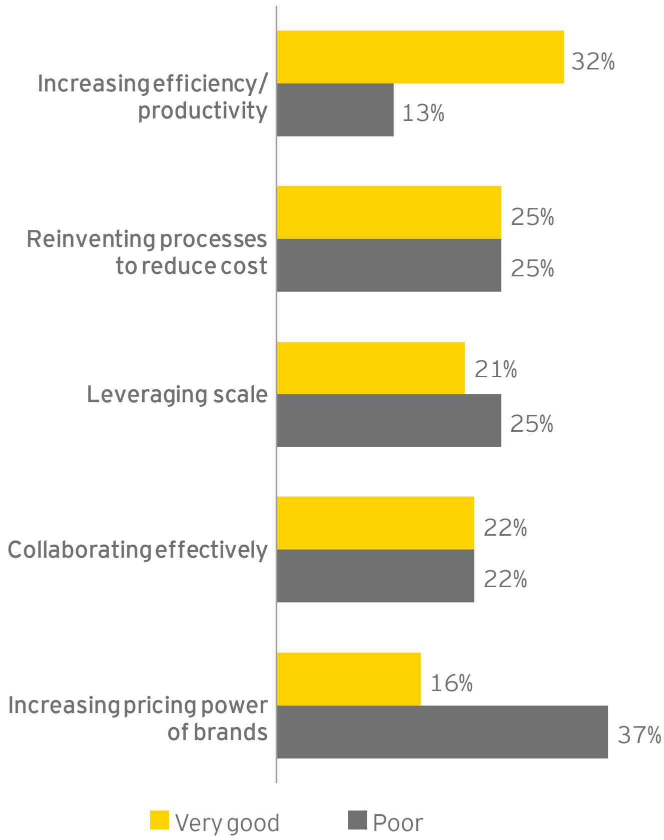


Source: IMF -http://www.imf.org/external/np/res/commod/index.aspx, accessed 10 April 2009

Margin improvement is an issue that is top of the management agenda. Almost three-quarters of respondents agree that significant changes are needed to sustain current margin levels (see Chart 1). And almost half of business leaders say that they spend more than 25% of their time on this issue alone.[17]

Again, this is another area where improvements are needed. Just under one-third of respondents say that their company is very good at increasing efficiency or productivity, although only one-quarter offer the same assessment of their ability to reinvent processes to reduce cost (see Chart 12). "Every single consumer products company has potential to take cost out," says Ed Hudson, UK and Ireland Consumer Products Leader at Ernst & Young. "It should be an ongoing and iterative process, and it should be one of the top priorities every year."

Chart 12: How would you rate your company's performance in each of the following areas?

