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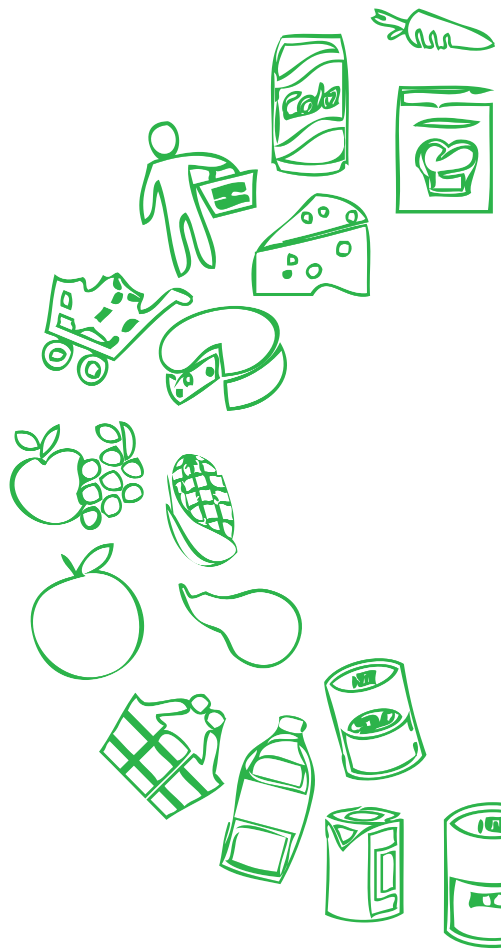
2017 Consumer products industry outlook

Deloitte Center *for* Industry Insights

Introduction



Most companies plan and manage for "business as usual," preventing them from being prepared for what may be around the corner … the unexpected, disrupting forces that can dramatically change the marketplace. Examples include Uber disrupting the taxicab market, Amazon transforming the US book market, and Airbnb reinventing the hotel industry. It's critical for businesses to try to identify potential disrupting forces of today that might impact the business of tomorrow. Deloitte's Center for the Edge's publication, *Patterns of disruption*, identifies five catalysts that drive disruption: **the economy**, **enabling technology**, **platforms**, **consumer mindsets**, and **public policy**.

In the *2017 Consumer products industry outlook* we'll discuss the role played by four of the catalysts that drive disruption in the consumer products industry: the economy, enabling technologies, platforms, and consumer mindset. These catalysts present significant challenges and opportunities for consumer packaged goods (CPG) companies, potentially disrupting traditional operational models: ways of engaging with consumers in a digital environment; supply chain; and hiring and managing talent. CPG companies need to anticipate these catalysts to better position themselves for the future rather than wait for a catalyst to occur, in part because they aren't discrete events, but happen gradually. By the time companies recognize they've been impacted, there's a short runway for corrective action.

The economy:
Will the economy support growth in the consumer products industry?

Capture the momentum of potentially strong consumer spending in 2017, but be prepared to pivot as fundamentals may face headwinds from policy uncertainty.

The economic fundamentals for consumer spending appear to be solid going into 2017. The labor market continues to strengthen, adding an average 181,000 jobs per month in 2016.[1] Disposable personal income was up 3.4 percent in the year ending October, and average hourly earnings are starting to accelerate.[2] As the labor market tightens further, income growth is likely to edge up in the short- to medium-term. Income growth for consumers has come at a time of rising asset prices. House prices have crossed their pre-2008 peaks and key equity indices hit all-time highs in November. This has boosted household wealth, thereby aiding consumer spending. And consumer confidence remains elevated, even after the 2016 election cycle.

The election cycle, however, has created an unusual level of uncertainty about the economy and consumer spending in 2017. Some of the policies suggested by the new administration, such as tax cuts and infrastructure spending, could support consumer spending, but others might create potential problems. In particular, the proposed restrictions on trade could raise prices for imported goods, reducing consumer spending power, and lead to job cuts in export sectors. Proposed policies in other areas, such as health care and housing, could also have significant impacts on consumer spending. The potential for economic policy that leads to a fall in consumer spending power, added to risks in the global economy from China's financial situation and Europe's political problems, suggest some downside risk for consumer spending in 2017.

