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BEING RESILIENT

CPG FIRMS — RETURNING TO THE 90% ECONOMY

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BEING RESILIENT. THAT'S LIVE ENTERPRISE.

The world is slowly starting to open up as many economies pass their COVID-19 peak. But we've been through a tough time. The world economy shrank by 1.3% year on year in the first quarter of 2020, mainly due to a decline of 6.8% year on year in China. In America, the unemployment rate jumped to 14.7% in April, and the number of employees on payrolls fell by 20.5 million.[1] Figures like these haven't been seen since the 1930s. Some say the worst is over. On Wall Street, investors are betting on a rapid rebound in employment, output and profits. Since stocks bottomed out in late March, the Dow Jones index has risen by more than 30%. But this is optimistic. In China, with many still fearful, the rebound has been slow and partial.

Consumer spending has taken a hit, and 44% of Americans are worried about salary cuts, according to Morgan Stanley.[2] Many consumers once interested in luxury purchases now are paying down debt or attempting to recoup some of the income lost at the height of the crisis. A rise in corporate and personal bankruptcies is on the horizon. Moody's Analytics, a research firm, found that investment intentions across all sectors are substantially lower even than during the financial crisis of 2008.[3]

The 90% economy

The world is reemerging, but it won't be the same. If most countries follow in the footsteps of China and people choose to avoid person-to-person proximity of the length of an arm or less, reduction in gross domestic product will be 10% going forward, creating what The Economist calls the "90% economy."

People will stick with what they know and will be afraid of what they don't. Buying fresh, healthy produce, especially from "feel good" artisans, will become more important, and consumers will nest at home with people with whom they have "a stable and enduring emotional link," something the Italian government has called "congiunti."

What this outlook means for consumer packaged goods firms is tricky to characterize going forward. Many have withstood the initial economic shock well, even as discretionary spending has fallen by 50%.[4] For those countries that are coming out of the crisis, CPG firms will have to prepare for staggered easing of social distancing by risk groups, and the opening of retail with "safe stores." Lower spending, more saving, rising hygiene expectations and a continued increase in online spending all loom large. In countries that are already managing in the 90% economy, CPG consumers are more price sensitive, show higher digital engagement and care more about wellness and hygiene.[5]

> Customers will save more and there will be a continued increase in online spending

If there are any lessons to be learned from the financial crisis of 2008, it's that consumer confidence returned in a phased recovery, with Chinese consumers back to prerecession behavior as late as 2017. In the long years after the recession, people ate out less, cut back on nonessentials (two-thirds of U.S. shoppers cut back on luxury goods, while one-third cut back on cosmetics) and bought more products at a discount. They also switched to cheaper brands and private labels while doing more shopping at value retailers.[6]

Going forward, some studies suggest that three to six percentage points of online market share will be "sticky" for CPG firms, driven by those in older generations who have set up accounts with third-party e-commerce providers and grocery outlets.[7] And physical hygiene will be the order of the day for both consumers and employees who work across the supply chain.

What CPG firms need to do now

Brands should consider these implications for their strategy and communications in the next 12-16 months. They must reassess manufacturing processes and packaging as well as emphasize health and cleanliness in marketing messages. They must also increase their social media presence, nimbly connecting with their communities to show they care about people who have been hard hit. For those that haven't made a foray into environmental, social and governance policy, this is the perfect time to make a start.

In the previous recession, 75% of consumers agreed that "corporations should operate in a way that aligns with society's interests, even if that means sacrificing shareholder value."[8] Sensitivity will be key, however. Even though three-quarters of consumers appreciate CPG companies communicating how their brands can meet the need of the hour, a similar percentage were keen to note that brands shouldn't exploit COVID-19 as a commercial opportunity.[9]

CPG firms should also work with grocers to make the economics of e-commerce work. This means having the right processes, the right talent and the right customer segmentation strategy in place. It also means having a fully unified experience across every customer touchpoint, with an ongoing and consistent conversation with the customer. CPG relationships with third-party e-commerce partners should become deeper, with more data exchange or shared warehousing so that new demand spikes can be factored into logistics and product allocation.

Across the board, supply chains will need to become more resilient to both supply and demand shocks. Software-as-a-service solutions from SAP and Oracle can be used to manage inventory and allocations and to predict outages if a second wave of the pandemic occurs.

Members of the workforce, especially those in offices or plants who can't work easily from home, also need to be reassured of their safety. One leading CPG company introduced staggered working hours, plexiglass barriers between workstations and stringent sanitization protocols in its workplaces.[10] This will be the new normal until a vaccine appears, and other firms should do the same.

> This is a chance to test unique offerings that capture niches beyond a firm's current scope

And CPG firms should refocus previous priority growth markets on new behaviors and the economic outlook. It would be wise to prioritize at-home essentials while using marketing channels to rebuild demand for products that customers have held off buying during the pandemic. This is also a chance to test the market for products that are not widely distributed, leading to unique, distinguished offerings that capture niches and demographics beyond a firm's current scope.

With fewer people going to popular gatherings and other entertainment venues, demand for cosmetics will suffer in the long term. Social media will be important to entice the younger generation to buy these sorts of health and beauty goods, taking care to reposition premium offerings and prioritize cheaper brands. Here, a good offline-to-online presence will make all the difference, and capturing and managing data will be increasingly important to deliver precision marketing at lower cost.

One way of keeping a brand top of mind is to reassure customers of the provenance of their products. "Direct to consumer" models work well here while also reducing costs. Such a business model also gives a CPG firm valuable data after a purchase — proving invaluable for innovation, cross-selling, upselling and customer service. To do this, visionary firms can think about creating a network of stores in close proximity to residential areas, launching mobile commerce operations, setting up subscription-based models, or partnering with a third party to operate a new channel or format.[11] Within all this strategic calculus, firms that play it right can also merge or acquire promising players in their distribution networks. This will call for constant market vigilance.

The place of technology

As the market becomes tougher, and digital more relevant, now is the time for CPG firms to push their various digital transformation initiatives to full completion. Machine learning and analytics are a good place to start. Using these tested technologies to understand consumer behavior, demographics and buying patterns in next-to-real time will pay off handsomely. SaaS solutions can be used to build stronger supply chains as well as trust and transparency with partners and customers. Digital learning, governance and collaboration platforms will become highly necessary as remote working plays out for employees in the long haul. With this increased online presence, tougher cybersecurity measures, including two-factor authentication and safe cloud data storage, will need to be introduced.

> Technology can be used to understand customer behavior, demographics and buying patterns in next-to-real time

Though in the short term the onus will be on getting closer to the customer, safeguarding employee health and cutting costs, CPG firms also can start thinking about putting their employees at the center of a hyperproductive business model. As we wrote in a recent article on the purely cognitive supply chain, the CPG firm of the future will be a "live enterprise," using a digital brain (based on artificial intelligence) to sense and respond to market and business data in real time. Everything from predicting what customers will buy to planning how to meet spikes in demand will be guided automatically and proactively.

"The future influences the present just as much as the past," said Friedrich Nietzsche. The economy that emerges from this pandemic will be very different from anything we've ever experienced. While a live enterprise is the zenith for firms of the future, CPG firms still can make emphatic decisions across workforce, customers and operations to ensure their balance sheet grows, even as it rains.


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