

2011 Financial Performance Report Thriving in a Connected World

*Results for the food,
beverage, and consumer
products industry*





Based in Washington, D.C., the Grocery Manufacturers Association is the voice of more than 300 leading food, beverage and consumer product companies that sustain and enhance the quality of life for hundreds of millions of people in the United States and around the globe.

Founded in 1908, GMA is an active, vocal advocate for its member companies and a trusted source of information about the industry and the products consumers rely on and enjoy every day. The association and its member companies are committed to meeting the needs of consumers through product innovation, responsible business practices and effective public policy solutions developed through a genuine partnership with policymakers and other stakeholders.

In keeping with its founding principles, GMA helps its members produce safe products through a strong and ongoing commitment to scientific research, testing and evaluation and to providing consumers with the products, tools and information they need to achieve a healthy diet and an active lifestyle.

The food, beverage and consumer packaged goods industry in the United States generates sales of \$2.1 trillion annually, employs 14 million workers and contributes \$1 trillion in added value to the economy every year.

For more information, visit the GMA Web site at www.gmaonline.org.



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Foreword

The Grocery Manufacturers Association (GMA) and PwC are pleased to present our 2011 financial performance report and overview of the consumer packaged goods (CPG) industry.

The themes of our previous two reports were necessarily dictated by external economic conditions. Our 2009 report was issued in the midst of a major financial crisis and subsequent recession; in 2010 we reported on companies hunkered down amidst an historic consumer reluctance to spend. Today, despite rising commodity costs and uncertain consumer confidence, we are in recovery mode, with CPG companies focused on their growth agenda and looking to international expansion as an opportunity to enhance both the top and bottom lines.

Perhaps it's time, then, to focus not on the macroeconomic picture but on what's become the defining issue for our industry: the digital transformation that is altering how consumers behave, and the enormous ramifications for corporate management and productivity. Within this context, the articles in this year's report are divided into three sections: "Managing the enterprise," "Managing for growth," and "Spotlight on regulation." Preceding those topical sections, the report kicks off with an executive summary, an analysis of top-performing companies (TPC), and a high-level discussion of the year's financial data.

We've used a number of sources to compile our report: interviews with senior leadership of GMA members (including members of the GMA CFO Committee), publicly reported

company financial data, government statistics, analyst reports, and other published material. The manufacturing analyses are based primarily on public information from 148 manufacturers. We would especially like to express our appreciation to the following executives, who participated in the interview process and whose insights appear throughout this report:

Dan Heinrich, *The Clorox Company*

Dennis Hickey, *The Colgate-Palmolive Company*

Jon Moeller, *The Procter & Gamble Company*

Don Mulligan, *General Mills, Inc.*

Bill Schumacher, *Sunny Delight Beverages Company*

Gordon Stetz, *McCormick & Company*

Duane Still, *The Coca-Cola Company*

In addition, we want to highlight the extraordinary contributions of PwC team members Kristin Krogstie, Anbu Mani, and Jonathan Sackstein, as well as Patrick Yost, who guided the development and refinement of all aspects of this year's report.

We hope that you find the report insightful and useful. The GMA and PwC look forward to continuing our dialogue with you around these strategies, topics, and analyses.

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Executive summary: Meeting the needs of the connected consumer

Digitally empowered consumers represent a new global market—if CPG companies can make the connection

Just as “all politics is local,” as the late US Speaker of the House Tip O’Neill put it, most CPG companies have long held that consumer preference in food and other staples is essentially local in nature.

Yet while the nuances of consumer choice may still be largely dictated by geography and culture, the ongoing digital transformation is connecting billions of people worldwide. Empowered consumers from fishing villages in Brazil to the tony suburbs of Manhattan have more tools to demand a greater say in how, where, when, and at what price they make their shopping choices.

The terms used to describe digitally enabled consumer behavior—multichannel, online retailing, mobile shopping—create the impression that this is a different kind of shopping experience than a traditional brick-and-mortar visit. But that’s misleading. To many global consumers, multichannel retail *is* shopping.

With more than 5 billion mobile phone subscriptions worldwide,¹ many developing nations have skipped right over fixed-line technology, making the phone less a voice application than a means for accessing the Internet, transferring money, and—crucially for CPG companies and retailers—researching and purchasing consumer goods, often right at the point of sale. In the United States, digital shopping has become commonplace, with 25% of smartphone owners using the device to shop during the 2010 holiday season, according to the National Retail Federation.² Every day, from office cubicles, airports, and their homes, consumers are buying products via computers and tablets. And they’re not shy about posting their opinions about those products on Facebook, Twitter, and other social media—handing over reams of potential insights to anyone who can find the patterns in the noise.

A key challenge for CPG companies, then, is how to entice global consumers who can connect pretty much anytime and anywhere. Building a global brand used to be as straightforward as deploying a healthy advertising budget. While many CPG companies still spend heavily on television advertising, the new generation of wired consumers often rejects television in favor of web offerings. As Dennis Hickey, CFO at the Colgate-Palmolive Company, notes, “The consumer we are trying to reach is watching much less television these days. Really, the big opportunity is, how do you reach consumers on a digital basis?”

Using digital technologies to manage growth

Beside that big external opportunity, the digital transformation offers CPG companies a second major opportunity: managing the enterprise more effectively and efficiently in order to drive growth.

Just a couple of years ago, digital information meant one thing to senior executives: risk—associated with lost or stolen consumer data, crashing websites, employees surfing the web, or hackers filching intellectual property. While information security will always be a concern, corporate mindsets have changed when it comes to the digital universe.

Companies are no longer just thinking defense. Instead, they are considering how the analysis of digital data can improve their competitive position. For example, PwC’s *2011 Global State of Information Security Survey* shows a three-year trend away from chief information security officers reporting to IT, and toward reporting to the C-suite.³ Information has moved out of the IT silo and into the strategic decision-making arena.

But how is this data actually helpful in managing growth? In two ways. First, it can help to improve all aspects of operations. This report details how companies of all sizes have become more productive and efficient over the past few years. Many did so by harnessing digital technologies, some of which were viewed just a short time ago as strictly consumer-oriented. Today, the mobility provided by smartphones and tablets is boosting productivity at every stage of business.

The second big data opportunity lies in international expansion plans. Currently, CPG companies lack detailed insights about consumers in China and other emerging markets. Many of the norms taken for granted in developed markets—point-of-sale stock-keeping unit (SKU) numbers, predictable pricing models, even accurate information about how to reach a store or when it will be open—cannot be assumed in emerging markets. Connecting with consumers on their own digital terms will allow companies to learn how these markets work.

For example, General Mills is building a proprietary, voluntary database of households. The database will allow General Mills to interact in real time with consumers, and to compile consumer preference information about favorite recipes, preferred retailers, and more. This benefits both General Mills and its retail partners, because, as General Mills CFO Don Mulligan says, “Retailers know in depth the buying habits of the customers coming to their stores. What they don’t have visibility on are customers who aren’t coming to their stores.”

Consumers and employees are more connected and distracted than ever. So it pays to experiment with digital technologies and analytics, in order to arrive at the right mix of external and internal digital initiatives. IT used to be an outpost supporting the rest of the organization. This report shows how central it has become to all aspects of business.

Out of the woods, but economic worries remain

With input costs high and demand fragile, a reluctance to hire

Some liken it to a roller coaster, others to the proverbial slow march of progress: three steps forward, two steps back. Whatever the metaphor, the US economy in 2010 proved perplexing to many business leaders. Although back from its precarious brink-teetering of 2009, and squarely in recovery mode, the economy has been slow to gain momentum.

As Dan Heinrich, CFO of The Clorox Company, puts it, “It’s still pretty tepid. There are ups and downs, and still plenty of mixed signals.” Adds Duane Still, CFO of The Coca-Cola Company’s Coca-Cola Refreshments (CCR) operating unit, “We see positive signs and then something happens to slow everything down.”

Officially, according to the National Bureau of Economic Research, the deepest recession since World War II ended in June 2009.⁴ Yet it wasn’t until the third quarter of 2010 that personal consumption came back to pre-recession levels, and it took until Q4 2010 before consumption rates matched steady-state levels. A weak jobs market, with unemployment levels hovering at 9.6% throughout the year, only reinforced consumers’ reluctance to spend. In turn, CPG companies were reluctant to ratchet up production in the traditional way when emerging from recession: by hiring.

On the positive side, there was modest growth in the CPG industry, and shipment values rose. Yet employment, rather than rising to meet growing demand, actually dipped slightly. Commodity price volatility—a challenge with which CPG executives have wrestled periodically during the past decade—has increased again in recent months. Along with the run-up in gas prices, the aggressive rise in input costs has had as many ramifications for CPG producers as it’s had for consumers.

Will such pressures persist in the coming months? It depends in part on policymakers’ responses. What we do know is that, by some indications, the industry is on firmer ground this year than last—out of the woods if not over the worries, with the most definitive indicator being the steady rise in the value of shipments.

Demand is percolating steadily

The monthly value of shipments in the CPG industry continued its steady upward path through 2010, rising roughly 6% to almost \$124 billion by year’s end. And 2011 got off to a promising start, with shipment values rising another 4.1% between December 2010 and March 2011 alone, reaching almost \$129 billion—more than \$1 billion over the prior peak level hit in July 2008 (see Exhibit 1).

Exhibit 1
Monthly value of shipments, CPG Industry



Source: Based on Census Bureau data (accessed May 2011) and PwC calculations.

Coupled with steady inventory levels, this increase in shipment value is an indication that consumer demand is growing for many CPG products. During the recession, consumers substituted home-prepared food for costlier restaurant fare. “That obviously plays to our industry’s strengths,” General Mills’ Don Mulligan observes.

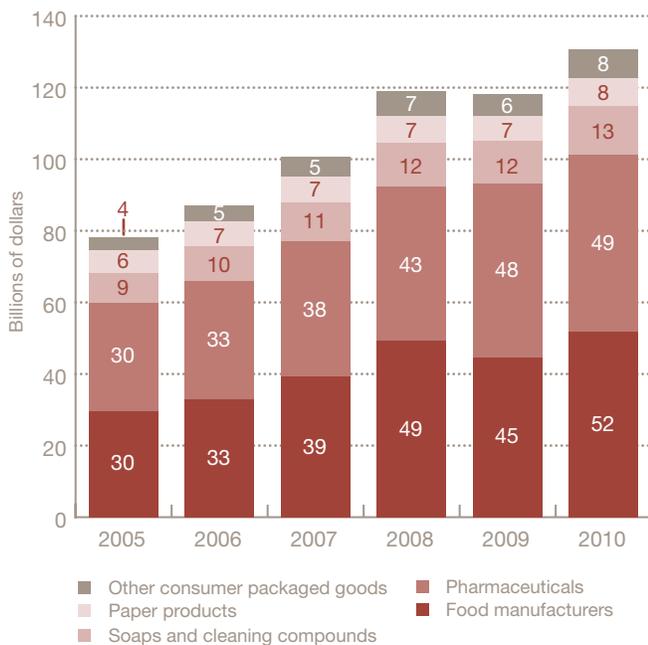
With signs that the economy is finally beginning to grow, “Consumers are now migrating back to brands after downsizing to private labels during the worst of the recession.”

A notable source of this demand comes from abroad. Export markets, although they comprise less than 10% of industry shipments, represent a promising source of growth.⁵ “Continued urbanization and expansion of a middle class is fueling growth in emerging markets,” says Coca-Cola’s Duane Still. Exports of CPG products grew by 11% last year, with growth levels rising proportionately across all key categories, from foods to paper products (see Exhibit 2). In certain emerging markets, growth rates were much higher: Exports to China grew by 42%, to South Korea by 41%, and to Mexico—the second largest recipient of CPG exports after Canada—by 12%.⁶

The labor conundrum

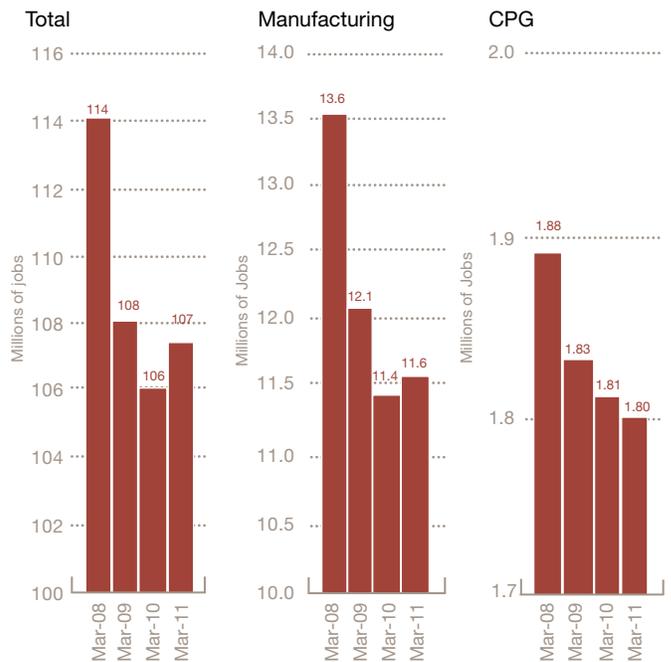
Amid the steady rise in the value of shipments, the CPG industry saw a paradoxical fall in employment, from 1.81 million jobs in March 2010 to 1.80 million jobs in March 2011. Though only a 0.8% drop, and much smaller than the industry’s roughly 3.8% decline between March 2008 and March 2010, it was nonetheless anomalous in a period of recovery. The decline in CPG employment during the recession was mild compared to overall US employment, which declined 7.4% between March 2008 and March 2010 before climbing by 1.6% by March 2011, and to US manufacturing employment, which declined even more sharply (by 16.2%) between March 2008 and March 2010, before climbing 1.9% by March 2011 (see Exhibit 3).

Exhibit 2
Exports of CPG products, 2005–10



Source: Based on International Trade Administration data (accessed May 2011) and PwC calculations.

Exhibit 3
Total employment by industry



Source: Based on Bureau of Labor Statistics data (accessed May 2011) and PwC calculations.

Out of the woods, but economic worries remain

With input costs high and demand fragile, a reluctance to hire

But a decline during a full year of growth is unusual. To meet rising demand, CPG companies have had employees working more overtime. After falling by more than 25% during the recession's worst months (March 2008 to March 2009), overtime increased slightly by March 2010. By March 2011, it had increased to an average weekly 3.3 hours, just under the prior March 2008 peak level of 3.5 hours.⁷

Why are CPG companies holding back on hiring? The fragility of the economic recovery is partially responsible, as is a concern that external shocks, such as the recent spike in commodity prices, could tip the scales. Also, companies remain concerned about legislative uncertainties and the prospect of higher taxes to meet ballooning state and federal deficits. Such possibilities make new hires more costly.

Growing price pressures—on consumers and CPG companies

Throughout 2010, overall consumer prices grew by only 1.4%, well below the past 20 years' average of 2.6%. Retail food prices for consumers increased slightly more last year, by 1.7%. Thus far in 2011, however, price increases have been accelerating more rapidly. Overall prices increased by 1.5% between December 2010 and March 2011 (6.1% on an annualized basis), while consumer food prices increased by a startling 2.7% (11.2% on an annualized basis).⁸

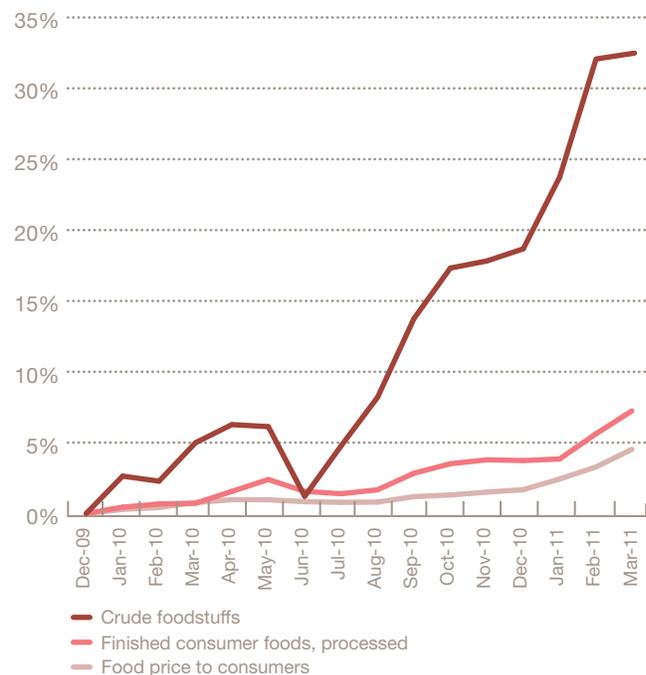
Driving those price increases are increases in input costs, which rose dramatically in early 2011. Between December 2009 and April 2010, crude foodstuff prices rose 6.3%; by March 2011, they were more than 32% higher than in December 2009 (see Exhibit 4). Rising grain prices (primarily the result of lower-than-expected harvest yields worldwide and intensifying demand) were largely to blame.