Key takeaways:

Fundamentals are potentially strong for consumer spending into 2017 and consumer confidence is high, but policy uncertainty may create economic headwinds.

CPG companies need to be prepared to adjust their strategies should these economic headwinds arise.

Enabling technology:
How can CPG companies harness the potential of enabling technologies?

Enabling technology refers to technologies that can be applied to drive radical change in the capabilities, structure, or economics of a business, user, or culture, often opening the door to entirely new business models and practices (that can be challenging to incumbents).

Enabling technologies such as digital technologies, cloud, and in-memory computing can benefit CPG companies in three ways: 1) companies are faster, able to quickly amass data, analyze it, and pivot as necessary; 2) they can operate with more granularity, attaining access to more detailed consumer behavior and retail activity than ever before; and 3) they help companies stay more connected, leading to two-way and real-time communication with customers and consumers.

Further, CPG companies need to be cognizant of the fact that enabling technologies also facilitate new ways of doing business that existing companies may be slow to recognize or embrace, preferring the more comfortable position of applying new technologies to more efficiently execute existing business processes. Enabling technologies also help create a more informed, empowered consumer who has more visibility into options than in the past.

Develop strategies to influence the digital consumer purchase journey:

Deloitte's *2016 Digital influence survey* estimates that $0.56 of every dollar spent in a store is influenced by a consumer's digital interaction with the product over multiple connected devices.[3] A challenge for CPG companies lies in effectively engaging with consumers and influencing their journey on connected devices across multiple touch points, ranging from initial research to the final purchase decision. Unfortunately, compared to other industries, CPG companies have been slower to harness the continued influence of the Internet (which has already disrupted the CPG marketplace) and the emergence of social media as a marketing tool. It's estimated that in 2016, digital ad spend by CPG is 8.7 percent versus retail (at 21.9 percent), automotive (12.7 percent), and financial services (12.2 percent).[4]

Optimize online retailing capabilities:

There's been a continuing shift towards online retailing as the number of consumers skipping traditional brick-and-mortar stores expands. For example, e-commerce sales in 3Q 2016 are estimated to be 8.4 percent of total retail sales versus 7.5 percent in 2015 and 4.6 percent in 2010.[5] Online CPG sales are projected to grow to $36 billion by 2018, up from $8 billion in 2013.[6] Even food and beverage companies are developing solutions to simplify the logistics of selling and delivering perishable items online: E-retail share of food and beverage sales in 2016 is estimated at 2.4 percent of total US e-retail.[7] A challenge is to understand how CPG companies can operate in this channel. While in the past, product placement in a store was crucial, it's also important to manage where the product actually appears on a website.

Manage your brand on today's most trusted source of information—the Internet:

What is significant about the Internet's omnipresence today is its emergence as the most trusted source of information over traditional media channels. According to GfK MRI's *Survey of the American Consumer*, 34.4 percent of US consumers in 2015 listed the Internet as the most trusted media, surpassing traditional media channels. Further, about 80 percent of consumers in 2015 agree the Internet is a great way to gather information about products they are considering, up from 48 percent as recently as 2011. While categories like footwear, apparel, cosmetics, and toiletries have dominated consumer purchasing on the Internet, GfK MRI has recently seen an increase (about 14%-19%) for food & beverage categories such as coffee, tea, and groceries from 2012 to 2015.

Adapt your communication strategies to the digital world:

In recent years advertising budgets have been shifting to include a strong Internet and social media presence. Digital ad spend in the US grew from $2.5 billion in 2011 to an estimated $5.82 billion in 2016 and is projected to grow to $8.7 billion by 2019.[8] The growth in digital ad spending facilitates a 24/7 presence among consumers by engaging them in two-way brand conversations, rather than speaking to them just through advertising. As a result, CPG companies are no longer in full control of the brand message and need to actively monitor and influence these conversations. From an advertising perspective, this poses a new challenge of how to communicate a consistent brand message across multiple media channels, both traditional and digital.