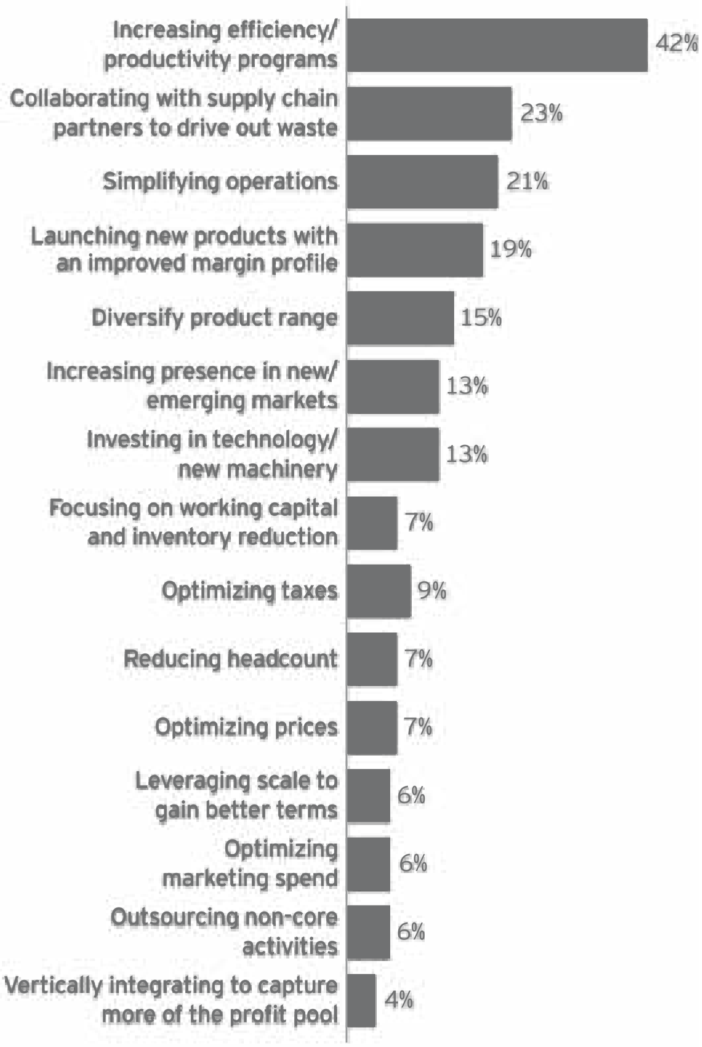


[17] "Brand new order," global consumer products executive survey, Ernst & Young, 2012.

Nestlé's Bulcke agrees, arguing that a focus on efficiency should form part of a broader culture of continuous improvement. "Driving out waste and costs and continuous excellence has to be a permanent thing because every organization tends to allow back inefficiency over time," Bulcke says. "This is a very positive dynamic because it empowers people in an organization like ours to be part of value creation."

Asked which margin-accretive activities or investments they expected to deliver the most positive margin improvements in their company, respondents point to efficiency and productivity programs as the leading candidate. But they also recognize that gains can be made from collaboration with the supply chain to drive out waste, simplify operations and launch new products with an improved margin profile (see Chart 13).

Chart 13: Looking ahead over the next 10 years, which three margin-accretive activities or investments do you expect to deliver the most positive margin mix improvements in your organization?



Ruthlessly execute to capture value

"You have to be very surgical in understanding the cost that you wish to optimize and the cost behind which you are prepared to invest."
Paul Walsh, CEO, Diageo

This focus on efficiency will undoubtedly remain extremely important, but companies need to think carefully about where savings can best be made. Segmentation of the product portfolio into value for money and more premium products can provide a useful framework for helping companies to prioritize where cost-cutting efforts should be targeted.

A focus on eliminating costs that consumers do not value helps to provide a framework for determining where efficiencies can be made. Equally, if cost-cutting does have an impact on products, then companies must be extremely careful not to jeopardize quality, affecting only the parts that consumers do not value. "If you change the product, the only reason should be because that is what consumers want," says Heineken's Van Boxmeer. "You should never do so just to meet quarterly earnings."

Ultimately, however, efficiency is just one way of preserving margins, and arguably not the most effective. A more powerful solution is to build brand equity to improve pricing power. By focusing on how greater value can be delivered to the consumer, companies can charge a premium for their products and not be forced into an endless cycle of cutting. "You can't afford to be complacent around your cost base, but at the same time, not all cost is bad cost," says Diageo CEO Walsh. "So you have to be very surgical in understanding the cost that you wish to optimize and the cost behind which you are prepared to invest."

Surprisingly only 7% (see Chart 13) of leaders cited price optimization as one of the top three activities expected to deliver margin mix improvement. Faced with value conscious consumers and retailers reluctant to raise prices, just 16% of companies feel confident in their ability to increase the pricing power of brands (see Chart 12). 37% rate their performance as poor. This makes it critical for companies to extract maximum value from current price levels.

Companies can also maintain discipline on pricing by optimizing their trade spend. There are two key approaches to this. "Companies can either get the same from less trade spend by reducing investment in non-strategic areas, enforcing existing contract conditions or improving price discipline," says Elaine Parr of Ernst & Young's Advisory practice. "In addition, they can get more from the same by optimizing promotional activities aligning pack price to minimize cannibalization or 'de-escalating' promotions and driving more brand activation through working monies."

Build talent and capabilities to enable the right decisions in a data-rich world

Of all the barriers that can impede execution, talent is by the far the most critical. Without the right people in place to implement the strategic choices that have been made, companies will find it impossible to meet their objectives. "I just cannot overestimate how critical it is to have the right talent and capabilities in place, and how easily lack of talent can become a barrier to growth," says Kimberly-Clark's Agarwal.