During 2010, CPG companies absorbed much of these increases. Early indications in 2011, however, suggest that companies are now adjusting their prices in response to

the changes. "We absorbed more than 60 price increases over a three-year period during the last run-up in commodities," says Dan Heinrich of The Clorox Company. "And now, in the front-end of another run-up, pricing is certainly going to have to be a bigger piece of adjusting profitability." By March 2011, prices for processed consumer foods leaving the factory had risen by 7.4% compared to December 2009 levels (see Exhibit 4).

Exhibit 4
CPG price growth, 2010

(Growth relative to December 2009 price level)

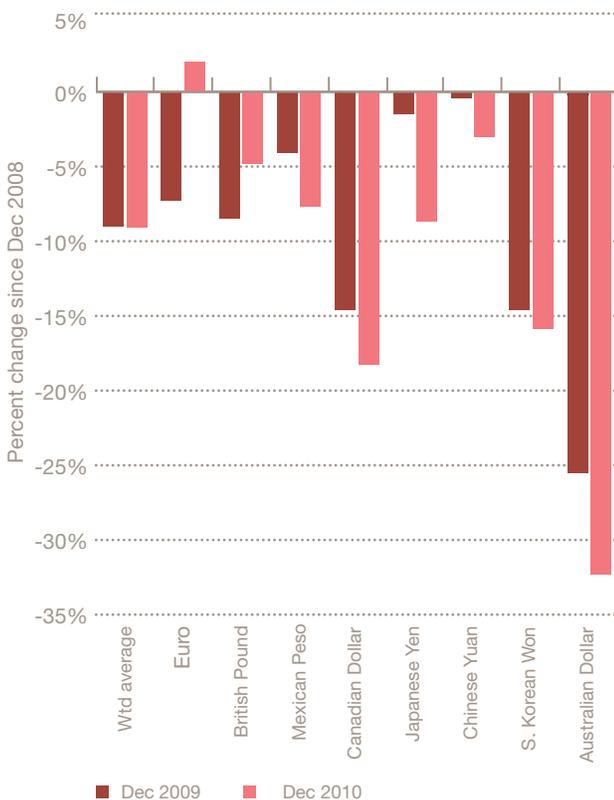


Source: Based on Bureau of Labor Statistics data (accessed May 2011) and PwC calculations.

Compounding food price pressures are escalating energy prices. Between May 2010 and May 2011, consumers paid 36% more for a gallon of motor fuel.⁹ Unrest in oil-producing regions, new demand from emerging economies, and resurgent demand from the recovering developed economies could push prices higher.

There was a bright spot amid these price pressures: The dollar's continued relative weakness made US exports more attractive. Between the end of 2008 and the end of 2010, the dollar lost nearly 10% of its value relative to the currencies of the 11 largest recipients of CPG exports (see Exhibit 5), and its value has continued to fall in 2011.¹⁰ A weaker dollar helped mitigate the squeeze on operating margins of US exporters, although it meant yet another source of increased cost for companies on the import side.

Exhibit 5
Change in exchange rates since December 2008
 (Percent change in foreign currency relative to the US dollar)



Source: Based on Federal Reserve Board, Foreign Exchange Rates, Release G.5 data (monthly) and PwC calculations.

The federal government and the recovery

While the recovery appears to be solidifying, spurring hope for future growth, its progress and trajectory—and the prospects for the CPG industry in 2011—depend to some extent on the fiscal and monetary policies of the US federal government.

The government's efforts to jump-start the economy over the past few years—stimulus measures such as monetary expansion and the extension of Bush-era tax cuts—have investors wondering what's next. The ballooning budget deficit, which sat at \$1.3 trillion in fiscal 2010, is projected to grow, with some forecasts showing that cumulative federal borrowing under current policies would exceed the size of the US economy by 2020.¹¹ At some point, investors could lose faith in the government's ability to service the debt, leading to higher interest rates across the economy and additional pressure on inflation and the dollar. In turn, the US economy would suffer.

The Obama Administration and Congress have begun to address the federal budget situation. Their challenge is to balance the long-term dangers of escalating deficits against the short-term impacts of reduced government spending and revenues in a tenuous recovery.

The Federal Reserve faces a similar balancing act following its 2007–11 liquidity injections: lowering key interest rates, buying almost \$1 trillion in mortgage-backed securities from banks, and buying \$500 billion in Treasury securities (“quantitative easing”). At some point, the Fed must withdraw this liquidity or risk increased inflation. Yet moving too soon could imperil the recovery by causing interest rates to rise and the dollar to strengthen. This would raise borrowing costs for CPG companies and add to consumer budget pressures, while also making US exports less attractive.

Out of the woods, but economic worries remain

With input costs high and demand fragile, a reluctance to hire

Global risks keep on coming

In a connected world, the US economic recovery also hinges on the performance of the global economy. Despite the promise of growth from emerging markets, several risks loom overseas. Fiscal bailouts in Greece and Ireland have strained the coffers of other European Union members, and more bailouts are possible. The resultant instability could spread across the EU, potentially affecting US markets. For example, worldwide interest rates could rise as European governments face increased financing needs. Demand for US exports in Europe could falter.

The impact of the March 11 earthquake and tsunami in Japan could also slow the US recovery. Japan is the second biggest buyer of US government debt; as the nation redirects its capital to domestic rebuilding, the US government may have to raise interest rates on Treasury securities to attract other borrowers. In addition, Japan is an export market for CPG manufacturers, so prolonged market instability there will dampen demand for CPG exports.

Finally, global energy markets remain volatile, and it appears unlikely that they will revert soon to historical price levels. Increased demand from emerging markets, along with economic recovery in the developed world, will put upward pressure on oil prices. Recent political upheaval throughout the Middle East and North Africa has exacerbated market instability. As the price of this fundamental asset increases, CPG companies will need to consider new measures to control energy input costs and be mindful of pricing strategies for consumers.

Mitigating broad economic jolts through vigilant planning

The CPG industry is beginning to experience positive results from the economic recovery, and many executives share the sentiment of Sunny Delight Beverages Company CFO Bill Schumacher, who is “guardedly optimistic.” However, in the coming months, industry executives must address some of the risks in the broader economy today—from the possible withdrawal of federal government fiscal and monetary interventions to developments in the international economy. If these factors lead to higher inflation, higher interest rates, or a weaker dollar, the ability of CPG companies to grow and prosper could be impaired.

CPG companies will need to aggressively take these risks into account in their planning processes. Potential strategies include incorporating flexibility in product-pricing decisions, adopting long-term contracts for inputs, expanding hedging programs, and balancing short-term and long-term debt. At the Colgate-Palmolive Company, says CFO Dennis Hickey, “It’s a little bit of everything. Our agenda is clearly focused on growth through a balanced portfolio of products and geographies, and at the same time—consistent with our traditional prudent financial management—we are looking at commodity strategies, pricing strategies, and what that means to the average selling price of our portfolio.” By actively addressing the potential risks posed by the broader economy, CPG companies can better position themselves to take advantage of the growth prospects that await them at home and abroad.

The best of the best: A financial analysis

Breaking down the performance of the CPG sector's top-performing companies

With regional economies and consumer spending trends quite varied around the world—strong in certain emerging markets and tepid in the United States, much of Europe, and Japan—CPG companies were hard-pressed to generate overall sales growth in 2010. Yet some companies still managed to produce very healthy margins, free cash flow, and other financial results. They made good progress building their brands in those fast-growing emerging markets, and were able to balance long-term investment with smart cost management in ways that still generated substantial dividends for shareholders.

This discipline is what the Colgate-Palmolive Company calls “Funding the Growth.” At Colgate-Palmolive, as soon as a department’s budget is complete, it routinely goes back to challenge all its costs at the most detailed level, according to CFO Dennis Hickey. “We ask why you are spending it, how you can do the same for less, and how you can improve effectiveness and efficiency,” Hickey says. “This protects the gross margin, so that when we’ve seen significant cost increases in commodities, those have been offset by an aggressive Funding-the-Growth program combined with appropriate price increases.”

PwC’s performance ranking

For our analysis this year, we examined a variety of financial metrics to see which common characteristics link the CPG companies that performed best during the erratic economic environment of 2010, and how those characteristics have changed over the past five years.

We reviewed the total sample of approximately 150 CPG companies for which we gathered publicly available data. We then sorted 52 large and very large companies into performance quartiles.

We avoided measuring companies primarily on shareholder return. This standard corporate barometer, while obviously important to investors, is relatively narrow.

Instead, we took a more balanced approach by assigning scores to the 52 companies based on their relative performance across three fundamental metrics:

- Economic profit spread, which is based on return on invested capital (ROIC) and the weighted average cost of capital (WACC)
- Return on assets
- Free cash flow relative to sales

Armed with this breakdown, we then ranked all 52 companies to create an index of top-performing companies (TPC). We were then able to easily compare groups of the ranked companies across many different financial indicators, including growth, profitability, liquidity, and leverage. We were particularly interested in setting the top quartile (best performers) versus the bottom quartile (weakest performers) to isolate those business drivers that might further explain their ranking.

Of the 13 top-quartile companies, 6 are in the household products sector, 4 in beverage, and 3 in food. Our analysis reveals that the top performers were distinguished from the bottom quartile in the same five areas we identified for the previous year’s analysis: gross margins; profitability; liquidity; spending on strategic selling, general, and administrative (SG&A) expenses; and managed debt capacity as represented by the ability to cover interest payments. The story, in many respects, continues from 2009. Some of the reasoning and outcomes may be different, such as the stronger growth in median earnings before interest and taxes (EBIT) by the bottom quartile in 2010. However, year on year, our top performers have been consistently characterized by similar strengths.

In addition to our index of the large and very large top performers, we applied a similar scoring methodology to the medium and small company segments, and found that the same themes apply. As we contrast the performance of the top and bottom quartiles for our large and very large top performers, we will highlight outcomes for medium and small players only where there is a significant difference.

The best of the best: A financial analysis

Breaking down the performance of the CPG sector's top-performing companies

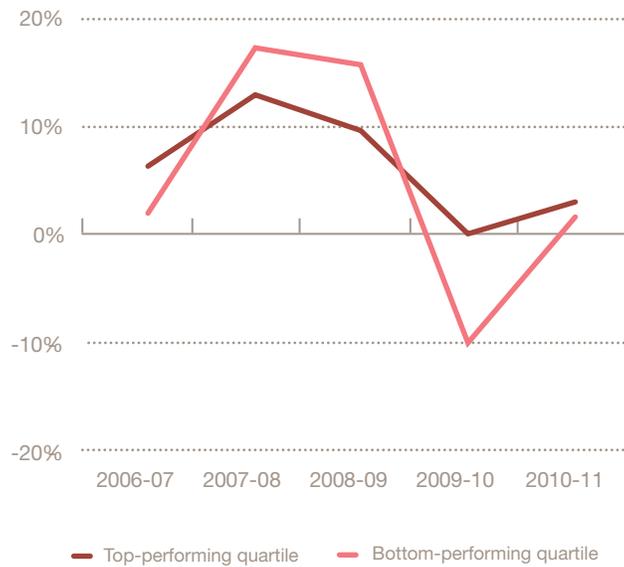
Maintaining strong margins in the face of weak sales growth

After a dismal 2009, in which net sales actually declined for both top and bottom performers, each group returned to growth in 2010, as shown in Exhibit 6. The 2.9% growth for top performers was only slightly above the 1.5% growth for the bottom quartile. But the top quartile shows less volatility year to year, achieving more reliable sales growth over the long run.

Where did that sales growth come from? In most companies, it was a mix of organic growth and acquisitions. The strongest organic growth came from emerging markets such as Latin America and Asia, as well as from selective price increases by some companies.¹²

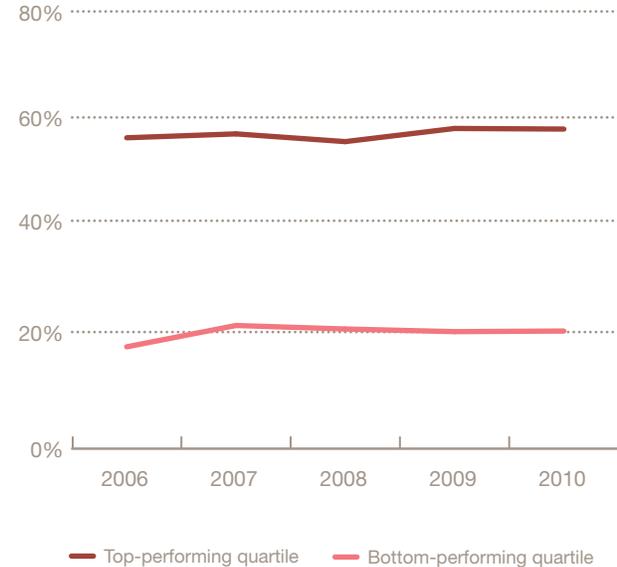
Top performers also consistently produce higher gross margins, with a gap between top and bottom performers close to 40 percentage points, as shown in Exhibit 7.

Exhibit 6
TPC median net sales growth



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 7
TPC median gross margin



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

The best of the best: A financial analysis

Breaking down the performance of the CPG sector's top-performing companies

Faced with the same challenges as the rest of the pack, top performers maintain brand equity that allows them to get premium prices—depending on the local markets. It's important to recognize that for certain products, some markets are far more profitable than others. As Coca-Cola's Duane Still says, "Profitability has to be examined on a country-by-country basis, or even within a country on a local geography-by-geography basis."

The right kind of spending

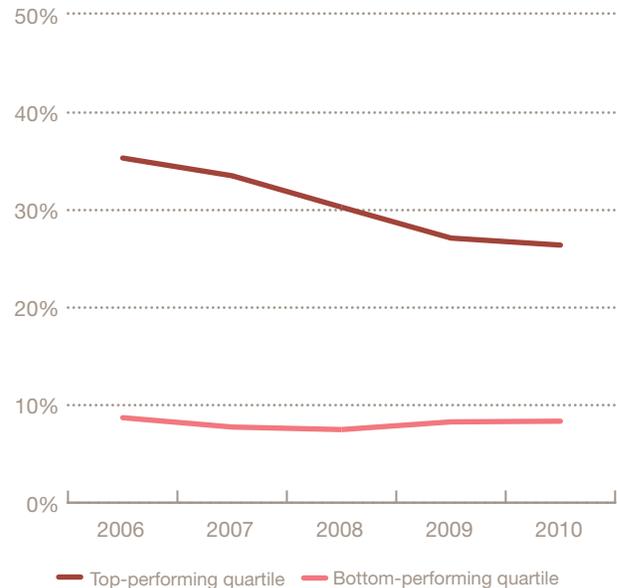
Large CPG companies make substantial investments in innovative products as well as marketing and advertising to support their core brands. Over the past five years, our top quartile has spent more on defending its market share than has the bottom quartile, as measured by SG&A spending relative to sales. Investment in brands and in long-term positioning remains a significant predictor of performance. For example, many of our top performers have invested heavily to promote corporate brands in China and India, in order to build trust and mindshare among the hundreds of millions of consumers that may be unfamiliar with a particular product line. Top performers also have expanded their sustainability initiatives with an eye toward controlling costs and risks.