Exploit the potential of social media marketing: Changing the way CPG companies market their products, interactive social media is a newer option for delivering exclusive offers, coupons, and discounts to target consumers. YouTube is just one example of a social media platform with broad influence, accounting for 24 percent of social media traffic.[9] YouTube reaches more 18-49 year olds than any cable network in the US[10] and its appeal is cross-generational: 91 percent of 13-17 year-olds and 81 percent of Millennials use YouTube, but so do 58 percent of Gen X and 43 percent of Baby Boomers.[11]

According to online-video tracking firm Tubular Labs, as of October 2015 YouTube had 17,000 channels with 100,000 or more subscribers and nearly 1,500 with more than a million subscribers.[12] Many of these channels are operated by YouTube celebrities who often endorse products; everything from cosmetics, fashion, diet and exercise, beverages, and technology to travel and entertainment.[13] Approximately 70 percent of YouTube subscribers say that YouTube creators change and shape culture, while 60 percent say they would follow advice on what to buy from their favorite creator over a TV or movie personality.[14]

Explore methods to customize products:
The success of many mass-produced products is based on economies of scale. This approach is being disrupted by new business models that employ delivery of customized individual units. Deloitte's 2015 *American pantry study* found that approximately 42 percent of consumers are interested in technology to customize products, while 19 percent indicate a willingness to pay a 10 percent price premium for them.[15] Even though customization goes against the dominant package goods approach of offering a few high-volume SKUs through large traditional retailers, it will likely be critical for CPG companies to customize both the product and shopping experience.

One example of customization is additive (3D) manufacturing. Deloitte's publication, *3D opportunity serves it up: Additive manufacturing and food*,[16] suggests that additive manufacturing using edible materials allows food makers to explore the customization of their otherwise mass-produced and, in many cases, commoditized products. The benefits of edible advanced manufacturing include product differentiation, product customization, and direct-to-consumer (DTC) relationships. In the future, this may lead to more evolutionary capabilities, such as the creation of unique food formulations for dietary needs, simplified distribution into hard-to-reach locations, and customized medical/nutritional supplements.[17]

Engage your consumers with wearables and artificial intelligence (AI):
A relatively new market segment, wearables incorporate computer and advanced technologies that facilitate unbiased monitoring and data collection. Examples include smartwatches, wristbands, smart garments, chest straps, sports watches, and other fitness monitors. When combined with location-based services, wearables can be a means to deliver coupons, advertising, and product promotions to consumers when they are shopping. Representing an untapped market for consumer products companies, it's estimated that by 2019 about 86 million US adults will be users of wearables. According to a forecast by Gartner, wearable electronic devices will offer revenues of $61.7 billion.[18] In addition, consumer products companies are finding creative ways to capitalize on wearables. For example, a beverage manufacturer has experimented with micro-chip-fitted, smart-cap bottles and sweat patches that digitally provide athletes continuous updates on how much to hydrate, and, thus, use their product.[19]

Similarly, AI in consumer products is gaining ground with creative applications related to product pricing, customer segmentation, and ad targeting.[20] For example, product pricing involves dynamic price optimization that employs machine learning to correlate price trends with sales trends. AI can also align other relevant data, such as inventory levels and category management, to provide estimates of price elasticity and, in turn, optimized margins for manufacturers and retailers. Further, AI can be applied to the enterprise value chain on an end-to-end basis, potentially impacting smart sourcing of products and optimizing inventory levels in real time.

Key takeaways:

As the consumer journey to purchase becomes increasingly facilitated by enabling technologies, CPG companies need to engage and influence consumers at every stage of the process, from research to the final purchase decision. It's imperative to target the right consumer with the right message in the right moment through whatever device they are using.

CPG companies should develop solutions to support the latest trends in brand personalization. This has implications for the supply chain and the talent needed to manage the process in a more complex environment. For larger CPG companies that tend to be structured around traditional lines of business, this will likely mean a learning curve. During this transition, it will be important for companies to be both agile and quick to respond to the consumer and unexpected supply chain issues.