Asked about the most significant barriers to executing strategy, respondents point to talent and capabilities as the leading factor by some margin (see Chart 14). Yet despite the importance of talent to successful execution, this remains an area of weakness for many companies. Just 20% of respondents say that they are very good at attracting and optimizing talent and resources – this is a particular problem for smaller companies in the survey (see Chart 15).

Chart 14: What are the three most significant barriers to executing your company's strategy?

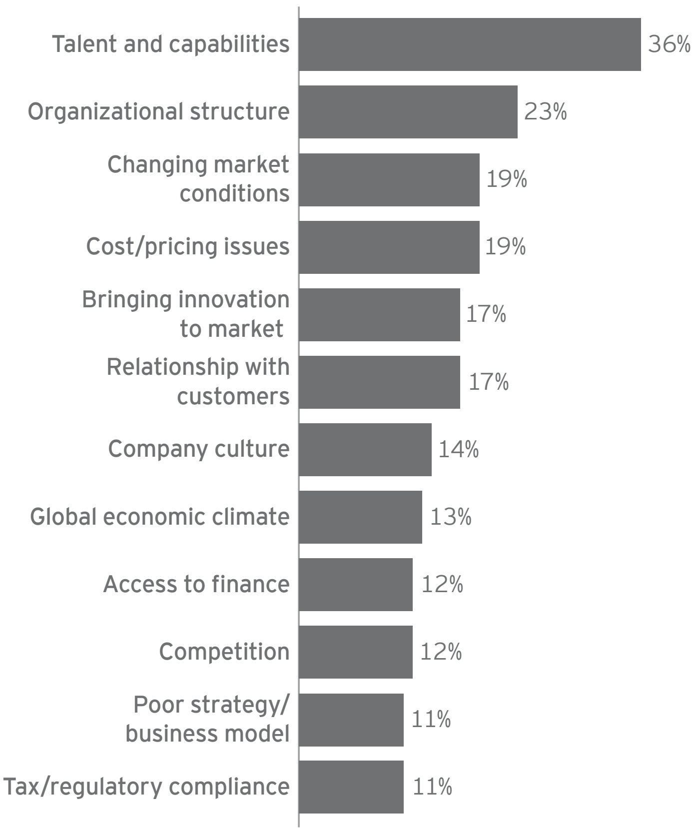
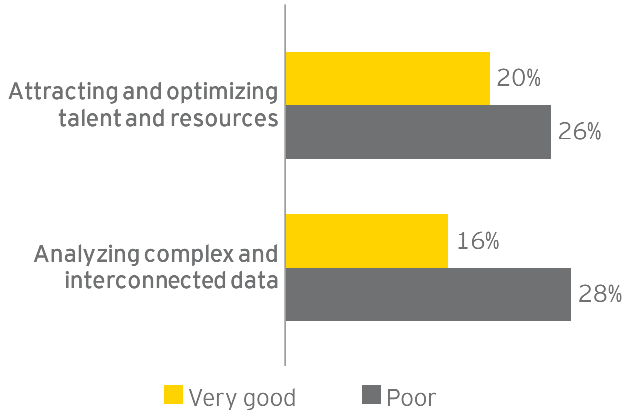


Chart 15: How would you rate your company's performance in each of the following areas?



A key part of the problem is that the capabilities required for success today are quite different from those that were needed in the past. Major shifts in the business landscape – from the rise of rapid-growth markets to the emergence of social media and digital as key marketing channels – require entirely new skills. And those skills may be very different from what managers would have been expected to acquire in the past.

What's more, these changes are happening at an incredibly rapid rate, which means that it is difficult for management skills to keep pace. "The tried and tested management capabilities will no longer be sufficient to enable people to move through the organization, and you can see good examples of that in almost every function," says Paul Moody, CEO of Britvic.

Many companies are also experiencing shortages in the areas where they need them most – the high-growth, rapid-growth markets that will be so important to the future of their business. "The relative supply of talent tends to be much lesser in rapid-growth markets," says Vivek Gambhir, Chief Strategy Officer of Godrej. "One of the biggest challenges is how quickly we can scale up our talent needs in these geographies."