So some SG&A costs are good in the sense of investing for future growth, while other costs are bad overhead and should be continually tightened. For instance, research and development (R&D) spending comprised 14% of SG&A spending among the top performers, versus just 3% for the bottom quartile. Disaggregating the average, however, shows that the R&D gap exists mainly among household products companies, while there is little difference between the top and bottom quartiles in the food or beverage sectors.¹³

Looking at the overall SG&A spending trends in Exhibit 8, we see that in 2008 and 2009, the top performers on average decreased their SG&A spending. This could indicate that, given the slow and fragmented economic recovery, they were managing all costs more tightly, even R&D and advertising. By 2010, the trend line was nearly flat, indicating that these companies may have exhausted the easiest initiatives in cost management. But the top performers clearly remain better at cost management in such areas as production and distribution.

Exhibit 8

TPC median SG&A as a percentage of sales



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

The best of the best: A financial analysis

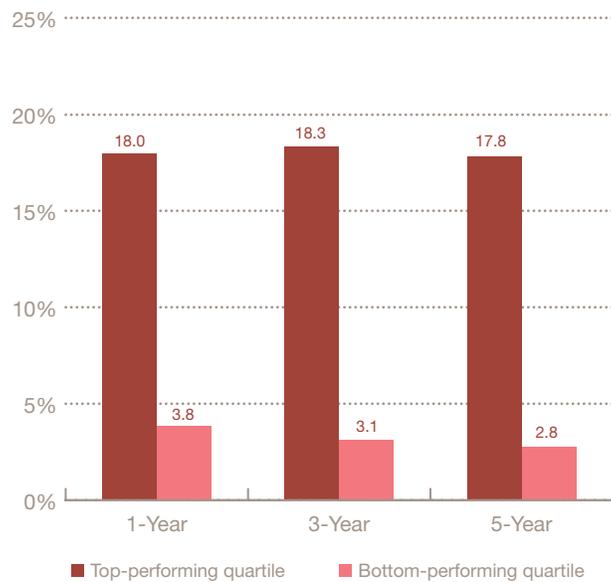
Breaking down the performance of the CPG sector's top-performing companies

Top performers are generating cash and dropping debt

As the significant gap between quartiles in Exhibit 9 illustrates, the top-performing CPG companies are generating more cash than poorer performers: 18% cash flow to sales for the top performers versus 3.8% for the bottom quartile. The cash may have come from pricing actions as well as belt tightening, expense management, and a gradual shift to more collaboration through digital tools rather than costly in-person meetings.

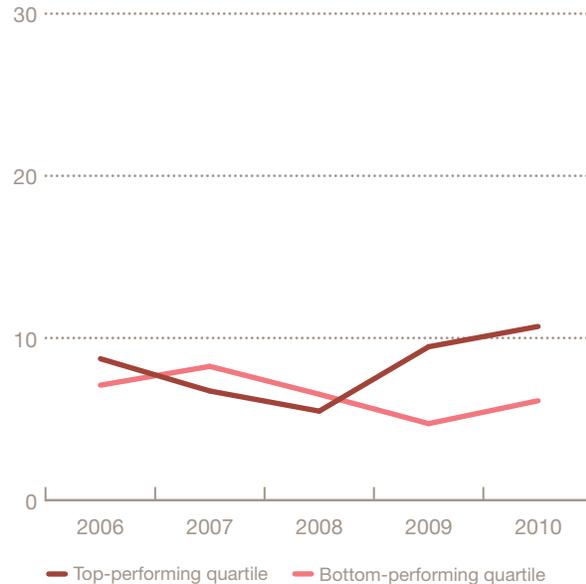
The difference between top and bottom becomes even more dramatic when looking back three and five years. Even with a drop in investment spending, having capital available does provide top-performing companies with ample liquidity as well as the room to think and act strategically. For instance, top-performing companies are well positioned to make more acquisitions or increase their dividends. Bottom performers are generating less cash, and their limited access to credit means they don't have the luxury of hoarding what little cash they have to defend their market share.

Exhibit 9
TPC median free cash flow to sales



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 10
TPC median interest coverage ratio



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

The best of the best: A financial analysis

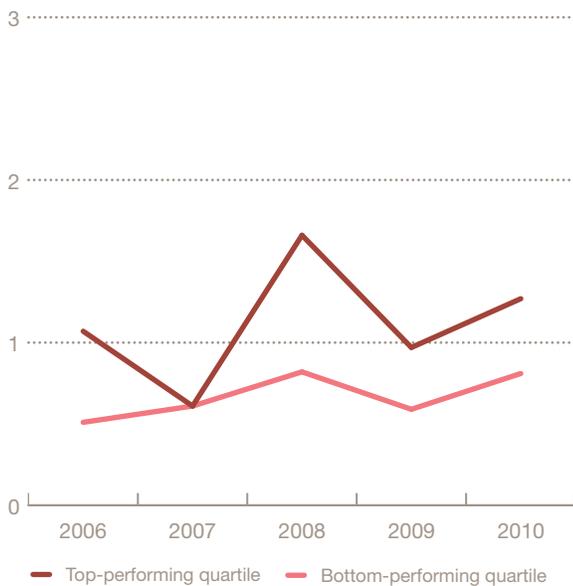
Breaking down the performance of the CPG sector's top-performing companies

A review of the median interest coverage ratio is consistent with this trend. Both top and bottom performers are focused more on reducing the risk associated with debt, as shown in Exhibit 10. But top-performing companies find it easier to manage the debt they retain. The bottom quartile has to cover higher interest payments, which weakens their balance sheets. Top-performing large companies have more cash in hand, so they feel more comfortable taking on slightly greater percentages of debt, as seen in Exhibit 11. For medium and small companies, the debt-to-equity ratio measured consistent for top

and bottom performers in 2009; however, the bottom performers took on more debt in 2010, as borrowing became more accessible.

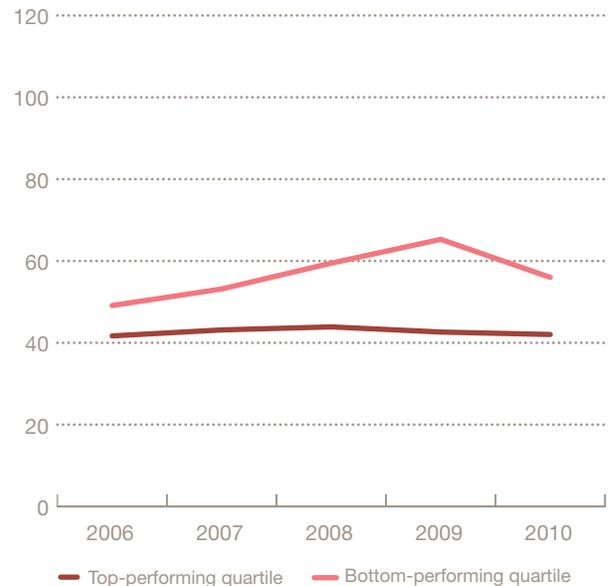
A related variable is the cash conversion cycle, which highlights the speed in days with which companies can turn assets into cash. The lower the number of days, the more efficiently a company gets cash in the door. We see in Exhibit 12 that top performers have a stronger ability to manage their day-to-day cash flow, although the bottom-quartile companies substantially improved their performance in 2010.

Exhibit 11
TPC debt-to-equity ratio



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 12
TPC median cash conversion cycle



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

The best of the best: A financial analysis

Breaking down the performance of the CPG sector's top-performing companies

A deeper look at profitability

We noted earlier the substantial gap in profitability, more so than sales, that distinguishes the top and bottom quartiles. To probe a bit deeper, we examined companies' net operating profit after tax (NOPAT) margin and median operating cash flow ratio (see Exhibits 13 and 14).

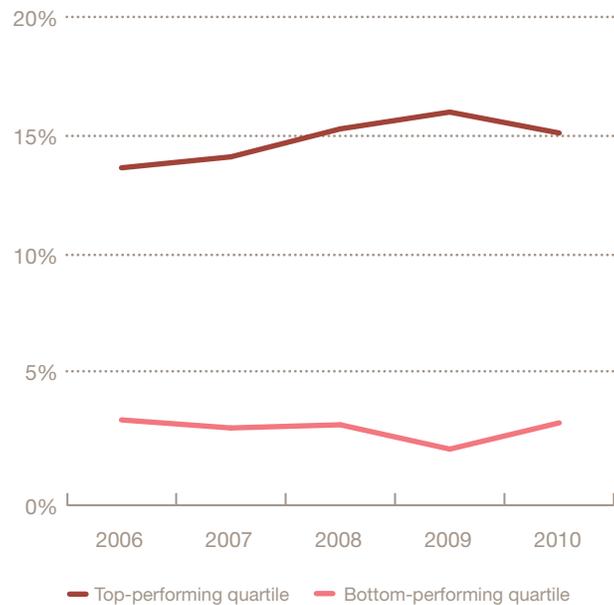
For our top performers, the NOPAT margin has been between 15% and 16% for two years, while the bottom performers have hovered between 2% and 3%.

This represents a widening of the gap since 2006. Further, the operating cash flow ratio decreased at a similar rate in 2010 for both the top and bottom quartiles.

Sharing gains with investors

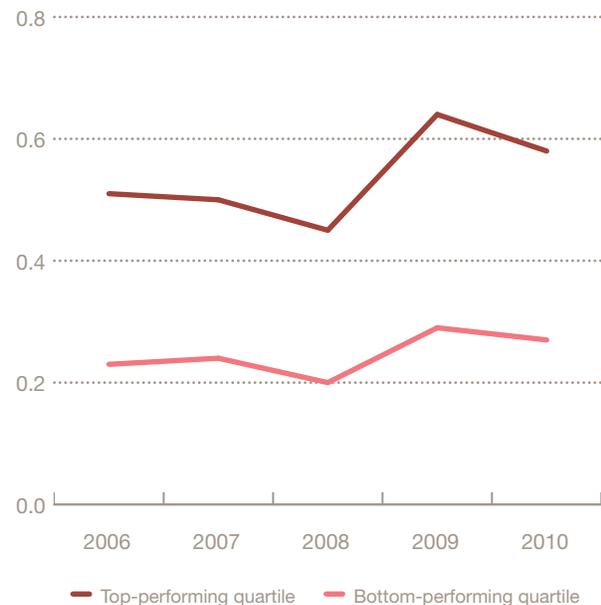
Given the consistent gap in performance between top and bottom performers along all these metrics, it's not surprising that shareholder return shows a similar trend. Exhibit 15 illustrates how top performers provide higher

Exhibit 13
TPC median net operating profit after tax (NOPAT) margin



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 14
TPC median operating cash flow ratio



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

The best of the best: A financial analysis

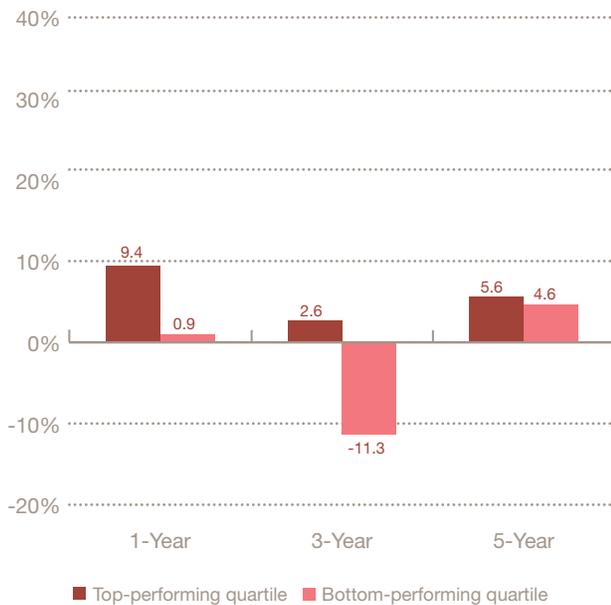
Breaking down the performance of the CPG sector's top-performing companies

and more stable returns over the long run. They are better equipped to handle tough economic environments and thus are more attractive to investors. Here's one relevant statistic to consider: The top performers paid out an average of four times more dividends per share during 2010 than did the bottom performers.¹⁴

EBIT growth supports the notion that the top performers are more consistent than the bottom. As shown in Exhibit 16, the top quartile exhibited slightly lower EBIT

growth in 2010, likely because of tepid net sales growth. The bottom quartile, meanwhile, rose sharply from the depths of 2009—but given how bad 2009 was for this group, it didn't take much effort to post a significantly improved 2010. The divergence between top-performing and bottom-performing companies is distinguished by size, however, as the medium and small size companies had consistent EBIT growth over the past three years.

Exhibit 15
TPC median shareholder return



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 16
TPC median EBIT growth



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Company size segments: 2010 trends

As fragile consumers look for value, cost management and pricing agility come to the fore for manufacturers of all sizes

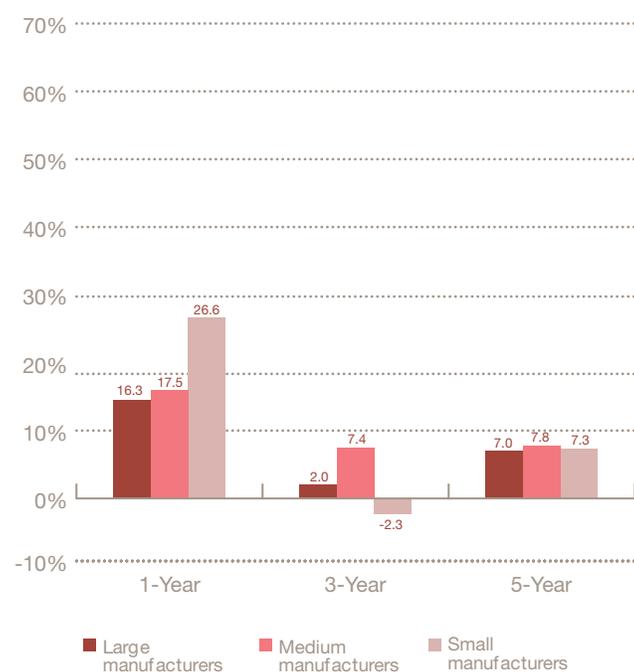
For the first time since the onset of the Great Recession, manufacturers of varied sizes experienced more commonalities than differences when it came to financial performance. From shareholder return to productivity, from EBIT to SG&A as a percentage of sales, the performances of different size categories were consistent.

Large, medium, and small manufacturers

First, all three size categories—large (which for purposes of this analysis includes “very large”), medium, and small—experienced steady, double-digit growth or near double-digit growth in one-year median shareholder return (see Exhibit 17).

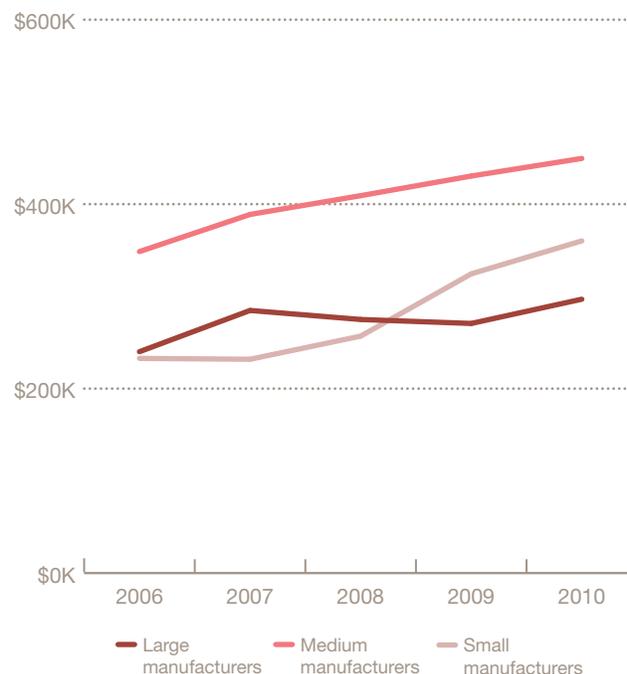
Productivity, as measured by median sales per employee, also increased for companies in each category, something that could not have been said at any point in the three prior years, as large manufacturer productivity declined from 2007 to 2009 (see Exhibit 18). In fact, according to Coca-Cola’s Duane Still, productivity in today’s uncertain times is just the price of admission, no matter what size the company. “Commodity pricing and other economic challenges have made productivity an absolute necessity, and I don’t think we’re any different from any other consumer products company,” Still says. “It’s just imperative that you operate as efficiently as possible.”