Platforms: Are CPG companies optimizing the potential of platforms?

Broadly defined, platforms help resources and participants become more accessible to each other on an as-needed basis. They can become powerful catalysts for rich ecosystems or resources for participants.

Platforms are closely linked to enabling technologies. Just as CPG companies were late to the party on deploying enabling technologies compared to the retail and travel industries, they are behind the curve on creating platforms specifically for consumer products. As mentioned earlier, one challenge faced by CPG companies is to maintain relevancy in the digital world. This might be achieved through a focused effort on platform development specifically for consumer products. Not to imply this is an easy task, but it could lead to creative, breakthrough solutions.

Focus on developing platform applications specific to CPG: A place to begin might be in consumer products distribution. How consumers access products today is changing by the month. Subscription-based services such as soap.com and drugstore.com are growing rapidly. Consumers no longer need to get dressed and leave their homes to get the products they desire. New apps are continually being developed to facilitate the ordering and delivery of products to the consumer's doorstep at nearly a moment's notice. Since they are disrupting traditional distribution models, CPG companies need to not only stay apprised, but get ahead of the growing trends in subscription services and the on-demand economy. Additionally, platforms that facilitate consumer discussion (through use of enabling technologies) provide consumers with greater visibility into the dimensions of products and services (as well as social issues) that matter most to them.

Key takeaway:

In the digital world, it is imperative for CPG companies to create platforms tailored to their products that facilitate consumer engagement with their products and build off the success of what's happening in the retail and travel industries.

Consumer mindset: What consumer trends influence CPG companies?

Consumer mindset as a catalyst addresses the need for understanding consumers' values, preferences, and expectations that are not fixed or universal and that can be rapidly influenced by developments in adjacent markets or industries.

Consumer behavior and trends are continually developing as the drivers of the purchase decision evolve and consumers become increasingly immersed in the digital world. In addition, the composition of the US consumer population is changing and is increasingly no longer one homogenous group; more significantly, consumers have growing expectations of not being treated as one group and likely won't settle for mass produced products in the future.

Capitalize on evolving drivers in the consumer purchase decision process:
Disrupting the consumer food value chain is an evolving set of drivers that used to be considered niche but are increasingly becoming mainstream. These evolving drivers are health & wellness, safety, social impact, experience, and transparency. Fifty-one percent of consumers in the Deloitte study, *Capitalizing on the shifting consumer value equation*, say that these drivers play a significant role in their purchase decision.[21]

Aligning with our discussion on enabling technologies, consumers who place more value on these evolving drivers tend to be heavy users of social media, mobile apps, and other digital sources in their paths to purchase. They use these tools to give them more visibility into, and be far more informed about, how a product aligns with those drivers, as well as to develop more specific, nuanced preferences around them. A challenge for CPG companies and retailers is to assess where their consumers reside in the evolving value chain and balance the extent to which they still value the traditional value drivers of taste, price, and convenience. Future consumer purchase decisions are likely to be based on a mixture of traditional and evolving drivers.

Ride the wave of consumer immersion in the digital world:
Again, echoing the discussion of enabling technologies, consumers of all ages are becoming increasingly immersed in the digital world and empowered to easily access more information and more perspectives wherever and whenever they want or need to. As a result, they are assimilating media content in new ways, disrupting traditional marketing tactics. This fundamentally changes the way CPG companies deliver content and creates a challenge to attract consumers of all ages to marketing content in the new digital world.

For example, Deloitte's *Digital democracy survey*[22] found that Millennials spend 50 percent of their time watching TV or movies on devices other than a TV—primarily laptops/desktops, followed by smartphones and tablets. And 46 percent of US consumers subscribe to a video streaming service. Of those subscribers, 61 percent value their streaming video service among their top three subscriptions due to the ability to watch whatever they want, whenever and wherever they want.