Ruthlessly execute to capture value

Managing in mature markets and managing in rapid-growth markets require very different capabilities. In the former, the emphasis is likely to be on process, efficiency and cost management, whereas in the latter, there may be more need for entrepreneurialism and the ability to overcome challenges, such as lack of infrastructure or uncertain policy.

Diversity of talent is seen as essential. "Diversity is more than a strategic imperative, it's got to be part of our DNA," says Bob McDonald of P&G.

The dramatic shift in talent required to succeed in the brand new order highlights the importance of thinking more radically about how to build talent pipelines of the future. Generation Y employees are much less likely to accept traditional career paths, so companies need to develop highly varied career paths that give managers experience in different markets. By moving between markets with different characteristics, executives will gain more experiences and develop skills that can be transferred from one market to another.

Mobility should encompass moves between functions and as well as regions. By exposing managers to different parts of the business, companies can develop the free flow of ideas and bring different perspectives to functions that can help them keep pace with the rate of change.

The need to generate value and prioritize innovation requires companies to adopt a highly open approach to how and where they source talent. Internal development and training can help to create the capabilities of the future, but it needs to be supplemented with a focus on external recruitment to increase the diversity of thinking.

Companies should also consider a broader pool than they may have in the past to expose themselves to fresh thinking. "Usually we try to hire people either right out of school or within three to five years of starting their employment somewhere else." says Richard Smucker. "Occasionally we see that home grown talent isn't sufficient. We try to identify where we're lacking and then go out in the market to supplement what we currently have."

Some companies have adopted an even more proactive approach. They are tracking the careers of talented individuals from outside the company, even if they are not currently seeking to recruit them. As soon as the right vacancy becomes available, companies can move quickly. "We have a program called 'Map and Track', which selects a pool of people even though we don't have roles for them today," says Gustavo Calvo Paz, President of the Middle East, Eastern Europe and Africa region at Kimberly-Clark. "We track how they are doing in the market, and then as soon as we have a vacancy, we contact them."

Ultimately, consumer products companies need to adopt every approach they can to capture the capabilities they need to build the business of the future. "If you want diversity of thought, you need diversity of talent," says Diageo's Walsh. "Operating in the global arena means that we can access people from very different cultures and hopefully learn from each other. You need to have a hallmark of quality in your employee base that thrives on curiosity, that is prepared to explore new options and that is prepared to do things differently from how they did them in the past."

Questions for management

- How do we ensure our long-term strategic goals are understood internally and behavior across the business reflects them?
- How do we optimize our performance and execution with the talent we have?
- What is needed to embed a culture of continuous improvement?
- How do we make sure that cost-cutting programs do not affect the quality of products or remove features that consumers value?
- How do we "right price" our portfolio to satisfy consumers, trade with customers and maximize our gross profit?
- What capabilities do we need to build to succeed tomorrow as well as today?

How effective is your execution?

In the disruptive environment that is the brand new order, disrupting entrenched ways of thinking, making the right strategic choices and ruthlessly executing are critical to create value for the consumers, capture value for the company and deliver value for the shareholders.

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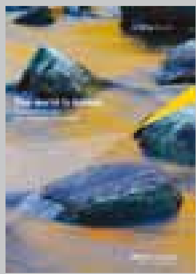
We have selected some of our best industry and issue based reports to help you thrive in the brand new order

Growing Beyond series


The world is bumpy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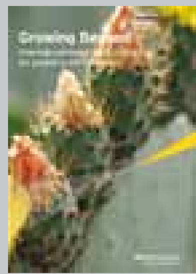
Growing Beyond: how high performers are competing for growth in difficult times


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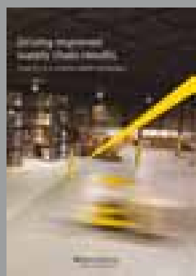
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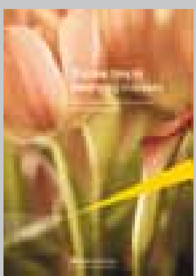
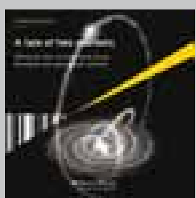
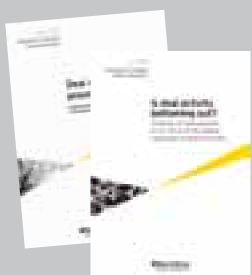

Transacting in emerging markets: critical success factors for consumer products companies


A tale of two markets

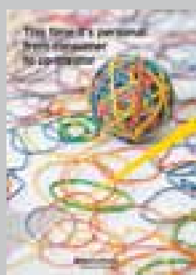
Telling the story of investment across developed and rapid-growth markets


Building profitable retail relationships


Understanding risk: eleven risks for global consumer products companies


Consumer Products Deals Quarterly

A quarterly review of the M&A activity in the sector.