Exhibit 17
Median shareholder return



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 18
Median sales per employee



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Company size segments: 2010 trends

As fragile consumers look for value, cost management and pricing agility come to the fore for manufacturers of all sizes

EBIT, perhaps the best indicator of a firm's profitability, saw an increase in growth percentage within the large and medium size categories. Even when it came to SG&A as a percentage of sales, an indicator which in 2009 saw small manufacturers register an astounding 36.2% in an apparent effort to stay relevant and keep some market share, each size category decreased its spend slightly—proof that all companies got very used to managing costs during the recession and are now keeping those efforts going.

So does this data mean that each size segment, respectively, is out of the woods? Does it mean that the much-ballyhooed New Normal, which has had the CPG industry bracing for years of slow growth, was just a rumor?

Not so fast. A solid 2010 performance can be attributed in many respects to the aforementioned cost management programs, a favorable macroeconomic environment of global growth and favorable monetary policy, and consumers who have gingerly opened up their wallets again (in the second quarter of 2009, the US savings rate was at 7.2%, but by the fourth quarter of 2010 it had decreased to 5.6%) (see Exhibit 19). The CPG industry must still overcome several obstacles before it can enjoy growth that's both consistent and profitable—with the emphasis on "profitable."

Take commodity costs, for instance. In December 2010, the Food Price Index of the United Nations Food and Agriculture Organization reached its highest levels since 1990.¹⁵ Price, in fact, is yet another area in which all size companies seem to be finding common cause, both in terms of their concerns about commodity inflation and the subsequent challenges of passing on those costs to consumers. As General Mills' Don Mulligan states, "The only final hedge you have against inflation is pricing. Pricing agility is the next frontier, in terms of how quickly can you get the right pricing in the marketplace, and how precise you can be by channel and by region of the world." As we'll see, companies of different sizes have varied capabilities in this regard.

Exhibit 19
Personal savings as a percentage of disposable income



Source: PwC analysis based on data from the U.S. Bureau of Economic Analysis.

The consistency in financial performance across these size sectors in areas such as shareholder value and profitability also applied to certain liquidity metrics. For example, in 2009, small companies had a much higher ratio of short-term debt to long-term debt, while in 2010 that gap narrowed—likely because the credit taps finally opened for smaller companies that had had a harder time securing good terms on long-term debt during the lean years of the recession. As it has in the past, the CPG industry continues to be far more fiscally disciplined and less leveraged than many other industries, with all size categories exhibiting a debt-to-equity ratio of less than 1:1.

Company size segments: 2010 trends

As fragile consumers look for value, cost management and pricing agility come to the fore for manufacturers of all sizes

And pricing? While each of the size categories saw net sales growth in the range of 3% to 5% during 2010, the real rub comes at median gross margins (see Exhibit 20). Median gross margin percentages improved for small and medium companies but declined slightly for large companies—an impressive feat for small manufacturers, who had their second consecutive year of improving gross margins. But all size companies will likely have a hard time replicating their median gross margin return performance in the coming year, due to rising commodities prices.

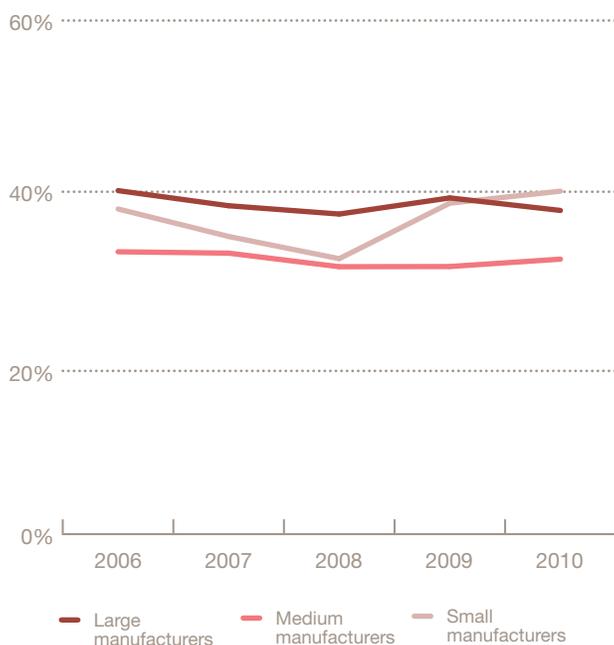
Other price-related metrics for small manufacturers showed their unique constraints, particularly when it comes to cash flow. Small manufacturers' median return on sales fell to below 5% (see Exhibit 21), suggesting that small companies, despite their gross margin success, were perhaps not pricing correctly for inflationary pressures and other stresses. If the economy improves markedly in the near future, it will be interesting to see whether small manufacturers can break through and price more

appropriately for their scale, thus improving on metrics like median free cash flow to sales. Exhibit 22 shows how, for the past five years, small companies have been relatively cash-restrained as opposed to their medium and large peers. Almost needless to point out is the discrepancy with very large manufacturers, whose median free cash flow to sales is a robust 9.9% (see Exhibit 23). Clearly, this is an area where the size categories are very much not alike.

Very large manufacturers

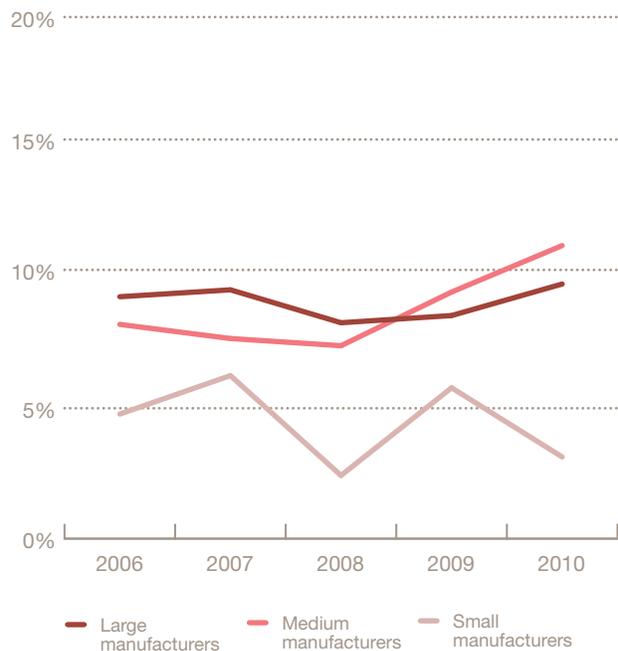
Why do we break out “very large manufacturers” from the other size categories? Simply because the largest of the large manufacturers, those with reported net sales of greater than \$10 billion in the last fiscal year, belong in their own weight class. Global in scope, broad in scale and product portfolio, and staffed by tens of thousands of employees in offices around the world, these companies really need to be measured against each other.

Exhibit 20
Median gross margin



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 21
Median return on sales



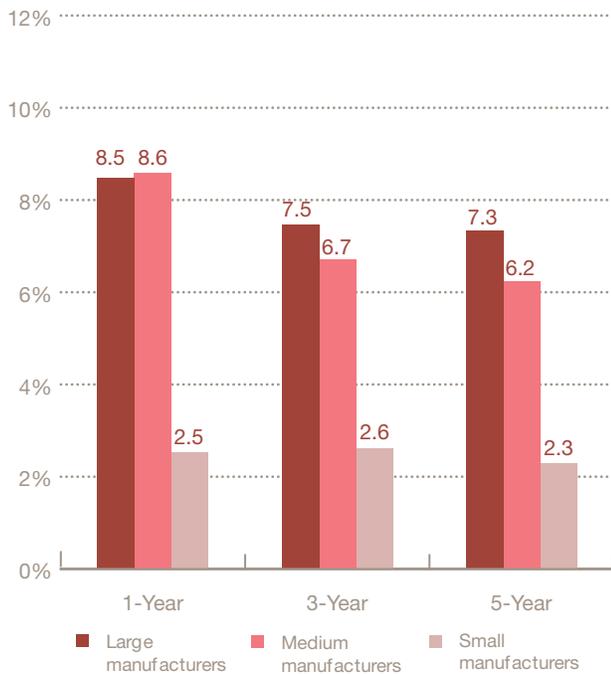
Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Company size segments: 2010 trends

As fragile consumers look for value, cost management and pricing agility come to the fore for manufacturers of all sizes

Exhibit 22

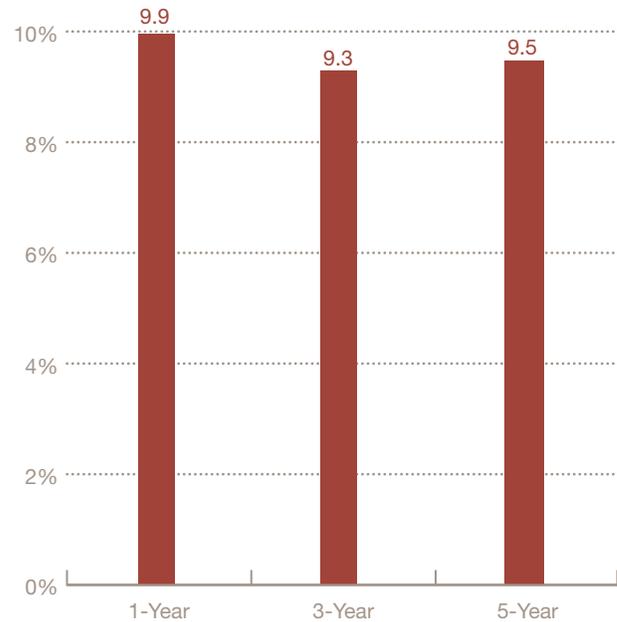
Median free cash flow to sales: Large, medium, and small manufacturers



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Exhibit 23

Median free cash flow to sales: Very large manufacturers



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

Perhaps appropriately, then, given their singularity as a class of CPG company, the performance of this size category differed most from the others, with marked improvement across a host of metrics: much improved EBIT growth after two years of declining growth, 5% net sales growth after negative growth in 2009, an 8% one-year median shareholder return that nudged the three-year cumulative performance into positive territory, and a continued excellent return on invested capital of 12.2% for 2010. While the one-year median shareholder return did not measure up to the return posted by the other size categories, there could be a host of other reasons for investors to hold back on these global behemoths, including their higher exposure to commodity costs, investments in talent and international expansion that haven't yet borne fruit, and the relative lack of dividends they've provided to investors.

In any case, the worldwide scope of these companies, when considered in context that the vast majority of consumer spending growth is anticipated to come from emerging markets, means that these manufacturers are likely the best positioned for sustainable growth. General Mills' Don Mulligan points out that the enormous potential of developing markets is finally coming to pass. "You hear a lot of companies in our space talk more about emerging market growth," Mulligan says. "That's because growth is now becoming a reality in many of these markets, where before it was always a promise. India is starting to get some real traction on its economic base, as are Indonesia, Turkey, and Brazil."

Section 1

Managing the enterprise

From barcodes to brand-building websites, it's no secret that digital technologies have radically changed the way CPG companies do business. But the recent past pales compared with what's in store over the next few years. This section discusses how mobile technologies are starting to raise productivity in the distribution center, in the sourcing field, in marketing centers, and in the sales trenches. Understanding how digital channels influence consumers' purchase decisions will be essential to the next phase of growth for CPG companies. Retailers and suppliers should collaborate on sharing and analyzing consumer data, in order to better understand real-time shopper behavior and to improve supply chain efficiencies. New technologies can even help improve commodity risk management by keeping closer track of dispersed commodity information. CPG managers, sharpen your digital skills!

Business mobility and the prospect for leaps in productivity

New digital technologies promise to boost innovation and efficiencies through business redesign

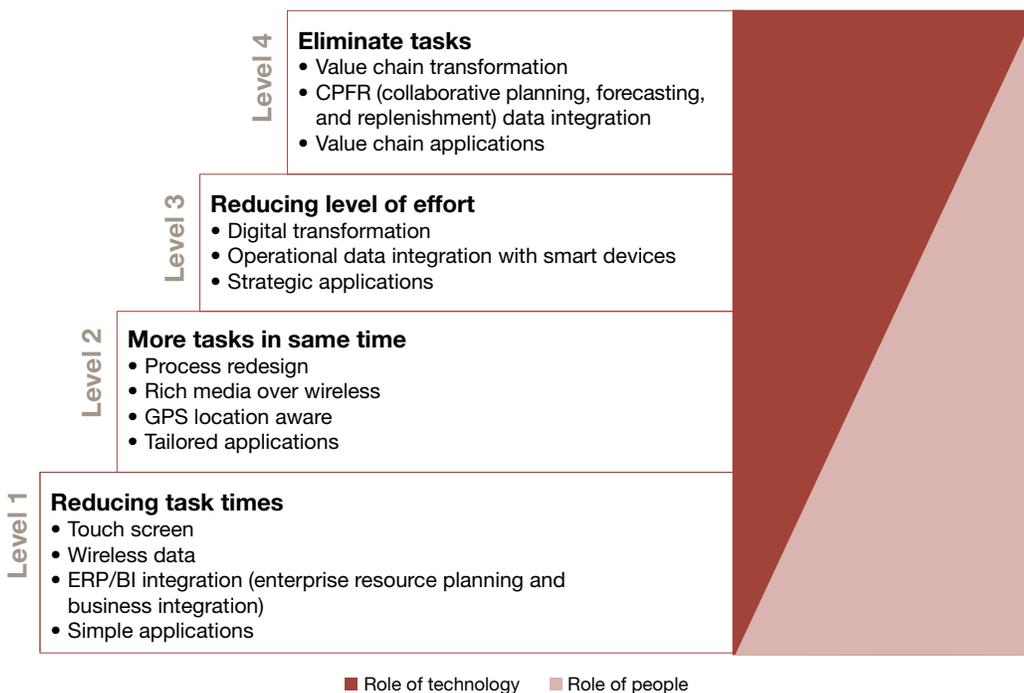
By any measure, mobile device adoption is occurring at an astonishing rate (see the sidebar “By the numbers: Consumer mobility”). In 2010, users “forced [the iPad] into the enterprise”¹⁶ after Apple’s release of the device in April. Now, little more than a year later, employees commonly bring their own devices to work and expect to conduct business on those devices. And, as second- and third-generation devices and applications flood the market, senior executives are beginning to realize that these devices are not just a consumer novelty.

Already, business mobility has been shown to boost productivity in sales, supply chains, distribution centers, and stores, as well as to contribute to individual productivity. This rise in productivity is derived from digitizing, accelerating, and automating business interactions across the CPG value chain. Exhibit 24 shows how people and technology can work together to produce these productivity increases.

Furthermore, as devices and wireless data networks grow ever faster, rich multimedia capabilities (e.g., video conferencing, multiple cameras) will continue to be added to business work flows. Jon Moeller, CFO of The Procter & Gamble Company (P&G), explains: “Our objective is to digitize the company from end to end. We want people to have 24/7 access—we call it ‘always on’—to the information they need to both update them on the state of the business and to make decisions. We want to have that in whatever format they find most convenient to access, whether that’s a laptop computer, a tablet, or another digital device.”

Analysts expect these new functions to support the doubling or possibly the quadrupling of productivity levels for those portions of the enterprise that use them in just the next few years.

Exhibit 24
Levels of productivity improvements



Source: PwC.