Digital immersion is not just a Millennial or Gen Z phenomenon; all age groups are joining the ranks of digital users. A recent global study by Nielsen[23] found usage of e-commerce options spread across most age groups with Gen Z (at 28 percent) and Millennials (30 percent) demonstrating the highest usage, but not far behind are Gen X (22 percent) and Baby Boomers (17 percent).

Engage with influential consumer segments: Hispanics, Gen Z, and Women: Hispanic consumers in the US continue to become a driving force in the marketplace. According to the Pew Research Center, Hispanic Americans comprised 17.3 percent of the US population (about 55.3 million people) in 2014 compared to 6.5 percent (14.8 million people) in 1980.[24] Further, the Hispanic population is projected to triple in size and will account for 29 percent of the nation's population by 2050.[25]

While Millennials have taken center stage in the marketing landscape, there's a new segment marketers must understand—Gen Z. Born before 2010 and roughly age 15-21, Forbes estimates Gen Z accounts for approximately 25 percent of the US population, making it the largest demographic segment, surpassing Millennials and Baby Boomers. By 2020 they will account for 40 percent of US consumers.[26] What distinguishes Gen Z is that they are truly digital natives, having grown up with technology, social media, and an on-demand mentality.[27] But growing up during the Great Recession, they differ from Millennials in that they tend to be more conservative and worry about the economy above anything else.[28]

Women continue to be an influential force in the marketplace and CPG companies should maintain and contemporize strategies to address them. For example, in 2013 US women reported having control or influence over $8 trillion (73 percent) of a total household spend of approximately $11.2 trillion. Further, women spend more on shopping trips, contributing about 60 percent of the total amount spent on shopping across different store types.[29]

Prepare for a shift to a global marketplace that's heavily influenced by Asia Pacific:
Just as US demographics are changing, so too are global growth trends. By 2025 the world will look different due to the continued shift from West to East. Asia will be driving the most growth due to urbanization and the burgeoning middle class. Further, many Millennials' attitudes differ in developed versus developing markets impacting regional level strategies targeted to them. This potentially will disrupt the US-centric model that many US CPG companies have followed in the past. A challenge will be to drive innovation in a global marketplace that's heavily weighted to Asia Pacific.

For example, by 2025, 4.7 billion people will live in urban areas, up from 3.9 billion in 2015.[30] Cities in Asia Pacific will account for 448 million people, nearly 10 percent of the global population.[31] Seven of the top 10 global cities by population in 2025 will be in Asia Pacific.[32] The burgeoning middle class in Asia is projected to have a disposable income of $18 billion vs. only $12 billion for North America and Europe.[33] Further, these new markets will drive consumer spending, requiring companies to discover their similarities and uniqueness. For example, in general Millennials in developed versus developing markets differ in their behavior and attitudes.[34] In developed markets, Millennials grew up during the recession and may have less disposable income than their parents. They view frugality and minimalism as a badge of honor and are influenced by ethical consumption. Whereas, in developing markets, Millennials grew up during rapid economic growth. On the whole, they are the richest generation in their nation. They value status and displays of wealth and though they are aware of ethical business practices, they are less influenced by them.

Stay connected to ongoing consumer trends: These demographic shifts are occurring against a backdrop of trends we've discussed in the past and that continue to be relevant: the desire for products reflecting an orientation towards health and wellness, an interest in organic foods, a concern for the environment/sustainability, and a consumer that demands quality and convenience at a good value.

Key takeaways:

- CPG companies should modify their traditional marketing strategies and tactics, developing contemporary messages delivered through cutting-edge, digital platforms in light of the evolving drivers of consumer purchase and consumers' continued immersion in the digital world.

- Due to the shifting composition of the US consumer population and the growing influence of Asia Pacific consumers, CPG companies will need to develop strategies to both understand and optimize innovation and marketing communications that address these trends.

- Enabling technologies is a common thread in the evolving consumer mindset, making it imperative for CPG companies to leverage these advancements to form lasting bonds with younger, connected consumers in all aspects of marketing.

Endnotes

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