This time it's personal: from consumer to co-creator

Profile of respondents all from the consumer products industry

Region and country

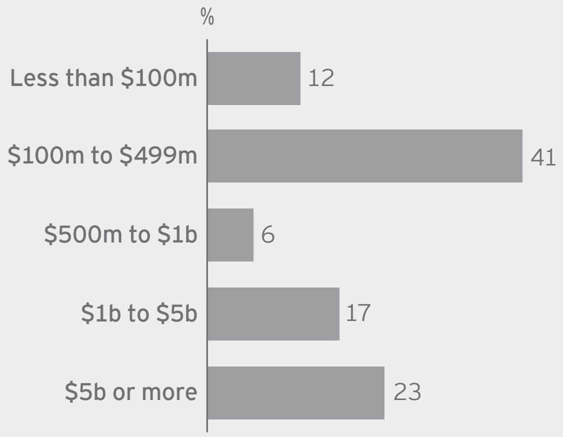
Number of interviews

Europe	**86**
Nordic countries	8
France	10
Germany	15
Italy	10
Netherlands	1
Spain	9
Switzerland	11
UK	16
Ireland	6
South Africa	**5**
North America	**62**
Canada	6
US	56
Latin America	**10**
Brazil	6
Mexico	4
Asia-Pacific	**84**
Australia	9
Greater China	25
India	20
Indonesia	5
Japan	15
South Korea	5
Singapore	5

Base: all respondents (247)

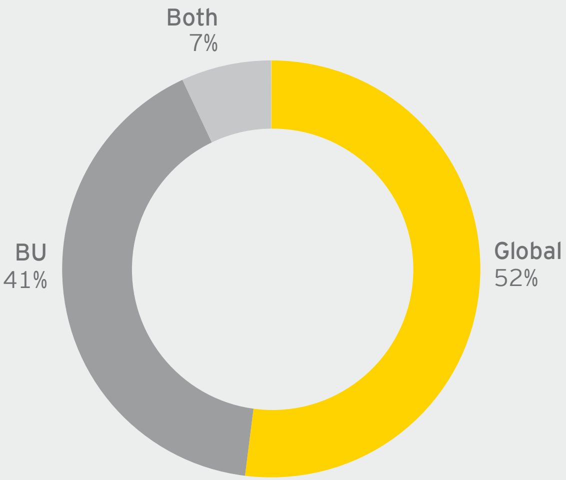
Job titles and revenue

What is your job title?



Respondent perspective

Is your role based in your global/headquarters business or within a business unit/subsidiary of the global business?



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We would also like to thank the following people for their invaluable contribution to the report:

- Mark James for his research guidance
- Rob Mitchell for his interview and writing skills
- Mark Yeomans for his invaluable content input
- Sky Grania Young (and team) for her creativity and design prowess
- Ann Burton for her media direction

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How Ernst & Young's Global Consumer Products Center can help your business?

The global recession has reset the consumer products landscape. Value-seeking consumers, intensified competition, increased commodity costs, and growth opportunities in emerging markets are driving change. Consumer products companies now need to be leaner and more agile, with a relentless focus on execution. If you lead a consumer products business, you need to anticipate trends, identify implications and make informed decisions that support your business goals. Our Global Consumer Products Center enables our worldwide network of over 13,000 sector-focused assurance, tax, transaction and advisory professionals to share powerful insights and deep sector knowledge with businesses like yours. This intelligence, combined with our technical experience, can help you accelerate and improve your execution. We can help you to realize the full value of your transactions, improve customer and brand profitability, drive down costs and build an agile and resilient supply chain. If you want to compete powerfully in your market, we'll help you achieve your potential today and tomorrow.

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