By the numbers: Consumer mobility

- Nearly 110 million Americans are expected to have smartphones by the end of 2015.¹⁷
- Time spent on mobile devices is rising faster than any other medium, up 28.2% in 2010.¹⁸
- Worldwide handset sales to end users rose 32% in 2010, to 1.6 billion units. Smartphone sales rose 72% from 2009, to 297 million units.¹⁹
- Tablet sales are expected to rise from 18 million in 2010 to 61 million in 2011.²⁰
- Two in five US adults used mobile devices in 2010, an increase from the 32% of adults who did so at a similar point in 2009.²¹
- Among US young adults (18–29 years old), 95% send or receive text messages, 93% use their phones to take pictures, and 81% send photos or videos to others.²²
- Mobile phones are the world's most widely distributed computers. Even in less developed countries, roughly two thirds of people have access to one.²³

Let's use equipment inspections in a distribution center to illustrate the point. An inspector may take two hours to walk around the factory floor and manually inspect each piece of equipment. That same employee, using a mobile tablet that automatically gathers and analyzes data wirelessly, can view the rolled-up report in a minute or two. Further, with the right technology configuration, that inspector could complete his inspection remotely, without driving to the factory at all.

Mobile workforces navigating a sea of sensors

Besides handheld devices and the wireless network, business mobility depends on the placement of wireless sensors on assets such as trucks, lifting equipment, locations in distribution centers, pallets, and machinery. Small sensors monitor physical conditions, such as temperature and moisture, to protect foodstuffs and products in transit or in storage. Even smartphones include sensors, transmitting a wide range of information (e.g., the user's location and device statistics) as well as providing data analytic capabilities (e.g., capturing the amount of ambient light).

There are seemingly no limits on the placement or use of sensors, which, by some claims, will "disrupt more than one industry and perhaps the economy as a whole."²⁴ Even farmers and their herds are not immune. Farmers use sensors in the ears of cattle to monitor the herd's health, track the animals' movements, and determine when the cows are ready to freshen (give birth). An amazing statistic: Each cow produces some 200 megabytes of data per year.²⁵

Sensors may soon be as small as grains of dust and nearly as ubiquitous. Data from these sensors flows through wireless networks to the handheld devices of mobile workers, thereby automating the collection and analysis of data that can be presented for immediate, real-time use.

Business mobility and the prospect for leaps in productivity

New digital technologies promise to boost innovation and efficiencies through business redesign

Applying the “three F’s” of the mobile workforce

To determine the best ways to deploy mobile devices across the workforce, companies need to view mobile workforce productivity through three lenses: mobility on the floor, in the field, and in flight.

Mobility on the floor

Mobility “on the floor” covers supply chain efficiencies in the distribution center, where workers touch their smartphones to shelves or forklifts to instantly access status information rather than waiting to review a printed report at the end of the week. Scorecard data flows to the handheld, where it is analyzed for variances.

“On the floor” also includes the sales representative who visits a store and video chats with the marketing director from headquarters about product placement in the aisles. GPS functionality on the salesperson’s handheld lets the marketer see what store the rep is in (known as “geofencing”), and even which aisle. While they talk, the rep transmits pictures or video of products, and they collaborate right there on the assortment changes they want.

When the rep meets with the grocery store owner to negotiate the next order, they review the latest data on their tablets and come to agreement before the rep leaves for his next appointment. This time efficiency reduces the cost to serve and the total landed costs, so the consumer wins as well.

In the 1990s, laptop tools and customer relationship management (CRM) systems sliced the number of hours that salespeople had to spend on administrative tasks. Instead of filling out forms and faxes, they entered updates on their laptops and synchronized at headquarters. Mobility on the floor represents the next technological step forward for salespeople, allowing them to spend more time in stores and in front of consumers.

Mobility in the field

“In the field,” mobile employees can make sourcing decisions on the spot. At a farm, for example, a buyer may transmit pictures or video of the crop (and sensor data, when available) to her team, explore various price points with a colleague, and compare prices to those of a neighboring operation.

Supply chain collaboration in a digital universe is not just about how much product is going to be purchased, or haggling over the price of a case. It is also an exploration of possibilities: “What else do you have on the farm that’s fresh? We are interested in a new organic yogurt line—what do you have?” And mobility allows buyers to make immediate decisions, based on data sent from and received on the handheld. Maybe the cows seem healthier and the yogurt tastes better at a particular farm, so the buyer organizes on the spot for that product to be piloted in a couple of stores.

Mobility in flight

By using mobile devices, workers who are often “in flight” can increase their productivity by logging fewer travel hours. Sales reps can have video chats with store managers, for example, rather than driving all over the region.

District store managers can do the same, particularly when retailers use predictive modeling to analyze parameters such as sales or returns on promotional efforts. That data, along with suggested next steps, can be pushed out on operations performance scorecards to the tablets of the district managers, who can learn best practices on the job rather than traveling to headquarters for training. And they can take preemptive actions rather than having to spend extra time with the store managers reviewing disappointing store metrics in the rearview mirror.

When travel is necessary, mobile devices accelerate workflow and handoffs, and improve the efficiency of the routing. For example, drivers delivering goods to grocery

stores follow routes automatically amended in real time based on traffic, keep an eye on temperature sensors in their trucks, and provide delivery receipts wirelessly.

Optimized routing helps service technicians, too. For example, grocery retailers install custom-designed remote diagnostic sensors in their refrigerators, freezers, and rotisseries. These sensors feed hourly updates on equipment performance to the technicians, giving them an opportunity to organize efficient routing to fix the equipment before it breaks. Servicing the equipment has proven to cost about one tenth what it costs for emergency fixes after failures, and the utilization of service personnel has also risen significantly.

Combining the three F's of mobility

Many companies in the food, beverage, and fast-moving consumer goods spaces are using the three F's simultaneously. Consider a service technician who depletes his inventory of a specific refrigerator part during a call. While he is in the field, he pings the retailer's inventory to replenish his supplies before the next day.

Incorporating business mobility into the enterprise

The fast pace of mobility adoption means that many enterprises have had to “simultaneously perform both first aid and major surgery”²⁶ to incorporate these devices into a managed environment. Understanding the playing field is a good first step. As General Mills' Don Mulligan says, “It's a matter of staying very close to an industry that's outside of our core. And hiring the experts we need to translate the technology into practical tools for our brand markets to use.”

The Clorox Company's Dan Heinrich adds, “We look at mobility area by area. We look at the tasks, such as getting better information on current inventory levels. And we

ask whether an investment in technology would get us quicker access to the data and, at the end of the day, result in better decisions and business lift.”

These types of conversations feed into an enterprise mobility strategy that covers process drivers, architecture selections, security, and controls. Mobile technologies help teams to develop concepts quickly through proof-of-concept (POC) projects. It is important, however, to take the time to ensure that infrastructure choices are strategic—enterprise-grade and scalable, rather than just short-term and tactical.

Security of wireless data remains a concern, but one that manufacturers and retailers can help address through policies and processes as well as by adding their own layer of software security on top of mobile operating systems. We are starting to see more robust mobile security solutions, such as the encryption of wireless data on computer memory.

Application developers see opportunities here as well. The startup Lookout provides a free application for Android and BlackBerry that lets users locate lost or stolen phones, back up data, and erase information remotely. DroidSecurity and RIM's BlackBerry Protect provide similar functionality.

Cloud computing will make it easier for enterprises to deliver and extend mobility apps and the data produced by mobile employees, including rich content, media, and interactive conferencing. Soon apps will work with a public or private cloud, expanding the inherent mobile capabilities to store data and rich content centrally. This transition will make it possible for mobile users with lower-cost devices to keep up with cutting-edge functionality.²⁷

Business mobility and the prospect for leaps in productivity

New digital technologies promise to boost innovation and efficiencies through business redesign

Guidelines for moving forward

Consider these guidelines when establishing a business mobility framework:

- Involve end-user communities early and connect with them in their work environments to identify how the technology can boost productivity. Then gain joint business and IT sponsorship for the investment. Think redesign, not just another layer of technology.
- Consider the total cost of investing in the mobile solution, in terms of both tangible and intangible benefits. Traditional two-year ROIs based on realized employee productivity gains must be tempered with the intangible benefits that may result, including improvements in customer satisfaction, employee and customer retention, and competitive advantage. Total project costs may be the best spending control in the near term of this innovation cycle.
- Think holistically when building a mobile development plan, but execute incrementally. Because adoption is the single most critical factor in realizing expected benefits, consider how the mobile technology impacts people's lives first, personal productivity second, and corporate performance third. Plans should incorporate an agile framework to take advantage of new technology innovations and deploy them in a rapid fashion.

- To evaluate the success of the strategy, select both hard quantitative performance measures as well as softer business measures such as “Did the mobile solution make our company easier to do business with?” and “Did the mobile solution drive innovation in how people execute their daily routines?”

Preparing for prime time

Many companies assume that deploying mobile technology is much simpler than deploying one of the enormous enterprise resource planning (ERP) solutions of the past. However, they should not assume that the process of adopting technology is different simply because the platform is mobile and “everyone loves mobile devices.”

Getting executive management buy-in is critical to a successful mobile business rollout. A top-down approach, with executives using mobile technologies in their daily work, is still one of the best ways to drive the rest of the organization to fall in line. Training executives to speak the language of mobility helps to ensure that all cascading lines of reporting follow that lead.

Maximizing multichannel growth

Four steps to a winning multichannel strategy

Brick-and-mortar stores haven't gone away, but consumer product manufacturers and retailers alike recognize the need for multichannel strategies that maximize high-growth opportunities in the digital channels. US retail e-commerce sales are expected to reach \$250 billion by 2014, with a five-year compound annual growth rate exceeding 10%, compared to 3% for in-store sales.²⁸ The mobile channel is growing at an even faster rate, buoyed by the billions of smartphones and tablets now in circulation.

The emergence of digital commerce channels is a disruptive factor. Just as retailers in the past focused on building stores in high-traffic locations, companies now have to adapt digitally to go where the consumers are. In 2010, digital web marketing spend exceeded print media spend for the first time.²⁹

Even when a purchase transaction does not occur online, digital channels heavily influence consumer behaviors and opinions. For example, a consumer in a store may receive a digital coupon or use the web to conduct product research. The percentage of new purchases in the United States that will be influenced by digital interactions such as these is estimated to be 48% during 2011³⁰— and that percentage is rising quickly as consumer behaviors continue to evolve in the digital era.

Multichannel consumers have high expectations

Multichannel consumers are an extremely attractive consumer segment, spending, on average, about four times more than single-channel shoppers.³¹ They also have high expectations for flexibility, and access to an unprecedented amount of information. Consumers who use multiple channels expect to be able to shop from the office, the kitchen table, the back seat of a taxi, or the aisle of a store. They know they have choices, locally and globally, and with a few touches on a smartphone, they can find the lowest price for any product.

Many multichannel consumers shop based on value and convenience, and they expect their preferences to be recognized based on past buying behavior. The more they use digital channels, the more they expect consistency and

seamless transitions across channels. They often focus on the product and the brand, not the channel they are using.

Many retailers in the food, beverage, and fast-moving consumer goods spaces are challenged to meet the demands of these shoppers and gain their loyalty. "There's only a limited amount of these direct conversations going on today," says General Mills' Don Mulligan. "But the idea that a consumer would be able to walk into a grocery store and either tap on an application or have a coupon or recipe idea automatically pop up that leads you to a specific brand—that is absolutely something that we are thinking about."

The gap between multichannel consumers' expectations and companies' ability to meet them has several components:

- **The expectation gap is partly technological.** Retailers' web and mobile commerce capabilities may not be sophisticated and agile, or the companies may not understand how to use online shopping data to achieve a deeper level of understanding of their consumers, or they may not have included location-based advertising in their digital media spend.
- **The gap is partly organizational.** Many companies are organized to execute and to go to market by channel, product line, or brand rather than by consumer, across brand and channel boundaries. With digital channel growth exceeding same-store sales growth, retail leaders may even be tempted to view digital commerce as a competing channel. As one retailer says, "The challenge is trying to get the stores on board and get them to understand that it's one business."³²
- **The gap is partly visionary.** Another gap exists in the vision of the opportunity. When Nordstrom adopted a multichannel approach to inventory, with a focus on satisfying consumers, the impact was immediate. The retailer displayed stock from its web warehouses and stores online, treating the stores as warehouses for the online business. It also upgraded its website to include editorial features, fashion blogs, videos, and multiple-criteria searches. After all, "The customer ordering via the website is not concerned with where the product is, only that it is in stock," said a company representative.³³ This change in attitude played through to margins and ultimately to earnings.

A day in the life of a multichannel shopper

6:30 am: Amy, a 45-year-old marketing executive in Minnesota, looks online for a recipe for a dish that a friend of hers tweeted about yesterday. She googles a cooking ingredient that she has difficulty finding in her local area, and adds a link for a web store that carries that ingredient to her cooking blog.

6:45 am: Before going to work, Amy orders groceries online to be delivered the next day to the refrigerator in her garage.

7:15 am: On the train to work, Amy looks online for a store near her office that carries a pair of shoes she wants to buy.

12–1 pm: At her lunch hour, Amy takes a bus to a nearby mall to buy her shoes. Amy uses a location-based social networking application to check in to her favorite restaurant at the mall and finds, to her surprise, that a

friend of hers is also in the restaurant. Together, they walk over to the shoe store, where her friend persuades Amy to buy a different pair of shoes.

6:00 pm: On her way to the train station, Amy receives a digital coupon from an electronics store she's walking past, so she stops and buys a new set of headphones.

6:25 pm: On the train heading home, Amy uses her tablet to upload pictures of her recent wedding anniversary dinner. She answers a tweet from a friend about the speed of the service at the restaurant. Finally, she browses the websites of several of her favorite brands, adding commentary to discussions on each one.

Building a multichannel strategy

Today, winning multichannel consumers represents a significant opportunity. Very soon, however, having a strong multichannel strategy will be table stakes to retain market share in many categories. The journey toward channel harmony includes four steps:

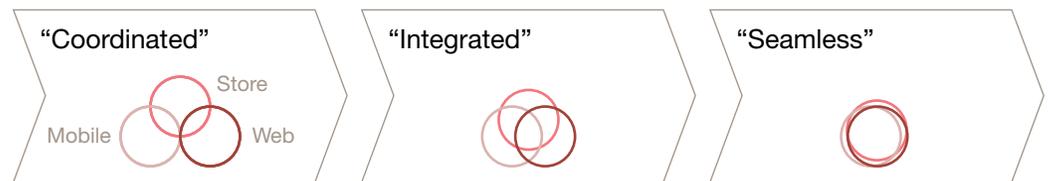
1. **Identify the current state.** Are competitors ahead in online capabilities and sales? Do legacy processes and systems constrain growth?
2. **Envision the future state.** Engage stakeholders in a common vision as questions are answered, such as: How can stores, media, fulfilment, and websites be aligned to drive consumer engagement and growth and achieve cross-channel excellence? What are the targets

for online and mobile sales by a specific date? How can customer experiences be digitally transformed to differentiate from the competition?

3. **Set a vision of multichannel as a differentiator.** Recognize the four dimensions of an effective multichannel model (customer experience, organization, processes, technology) and set metrics for each dimension. Define a roadmap for alignment and enablers to accelerate your growth plans, and involve stakeholders from across all functional areas.

The goal is to move from coordinated to integrated to seamless in each of the four dimensions of multichannel differentiation. Exhibit 25 provides an example of this progression for each dimension.

Exhibit 25
Move toward a seamless customer-centric experience



Multichannel Operating Model	Customer experience	<ul style="list-style-type: none"> Mixed messaging 	<ul style="list-style-type: none"> Integration of mass messaging across channels 	<ul style="list-style-type: none"> Personalized services and differentiated marketing
	Organization	<ul style="list-style-type: none"> Channel-centric 	<ul style="list-style-type: none"> Category-centric 	<ul style="list-style-type: none"> Customer-centric
	Processes	<ul style="list-style-type: none"> Separate processes/calendars by channel 	<ul style="list-style-type: none"> Planning touch points across channels 	<ul style="list-style-type: none"> One integrated calendar that supports unlimited channels
	Technology	<ul style="list-style-type: none"> Fragmented customer data and analysis 	<ul style="list-style-type: none"> Integrated customer data and segmentation 	<ul style="list-style-type: none"> Customer-driven scorecard

Source: PwC.

Maximizing multichannel growth

Four steps to a winning multichannel strategy

- 4. **Implement the vision.** This is done by tightly integrating IT and business functions, with joint goals and metrics. Fully integrate digital commerce with other channels to deliver seamless engagement (see Exhibit 26). Dedicate specialized business and technical resources to support digital commerce. And push toward maturation in each dimension, with regular assessments of progress.

Exhibit 26

Align retail, merchandising, supply, and IT for integrated digital commerce



Source: PwC.

Talk to and learn from consumers

CPG companies are still figuring out how to use digital channels to converse directly with consumers and to build the detailed profiles of consumer behavior that support seamless interactions across channels.

At The Clorox Company, “We’re really good at pushing data out to consumers, for example, if they befriend us on Facebook,” says CFO Dan Heinrich. “What we haven’t gotten really good at is how to have two-way conversations, in real time, and in a timeframe that is convenient for consumers. That is not the same thing as a consumer asking a question on a website and getting an answer in two or three days. And it’s not the same thing as waiting for consumers to pull data down or ask us to push it out. We want to integrate what we learn from these conversations with consumer insight on the product level. The tools for that are still young and evolving.”

Coca-Cola’s Duane Still echoes the sentiment: “We are having conversations with our mobile technology partners to figure out the best way to identify when consumers are in stores and push out promotions to them. If we already have a relationship with them and know they buy Caffeine-Free Diet Coke, we can push them a special offer coupon for that product.”

As is true at many CPG manufacturers and retailers, digital channels' ability to reach consumers is changing investment strategies at Sunny Delight Beverages Company. As the company's CFO, Bill Schumacher, says, "There is a tremendous amount of power in harnessing digital technologies so you become much more focused and much more targeted with the investments that you make in your brands and really hone in on your consumers. Our focus is on determining how we can leverage the available digital channels and make multiple digital channels work for us. This is getting more time and attention from us as well as a greater share of our investment dollars."

Digital channels have come of age

Creating seamless experiences for multichannel consumers represents an opportunity to gain the loyalty of an extremely attractive consumer segment. To do so, companies need to engage stakeholders across the enterprise to build a customer-centric organization capable of delivering value to this segment. And the clock is ticking. In a year or two, having these capabilities will be table stakes for winning and retaining market share.

Collaborate to keep up with digitally empowered consumers

Rich reserves of consumer data are waiting to be mined

Digitally connected consumers pose a major challenge to CPG companies and retailers: Will companies match consumers' voracious demand for more information and product where and when they want it, or even dare to be ahead of the consumer? Matching this demand will require collecting, sharing, and analyzing data together. Retailers and suppliers can no longer afford to remain apart because they worry about the accuracy and security of shared data.

Mobile technologies and social networks are supplying consumers with a wealth of information and capabilities, including making it easy to view prices and promotions and to compare products across a wide variety of attributes. The trend toward more sophisticated use of smartphones is clear: According to the Pew Research Center, 25% more cell phone users employed their devices to access the web in 2010 than the year before. Consumers are in the driver's seat and will continue to expect greater levels of sophistication and personalization.³⁴

Specialized applications for smartphones and tablets now allow for real-time comparative shopping, allowing consumers to point their phones' camera at a product barcode and, in seconds, know which other nearby stores stock the item, at what price, and what the item's availability is online. These capabilities are shifting consumers' shopping behaviors more rapidly than at any time in the past several decades. As a result, suppliers and retailers cannot assume that a store visit or a discount coupon translates to a sale.

Best Buy, for example, is experiencing the problem that consumers visit the stores to eyeball the merchandise and prices, and then use their handheld devices to find the best bargains in other stores or online. Essentially, Best Buy could become a "showroom" for its competitors, says Greg Melich of research firm ISI Group.³⁵

Although growing, digital shopping is still in its infancy. For the second year in a row, mobile holiday shopping peaked globally on the second Sunday of December—"Mobile Sunday." In the United States, mobile gross merchandise volume grew 127% over the same Sunday last year.³⁶ This activity is sure to continue to rise, and new consumer behaviors will emerge.

Fueling the speed of change

Now that consumers walk through the aisles with sophisticated applications loaded onto their handheld devices, it is only logical that suppliers and retailers should piggyback onto this capability. There are apps for short-term promotions and long-term loyalty programs, and use of these apps will broaden and deepen with information shared across the value chain. There is potential for companies to communicate with shoppers as they browse through the merchandise, logging their reactions to what they see. This technology is in test mode today and will become reality once privacy concerns are addressed.

Gordon Stetz, CFO of McCormick & Company, states that digital technology is "a big opportunity and a focus for us from a shopper insights standpoint." Colgate-Palmolive's Dennis Hickey shares this sentiment, stating, "We are investing in this area on a test-and-learn basis by systematically evaluating new approaches, and when we see something that works, then we will expand our investment." In the aggregate, available technologies will help inform consumer-driven media spending decisions about what should be stocked, where, and how to display and promote.

Other promising technologies are on the cusp of being deployed, such as the use of miniature barcodes that will allow consumers to learn about product details, special promotions, or loyalty rewards. Another technology awaiting roll-out tracks exactly where consumers travel in a store, using radio frequency identification (RFID) tags and/or near field communication (NFC). When these devices are combined with barcode entries at checkout, indicating what was bought, companies will get a good read on how store layouts and purchases interact. Similarly, RFID and NFC tags, which may be installed in the next generation of smartphones, can be embedded in a loyalty program card.

These and other enhanced technologies will give suppliers and retailers a better window into consumer needs, preferences, and real-time behaviors. To mine these opportunities, companies will need to improve their analytics capabilities. And suppliers and retailers will have to collaborate more closely.

The virtues of supplier-retailer cooperation

CPG companies have often struggled with and rarely embraced the notion of forming tighter information-sharing alliances with retailers. According to a recent survey of food retail and retail/wholesale companies, only 29% of respondents said they are sharing data with their suppliers. The share among larger retailers (those with 50 or more stores) is higher at 40%, but it's only 23% among smaller retailers.³⁷ With shoppers on the verge of accessing copious data on demand and using it to shop surgically, suppliers and retailers will need to go beyond their traditional positions regarding data sharing.

Closer collaboration could benefit both parties, through the exchange of essential information that allows each to better align supply with demand. Coca-Cola's Duane Still notes that the "My Coke Rewards" program obtains certain consumer insights such as flavor preferences, but lacks data on the kind of outlet from which a beverage was purchased. "The grand slam," says Still, "would be if we could know not only that it is a Caffeine-Free Diet Coke being purchased, but that it was purchased out of the Fastlane merchandiser while checking out at a regional supermarket."

To achieve optimal one-on-one marketing, the communication must go both ways, as General Mills' Don Mulligan explains: "The large amount of in-depth consumer data that we collect provides a level of understanding about the consumer that the retailer cannot obtain through point-of-sale data alone. Retailers don't have information about the consumers that are not coming to their stores, or the consumers that are coming to their stores but then going elsewhere for other shopping occasions. Because we have a view of the entire pool of consumers, we can not only bring insights about the consumer, we can bring insights about those consumers' buying habits that may not fall into a particular retailer's scope. This benefits all parties, as it allows for partnering opportunities on marketing campaigns, in-store promotions and events, and the like."

For a wired consumer, price often has been the initial driving factor in the purchase decision. Better understanding of consumer behavior beyond price considerations would have the effect of reducing promotion costs and increasing margins down the road. Promotions and spending can be more effectively targeted when both retailer and manufacturer know the outcome of spend.

Currently, there is little shared data or insight about how consumers behave inside a store. Given the scarcity of actionable data, remedy processes for poorly selling items are expensive and often result in losses for both parties. If companies could track what smartphone-wielding shoppers are doing and why, they would gain valuable insights that could inform better strategies around pricing, promotion, layout, packaging, and other elements of the shopping experience. And if companies could share regional and local store data more effectively, they would better understand micro-demand trends. Product placement, pricing, and availability all potentially could be improved.

Successful data-sharing arrangements between suppliers and retailers can also impact supply chain data, such as inventory levels, sales and product forecasts, shipment destinations, and status. Both parties can manage their logistics more efficiently, trace problems to the source, and respond more quickly to changes in demand.

One large food company has built such a foundation over the past decade by using Global Data Synchronization (GDS), a web-based network that exchanges standardized supply-chain data with retail partners. A PwC study found that food company retail trading partners using GDS generally outperformed non-users. GDS users, for instance, had 7% more accurate orders than did non-users, and were ahead on accurate invoices by 10%.³⁸ This demonstrates that even the most basic sharing arrangements yield substantial benefits.

The road ahead

The amount of digital data about shoppers' behavior is rising fast. Prith Banerjee, senior vice president of research at Hewlett-Packard, envisions a scenario where a young man shopping for a flat-panel TV uses his smartphone to compare prices and other consumers' experiences at different stores. When the shopper enters a store, the retail associate can identify him and tailor a sales approach. An expert in the latest TV sets greets him at the door, is primed to answer his questions, and can offer him discounts or package deals likely to resonate with him, personally—all gleaned from and informed by available data.³⁹

Companies are beginning to see the potential this new environment has in markets with maturing mobile applications usage by the consumer. McCormick's Gordon Stetz believes that collaboration with the retailer has been enhanced by digital technologies: "You want to make sure you are tapping into the tools that consumers are using now, collaborating with the retailer on the data we have, and making the shopping experience as easy as possible for the consumer," he says.

Companies leading the way are also beginning to position themselves appropriately to try and drive growth and effectiveness. They are investing in analytical and

operational infrastructure to simplify the capture, analysis, sharing, and leveraging of data—a fundamental building block of long-term capability. By investigating and choosing the right technologies, these companies are setting that foundation. They are also considering which specific retailers would make the best partners with whom to pilot new collaboration activities. These partnerships must be mutually beneficial, as measured by relevant metrics such as effectiveness, out-of-stocks, and bottom-line growth. Finally, these companies are building internal organizational capabilities with the mindset of analytics, collaboration, and results. Without an eye toward results and mutual, measurable benefit, companies will miss the opportunity to capitalize on these significant technology shifts.

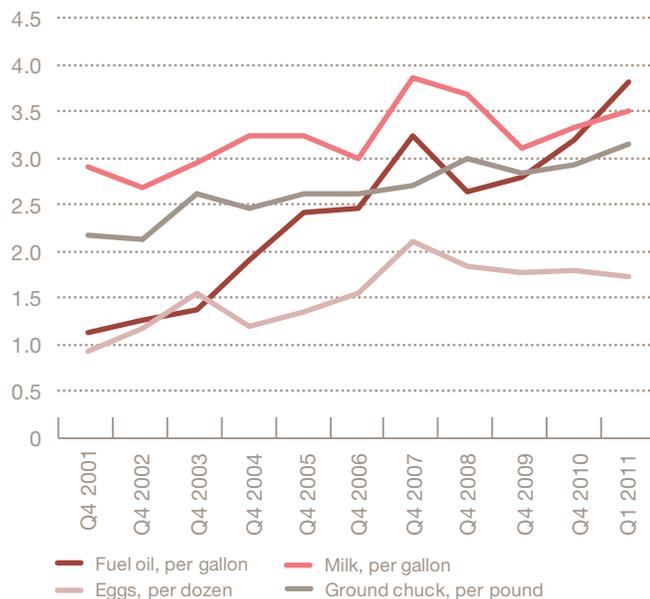
The digital shopping future is unfolding now, and it won't be long before consumers know a lot more about products—their availability, price, quality, and many more comparable attributes—than any retailer or supplier previously thought possible. In order to address the coming demands of the digitally empowered consumer, both suppliers and retailers will need to come together and learn to effectively share critical consumer data.

Roiling commodities: Protecting value by managing risk

Uncertain pricing demands a new, holistic paradigm of risk management

Commodity prices have been both high and volatile over the last three years (see Exhibit 27), and there is no relief in sight. Corn jumped 87% and coffee 77% over the past year,⁴⁰ for example, and in December 2010 the Food Price Index of the United Nations Food and Agriculture Organization reached its highest level since 1990.⁴¹

Exhibit 27
Commodity price indices



Source: Based on Bureau of Labor Statistics data (accessed June 2011) and PwC calculations.

For CPG companies, pricing volatility adds a dimension of unpredictability that makes it difficult to maintain margins and continue steady earnings growth.

Demand is high and climbing steadily, driven by the global economic recovery and fast growth in Asian and African consumer markets. With demand tracking or exceeding the available supply, every spike in orders or constriction in supply (e.g., because of a drought in Russia, a tsunami in Japan, or political turmoil in the Middle East) has an outsized impact on prices. Other factors also come into play, such as stockpiling of critical commodities, trade barriers, and increased speculation.

CPG companies face a huge earnings headwind as a result of these rising prices. Sara Lee reported \$550 million in higher commodity costs this fiscal year.⁴² And P&G reported an impact of \$1 billion after tax associated with commodity prices that were double their predicted levels.⁴³

Managing commodity price risks throughout the value chain thus has become more central in meeting strategic and financial objectives, as well as in reducing risk to acceptable levels.

Applying lessons learned from the last run-up

“There was a massive run-up in commodities several years ago,” recalls The Clorox Company’s Dan Heinrich. “I would have hoped those lessons learned were being reapplied now.” Sunny Delight’s Bill Schumacher agrees: “We certainly got a baptism from it, with the hurricanes and the oil shock in 2008 that went to \$147 a barrel.”

Even so, a recent PwC survey underscored significant gaps in the management of commodities risk. While many companies have adopted a more structured approach to risk management, their commodity risk management practices are not keeping pace with the escalation in price volatility.⁴⁴

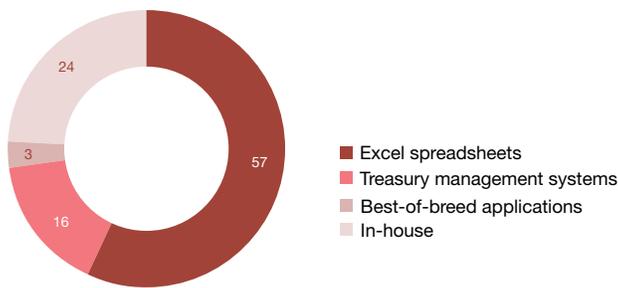
First, information about commodities (what, where, at what price, and on what contractual terms) has been dispersed across corporate departments. And decisions around commodities have often been made in individual functional silos (such as marketing, procurement, and treasury) without holistic management of these decisions through coordinated risk management governance—e.g., an enterprise risk management (ERM) group or commodity risk committee.

The second gap involves technology. At the same time these decisions are dispersed, companies are still struggling with identifying and implementing systems for aggregating commodity information gathered at different points in the enterprise. In addition, many corporate procurement organizations and treasury departments rely on Excel spreadsheets to track and manage commodity

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Uncertain pricing demands a new, holistic paradigm of risk management

price risk, even though this tool is poorly suited to the task (see Exhibit 28). Together, these two gaps highlight the old risk manager's adage that "you can't manage what you can't measure."

Exhibit 28
Commodity risk management systems in use (%)



Source: PwC, *Global Treasury Survey 2010: Can the Crisis Make Treasury Stronger?* (2010).

The third gap is the lack of a clear vision regarding how the company will continually evolve its approach to commodities price risk in light of its overall strategy. Sunny Delight's Schumacher explains how his company is developing a structured approach to commodity price risk management aligned with clear objectives: "We don't think about it in terms of beating the market. What we are going for is to develop a patterned philosophy in terms of how we approach our buying cycles. Whether you start out to buy 100% of your needed supply six months from now, or 75% nine months from now, or 50% fifteen months from now, you need a consistent philosophy of how you are approaching what you are doing. What we are after is price certainty, and then we can manage the tactics that we need to put in place to offset risk and maintain our margin structure. We are spending a lot more time expanding our skill sets in this area than we did in the past."

Assembling the right set of levers

CPG companies have long used a mix of strategic, operational, and financial mechanisms or levers to manage commodity price risk, with varying degrees of success. However, this time of slower growth in domestic markets, fast growth in emerging markets, constrained physical supply, and highly volatile prices calls for a new paradigm of commodity risk management. Prudent companies look at risk systematically within a holistic risk management framework that considers strategic, operational, and financial objectives. They understand their stakeholders' risk appetite. Furthermore, they approach risk management consistently throughout the company rather than separately in each functional area, and they employ leading-edge processes and tools.

Leading CPG companies establish objectives or thresholds within their risk appetite; they have action plans. And they understand the value that risk management adds to their organization—including, for example, predictability in commodity pricing and reduced risk of financial distress from high or volatile prices.

These companies have developed cultures and processes around identifying risk, reviewing the various levers for managing that risk, and then prioritizing levers based on a cost/benefit analysis. None of the operational, financial, and strategic levers is new; innovation comes in the mix and the evolution of the levers to meet specific enterprise goals.

Operational management levers

CPG companies employ a range of operational levers, such as:

- Changing their consumption of a commodity through adjusting formulation or demand
- Changing their procurement strategy
- Passing the risk on to consumers through pricing

- Passing the risk back to (or sharing it with) suppliers
- Reducing exposure by, for instance, becoming more efficient in energy consumption or other production costs
- Substituting an alternative for the commodity in production

Decades of scientific management, process re-engineering, and downsizing/rightsizing initiatives have made most large-scale CPG companies fairly efficient in how they operate their supply chains. Many industry leaders, believing they have reached the structural limit of incremental efficiency measures, have begun to get more creative by changing package sizes or using thinner plastic bottles.

As Sunny Delight's Schumacher explains, "We can't walk away from price increases, but we can soften the impact by sizing packages for specific price points or developing packages for new channels. Back in 2008, when there was a huge uptick in commodity expenses, we developed a product for a whole new channel for us, the dollar stores. Now, that product provides roughly 16% of our total volume. If a customer has \$100 to spend, she is going to have to make choices if prices go up. We have to insulate ourselves in the best way possible to ensure we stay in that basket when she walks out the doorway."

But as companies continue to push the limits of efficiency measures, they should take care not to alienate suppliers or consumers. As The Clorox Company's Heinrich warns about commodity substitution, "You have to be careful about consumer preference. You could end up with a chocolate chip cookie with no chocolate chips in it."

Collaboration along the supply chain is another approach commonly explored by CPG companies. As McCormick's Gordon Stetz explains, "We collaborate with our industrial customers on pricing to help them deal with volatility. We want to help them achieve their goals, whether they want to lock in a price for an entire year to have that certainty

or they are comfortable in their volatile environment and therefore don't want to take a definitive position. In this environment, it is essential for us to stay connected to our customers' goals."

Financial management

Price risk management using financial instruments reduces the residual risk that companies cannot address through operational levers. Leading companies are partnering treasury's knowledge and experience in managing price exposure in areas such as interest rate and foreign currency with supply chain's knowledge of commodity markets and the operational requirements of the business.

Hedging is a well-worn lever for controlling commodity price risk. Financial instruments create their own risks, however, so many CPG companies and their boards of directors are concerned about their misuse. With prices at or near all-time highs in many markets, companies are particularly concerned about closing the proverbial barn door too late. They are asking, "Is now the time to hedge?"

There is never a best time to hedge, just as there is never a best time to buy or sell. Hedging simply buys time and predictability from the time of the hedge to the end of the hedge. Hedging adds certainty and predictability to give the business time to employ other strategic or operational levers; it cannot be used to beat the market. For example, if a company locks in future prices for the next year and commodity prices continue to rise, the following year the company would again be hedging, but at higher prices.

Ultimately, rational hedging decisions can only be made through the lens of a robust financial risk management framework. Companies need to clearly identify their risk exposures and understand how these may impact their financial performance. With this knowledge, and in the context of well-understood objectives and risk tolerance, the company can make sound decisions about hedging strategy: what to hedge, how far out, and how much.

Roiling commodities: Protecting value by managing risk

Uncertain pricing demands a new, holistic paradigm of risk management

Finally, leading-edge processes and tools ensure financial instruments meet the company's objectives in a well-controlled and efficient manner.

As with all the levers, a company's hedging strategy should continually evolve in light of its management objectives. For example, some CPG companies are partnering with suppliers to jointly develop hedging strategies, while others are seeking sophisticated hedging instruments that allow them to turn any sharp market corrections to their benefit, rather than being locked in to a single price.

Strategic management

Strategic levers include vertical supply integration, operational efficiencies, and developing markets for product substitutes (e.g., the fructose market, which may have developed in response to the price volatility of sugar). These efforts may support more than one strategic objective; for example, creating new products and using new technologies may also help CPG companies with their sustainability goals.

Partnerships rather than full vertical integration may also be an option for some companies. As Coca-Cola's Duane Still says, "We don't necessarily plan to start buying orange groves for Minute Maid. Our preference is to find the right strategic partner that can do something better than we could if we were to vertically integrate up the supply chain. It's their focus and their core competence, but not necessarily ours."

While modern value-based management techniques and efficient capital markets limit the desirability and practicality of large-scale vertical integration across many industry sectors, we see examples of selective asset portfolio optimization geared toward either reducing exposure to commodity prices or managing supply chain risk. While these portfolio changes are typically made for multiple reasons, it is clear that reduction of price exposure and ensuring continuity of physical supply are among them.

Commodity-related risks encourage acquisition and divestiture activity. For example, commodity volatility and availability may be a contributing factor in some CPG companies' decisions to divest their non-core products. As Duane Still explains, "Pricing becomes moot if you can't find the supply. Continuity of supply has come into more commodity and even business strategy discussions recently than in the past couple of years."

Protecting value

We are well into another run-up in commodities prices, coupled with a high level of pricing volatility. No one can say with certainty where prices are headed over the long term, but most experts believe volatility is here to stay. Focused risk management, based on a cost/benefit analysis of a set of selected levers, is necessary to protect value and achieve the predictability needed for steady earning streams.

Benchmarking finance departments⁴⁵

Finance departments responded to the recession by cutting costs, but most of these departments have not yet addressed underlying issues such as process redesign, better use of technology, and organizational models. As a result, the cost of finance in these organizations has risen over the past year. Indeed, typical finance functions operate at over 60% higher cost than the finance functions at top-quartile performers.

To improve their performance, an increasing number of companies are benchmarking their finance function. This exercise has proved to be a highly effective method of comparison to companies of similar size, geographical location, and complexity, as well as within an organization (such as between business units).

Benchmarks combine quantitative and qualitative elements. Empirical fact-based discussions can be powerful on their own. And the qualitative side, distilled through interviews with finance team members, explores perceptions, mindsets, and priorities. Together, the quantitative and qualitative elements of benchmarks allow company executives to understand the gap between their own performance and that of top performers.

As these analyses show, key attributes that set top performers apart include:

- Systematic elimination of unnecessary process variation and the ability to improve processes that span across functional lines, rather than a narrow focus on finance.
- Higher levels of automation—for example, 37% of cash remittances are automated in top-performing functions, compared to 10% for typical functions.
- More consistent and reliable data sources, allowing finance specialists to spend over 30% more of their time on analysis than their counterparts.
- Effective use of shared services and outsourcing, underpinned by strong change and vendor management capabilities, typically managed on a regional or global basis and increasingly involving the development of multifunction business services.
- Use of smart planning tools, allowing budgets to be prepared almost 25% faster than can typically be done.
- Reinvestment of resources freed up by efficiency gains on core business and decision support, with over 40% more full-time equivalents (FTEs) in business insight roles.
- A commitment to attracting and developing talent (top-performing finance functions pay a significant premium for staff engaged in business insight roles) as well as high levels of automation to reduce time spent on data manipulation and allow staff to focus on intellectually stimulating analysis.

CFOs use the recommendations produced by benchmarks to focus their function's energy on the processes that are most important to their business. Benchmarking is based on a strong, repeatable methodology, which reinforces the credibility of the benchmark recommendations and makes it easier for companies to implement change initiatives based on these recommendations.

Section 2 Managing for growth

What does the consumer want? Increasingly, that question requires CPG companies to educate themselves about unfamiliar consumer behavior in new corners of the world. Multinationals will need to gain insights into the different cultures and preferences in emerging markets such as rural China. Here, digital can help, but it augments rather than replaces the value of feet-on-the-ground market assessment and reliance on the knowledge of local partners. Growth opportunities also lie in “green” products and services, and companies can tap into consumer attitudes about sustainability by monitoring blogs, wikis, and social networking sites.

International markets: The challenges of developing consumer insight

Analytics can make the difference between success and failure

For established CPG companies, the limited growth opportunity in their existing markets has been vexing. Developed markets such as North America, Europe, Australia, and Japan have stagnated as the global recession, coupled with saturated product categories, has significantly reduced annual growth. Consumers are wary of spending and are experiencing malaise from the bombardment of marketing messages. Corporate marketers in war-rooms from Cincinnati to London scour consumer data seeking an effective way to squeeze incremental growth out of their brands.

An alluring alternative has been to direct efforts into new markets, both the classic developing economies of Brazil, Russia, India, and China and other emerging markets in Africa, Latin America, Asia, and the Middle East. Yet there are major operational challenges to overcome, including tax and trade implications, sourcing and distribution challenges, environmental sustainability considerations, and a myriad of legal and cultural barriers to doing business. Unfortunately, as these issues are being addressed and a company starts to figure out how to *get* to market, the real challenge of what to *take* to market begins.

Such obstacles are heightened in developing and emerging markets because of the diverse and unpredictable nature of the prospective consumer base, and the structural problems of inconsistent infrastructures and immature channels for consumer messaging. Nonetheless, emerging markets are expected to grow at an 8% to 9% annual rate, and a recent report pointed out that “the 4 billion people living in poverty represent \$5 trillion worth of purchasing power.”⁴⁶ For both large and mid-tier CPG companies, these markets are difficult to ignore but intimidating to embrace.

One thing is clear: Gathering, understanding, and capitalizing on consumer insights in these new markets will be essential in creating long-term growth and market expansion. A company’s international success hinges on its ability to understand local consumer behaviors and priorities, by overcoming the challenges of collecting the right information and analyzing it in a way that is actionable. To truly address the needs and preferences of consumers in these new markets, and to win their loyalty, companies must be diligent in understanding every relevant aspect

of these consumers’ lifestyles—lifestyles that are often extraordinarily different from those of the companies’ current consumer base.

Misreading a prospective marketplace can be costly. CPG companies have pulled out of international markets when store formats and customer experiences that worked well at home did not excel abroad. Walmart, for example, pulled out of Germany in 2006 when consumers rejected suburban stores, overly solicitous employees, and checkout baggers.⁴⁷ Home Depot exited Beijing in 2011 because Chinese consumers had little taste for the do-it-yourself approach and fixed prices with no leeway for bargaining.⁴⁸ And Marks and Spencer pulled out of France for a decade, at least partly due to pressure from competitors with store formats designed to attract younger customer segments.⁴⁹

Another stumbling block can be product assortment and pricing. In South Korea, Walmart employed its Western marketing strategy of focusing on dry goods (e.g., electronics, clothing). However, South Koreans shop at hypermarkets for food and beverages. This mismatch was one of the factors that led to the retailer closing 16 stores in that country in 2006.⁵⁰ In another example, Best Buy closed all of its branded stores in China in 2011 when Chinese consumers proved unwilling to pay premium prices for high-quality service.⁵¹

How to gather consumer data?

CPG companies have begun to understand the challenges in even gathering accurate transaction or consumer information in newer markets. Unlike in developed markets such as North America and Europe, traditional third-party data providers cannot measure or provide SKU-level data from the point of sale in many new markets, because such technology is rarely available (and if it is, the breadth of the available data is not nearly as robust). Some category-level data is available in larger cities, but obtaining the detailed data that CPG companies take for granted in developed economies can be elusive. In fact, some CPG companies have challenged the accuracy of data provided by third-party research agencies. In 2009, Unilever challenged researchers’ data for India that showed a steady fall in the company’s market share across segments, saying it



contradicted the consumer product maker's internal estimates as well as data from another research firm.⁵²

Coca-Cola's Duane Still explains the challenges of unearthing the type of consumer data Coke needs to grow its broad portfolio of products in emerging markets: "Even if you have an IRI or AC Nielsen capability, the reality is that outside the United States, the consumer market is typically much more fragmented," Still says. "So even if you are able to get that data, the population you are actually getting that level of information about may be very limited." Coke relies heavily on its local bottlers to provide rich, real-time anecdotal data about prospective markets, be they large chain customers or smaller outlets in rural villages.

True feet-on-the-ground market assessment is one viable alternative. In order to better understand consumers in rural India, Colgate-Palmolive researchers immersed themselves in the lives of villagers, observing and discussing their oral care habits, how they clean their homes, and other daily routines. A key learning was that mothers hope for a better life for their children through education. Based on this insight, Colgate implemented a special promotion that helped build awareness for good oral care habits and offered scholarships to children.⁵³ "These types of programs have been very beneficial," says Colgate CFO Dennis Hickey, "and we have gotten some terrific insights that have turned into great ideas and initiatives."

Consumer data can also be acquired through traditional primary research approaches, as McCormick's Gordon Stetz explains: "We commission our own household paneling or surveys that are customized to the region to gain a better understanding of the local consumer's behavior and preference. This is done through either our teams on the ground or through the joint venture partners that we seek out to help us enter those markets."

Identifying and working with local partner organizations, whether commercial or governmental, is another alternative. P&G, for example, analyzed African markets through working with philanthropic and government groups⁵⁴ and discovered that African girls, lacking adequate sanitary supplies, often choose to stay home from school during their menstrual cycles, eventually losing a month or more of schooling each year and falling far behind in their

studies. To address this problem, in 2007 P&G launched its "Protecting Futures" program, in which the company created local aid partnerships and began distributing menstrual pads to African girls. In order to make the program viable, P&G had to find several local partner organizations, build clean bathrooms at the schools, and provide clean water. The program has already served more than 80,000 girls in 17 communities.⁵⁵ P&G hopes this effort will lead to profitable growth, as girls who use these free products are likely to continue to buy the same brand later in life and recommend it to their friends and family. "In Kenya alone, you need 20 partners," Gregory Allgood of P&G says. "The culture in rural areas is different from Nairobi, which is again different from the north, where so many of the Somali women are."⁵⁶ The obvious bet is that a reasonable investment in understanding the diverse consumer will lead to strong profits later.

Understanding the infrastructure

The level of technical infrastructure, and the maturity of customer channels in an emerging or developing market, also dictates how a company can leverage consumer insights to communicate with the customer. Consider mobile phones, which are ubiquitous in many immature markets. In a developed economy, a mobile phone represents one of multiple access points to the customer, but in many emerging economies it can be the only access point. Several CPG companies are currently exploring partnerships with telecommunications companies to help expand mobile phone coverage in exchange for consumer marketing access.

Ironically, the data collection weaknesses of developing markets (i.e., the limited technology infrastructure) can serve to focus the investment of CPG companies entering these same markets. In developed economies, the proliferation of consumer communication channels tends to fragment and dilute any single message. However, in a developing economy, it becomes easier to target the more limited channels with strong and focused marketing campaigns, which are also tailored to the level of technology and brand awareness. Further, as the messaging is consolidated, CPG companies are sometimes promoting goodwill for the overall corporate image, as opposed to an individual brand. This has the benefit of allowing

International markets: The challenges of developing consumer insight

Analytics can make the difference between success and failure

some flexibility in new product offerings and migration of products without having to rebuild consumer brand awareness. As consumer needs and preferences change, products in these markets tend to evolve at a more rapid rate than they do in developed markets. Investing to build recognition and loyalty at the company level allows a company's product portfolio to rapidly evolve to keep pace with a rapidly maturing market.

Paralleling the technical infrastructure and the ability of CPG companies to both understand and reach consumers, the physical infrastructure of a market also plays a key role in developing products to meet consumers' needs. Often, products sold in a developing or emerging market may have to be repackaged and reformulated to meet consumer needs. For example, smaller, cheaper, disposable packaging is important for lower-income consumers without cars who may walk several miles to reach a store. While detergent made for the US market is designed for washing machines and is often packaged in one-gallon plastic bottles, a similar product for the rural Africa market is sold in a single-serve disposable packet with a rinse agent formulated to work in buckets or in streams.⁵⁷ Similarly, Nestlé has adapted for certain regions by offering smaller, cheaper versions of products such as Alpino ice cream and Ninho milk powder through direct distribution to make them more accessible to low-income shoppers.⁵⁸ It is clearly critical to have insight into the lifestyle of the consumer.

Essential questions the world over

Consumer insight as applied to more mature, developed economies is important to drive incremental growth; however, consumer insight as applied to developing and emerging markets could very well be the difference between highly profitable success and earnings-draining failure. CPG companies seeking substantial growth and focusing on these rapidly evolving, fast-growing markets must ensure that they are targeting the right markets with the right messages.

General Mills' Don Mulligan points out that though the tools may not be the same, the goal is similar regardless of the marketplace: "How do you get inside your consumer's head and really understand their life?" Mulligan says. "How is your product making their life better or easier? What is the job that it is doing for them?"

That may differ by country, he added, and collecting data will shift depending on whether an individual is online, in a store, or in a home. "But what we have seen is that our consumer insight practices, that have been so well developed in the US and in Europe, serve us very well in the emerging markets as well. You might ask different questions, or catch them in a different setting. But you still want to understand how they interact with your product and how your product makes their life better."

There is no one-size-fits-all solution, and companies that recognize the challenges are seeking to quickly understand how to adapt to these new markets. These companies are often working with consulting partners to help them gather, analyze, and apply consumer insights on an ongoing, evolving basis. These consulting partners are able to apply their data-mining and analytical capabilities against local data to identify and exploit insights that can be applied toward specific product development and targeted marketing. Application of these insights allows companies to overcome technology and physical infrastructure hurdles with creative solutions that reward the challenges of international expansion with established local consumer awareness and long-term profitability.

An old axiom states that there are two kinds of companies: those that are playing to survive and those that are playing to win. CPG companies that are playing to win cannot ignore the opportunities of the world's up-and-coming economies. Leading companies are aggressive enough to take action, but understand that the same consumer preferences and behaviors that led to success in current markets will also lead to success in new markets—they're just different.

Global information reporting and withholding: Is your company ready for tax audit?

Many retail and consumer products companies are expanding into international markets to facilitate growth, or are considering international outsourcing arrangements to reduce costs. For these companies, global information reporting and withholding is becoming a significant business issue.

Of particular concern is the scenario in which a US company makes a payment of “US source” income (e.g., interest, dividends, rents, royalties, and compensation for services) to a foreign payee that otherwise may not be subject to US tax. Such a scenario may arise when a US company makes a payment to a nonresident alien contractor, such as an attorney or accountant, for overseas business expansion services rendered within the US, or when a US company makes a royalty payment to a foreign corporation for the use of proprietary formulas or know-how to be exploited in the US. Transactions of this nature typically require a company to file certain informational returns and withhold tax at a rate of 30%.⁵⁹ Failure to do so may result in the company being liable for the tax that should have been withheld, plus considerable penalties and interest.

Many companies are not in compliance with the global information reporting and withholding rules because they have not established policies and procedures designed to identify foreign payees and reportable US source income. Even where policies and procedures have been established, some companies are relying on manual processes or antiquated systems and software to ensure compliance, resulting in the need for ongoing training of those individuals responsible for implementing the global information reporting and withholding rules. Complicating matters is the fact that the departments most susceptible to noncompliance are frequently those outside the jurisdiction of the tax department, such as accounts payable, human resources, legal, marketing, payroll, pension, and treasury.

Despite these challenges, companies must ensure that they are adequately prepared for tax audit, especially since the IRS has designated information reporting and withholding as a “Tier I” issue, meaning audits in this area generally are mandatory. Once the IRS notifies a company of its intent to perform an audit, it may be too late to remedy any deficiencies, since remediation may take up to a year or more to complete. Therefore, companies should consider assessing their level of compliance as soon as possible. If deficiencies are found, companies should consider how to develop new policies and procedures, improve internal systems and software, and train personnel responsible for implementing the global information reporting and withholding rules. Such changes will directly impact a company’s success upon audit by the IRS.

China: Navigating the Twelfth Five-Year Plan

Growth through indigenization

With China's recently codified Twelfth Five-Year Plan, it is more important than ever for companies to revisit the strategies and tactics they use in China. Multinationals seeking long-term growth in China are adapting their business models to be more founded on indigenization—which in this context means the combination of two lenses, one domestic Chinese and one multinational, to develop and execute growth strategies. The domestic Chinese lens involves better understanding, respecting, and aligning with the perspectives of Chinese stakeholders, including central and local governments, suppliers, customers, employees, and universities. The multinational lens is a perspective aligned more with shareholder value and corporate citizenship. Successful companies are finding better means to grow profitably in China and to best reconcile differing stakeholder perspectives.

An overview of the Twelfth Five-Year Plan

China's Twelfth Five-Year Plan on National Economic and Social Development, reviewed and endorsed by the National People's Congress in March 2011, serves as a clear roadmap of governmental priorities and interests and a basis for company strategies and tactics. General Electric CEO Jeffrey Immelt says, "What I love about China is that it's transparent . . . you don't have to guess. You just say, 'What's the next Five-Year Plan?' Okay, here's our company strategy . . . here's where we're going."⁶⁰

While not a regulation or a law, the Twelfth Five-Year Plan does indicate how China's economic, social, environmental, geographic, regulatory, and legal landscape likely will evolve over the coming five years, as the government shifts from exports to domestic consumption as the country's engine of growth. It outlines how the government plans to guide business and society.

The plan aims to bridge the economic and social differences between the coast and the interior of China⁶¹ through a more inclusive agenda. In contrast to the predominantly economic agendas of years past (see the sidebar "Looking back at prior five-year plans"), this plan calls for a fundamental restructuring of the economy and transformation that will directly and indirectly affect

Looking back at prior five-year plans

The Communist Party of China has published Five-Year Plans regularly since the mid-twentieth century. Comparing the Twelfth Five-Year Plan to the previous two plans provides insight into the government's current agenda.

The Tenth Five-Year Plan (2001–05) focused on rapid growth via exports and investment in core industries and infrastructure. The Eleventh Five-Year Plan (2006–10) promoted a "harmonious society" with liberalization of the financial sector, indigenous innovation, and further incentives for promotion.

These high-growth plans boosted infrastructure and urbanization. However, they also resulted in a fracturing of society, with the "haves" (east coast cities, entrepreneurs, state-owned enterprises) and the "have-nots" (rural poor) separated by an increasingly wide divide. By 2010, China had surpassed Germany as the world's largest exporter and Japan as the world's second-largest economy.⁶² According to the International Monetary Fund, China could surpass the United States as the largest economy by 2016.⁶³ Yet the relocation of many of its citizens has caused social problems, and the environmental costs—such as from coal-fired plants—have been high.

how every company operates in China. Growth is still important, but there's a new urgency toward addressing social inequalities, environmental pollution, and resource scarcity.

The inclusive growth agenda of the Twelfth Five-Year Plan is intended to:

- Downplay economic growth (setting a target of 7% compared to the previous 7.5%) and emphasize structural issues
- Improve social infrastructure
- Increase wealth and a broader distribution of wealth
- Improve household consumption by reducing reliance on exports
- Adjust laws to encourage a consumer-driven economy
- Balance growth with sustainability

Companies are carefully evaluating the implications on their business and determining ways to manage their business in the rapidly changing environment. The expectation is that CPG companies have greater opportunities, but also that the competitive, political, social, and environmental landscapes will continue to evolve and become more complex as they intersect ever more with the overall economic agenda.

The significance for CPG companies

The Twelfth Five-Year Plan's emphasis on a more consumer-driven economy is clearly beneficial for CPG companies as it will drive actions and policies designed to boost consumption. Coming changes to the social security system, which historically has forced people to save, will help with the desired increase in consumption. This and other overall structural support is intended to create sustainable changes in consumer behavior, unlike the incentive-driven approaches used for major appliances and automobiles over the last two years.

One of the central strategies of the Twelfth Five-Year Plan involves increasing the income of the 900 million Chinese below the middle class, most of whom live in China's

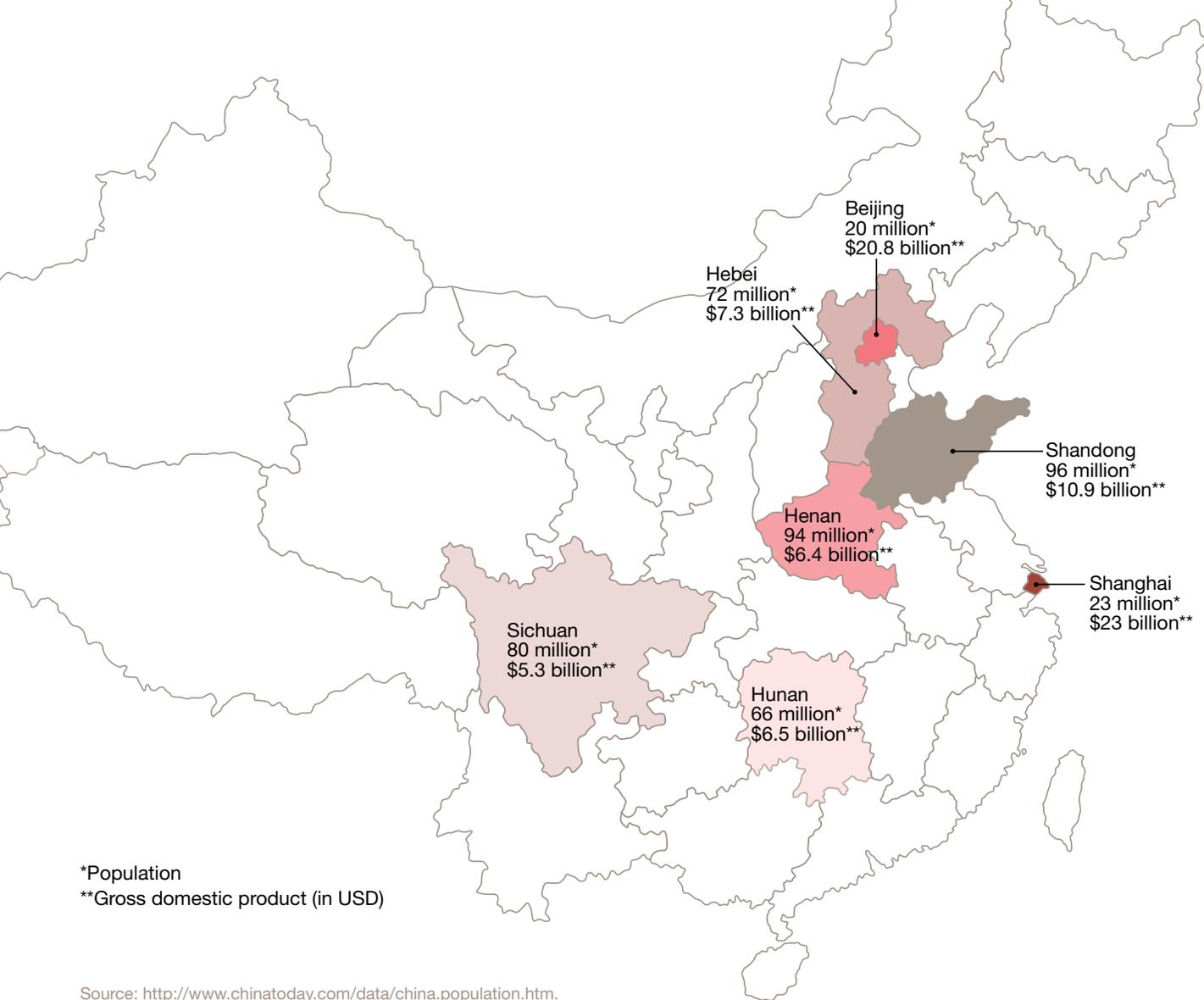
interior. To generate economic growth and absorb the new labor force coming online each year, the government clearly desires private investment in the inland provinces.

Cities within China are commonly grouped into tiers to describe their population and GDP—i.e., the largest three or four cities are tier 1, the next 15 or 16 are tier 2, and the next 20 to 30 are tier 3. Tier 1 cities (e.g., Shanghai and Beijing) represent the comfort zone for CPG companies currently invested in China. However, they are also reaching saturation in many categories. A hypermarket in the outskirts of Shanghai, for example, carries enough different beverages that consumers could try a different product every day for a year and still not sample every option.⁶⁴

As a result, many CPG companies are eager to reach consumers in the interior, particularly in the rapidly growing cities. There are more than 150 inland cities with populations over 1 million,⁶⁵ a number of which are tier 2 provincial capitals. And lower-tier cities are growing as fast or faster.

The size of these consumer markets has set off what Patrice Bula, until recently the CEO of Nestlé China, called “the last big industrial adventure.”⁶⁶ It will be no easy task to embark on this adventure, however. Even experienced personnel, with decades of experience in China, say it feels “like it's China all over again,” meaning they will face the same issues as they did when they first arrived on the coast—diversity and segmentation, achieving scale and speed, product distribution, acquiring talent—only on an amplified scale.

And as each of China's 33 provinces has its own Twelfth Five-Year Plan, companies cannot merely follow Beijing's lead. For example, the east coast province of Shandong plans to integrate agriculture and industry, which may create opportunities for food and beverage companies. The southwestern province of Yunnan, on the other hand, has focused its Five-Year Plan on technology and attracting companies such as Intel. Likewise, the implementation of the Five-Year Plan will differ in each province/municipality, so strategies and tactics that work in one province may not be effective in another.



The Twelfth Five-Year Plan includes new policies designed to stimulate growth in seven strategic emerging industries (SEIs): alternative energy, next-generation information technology, high-end equipment manufacturing, new materials, clean-energy vehicles, energy conservation and environmental protection, and biotechnology, which collectively are expected to generate 8% of GDP by 2015 and 20% by 2020, up from the current 5%. The absence of CPG from this list may actually be somewhat advantageous as companies in the sector may face fewer sensitivities than SEI companies related to mergers and acquisitions or other growth-oriented activities.

All of these positive signs will not come without their challenges. Companies should expect higher costs in the form of wages (with a 40% rise in the next five years), compliance (with more and stricter regulation), and taxes. In addition, companies should expect the implementation of new governmental policies to occur quite quickly and unexpectedly, rather than being phased in over months. As though this will not be challenging enough, expansion to the inland provinces requires a robust foundation to support incremental growth. Most companies will continue to expand their sales forces, construct more lines and plants, expand sales channels, and integrate acquisitions to drive growth. Much of this will be done during a period of changing policies.

Indigenization and growth

In China, the highly complex central and local governments tend to be the lead stakeholders in economic growth, shaping the interests and tactics of all companies that operate there. Beijing's pressure on Unilever to postpone price increases on shampoo and laundry detergent to help rein in inflation is a recent example.⁶⁷

P&G is placing the interests of Chinese stakeholders on equal footing with its own business interests. As company CEO Robert McDonald has noted, "P&G has an agreement with . . . [the] government that we call a joint value creation. Basically, it is our plan to say, 'Here's how we're going to help you create economic growth in [China].'"⁶⁸

A strategy developed through multinational and Chinese lenses involves a different degree of willingness to adapt and collaborate with national, provincial, and local governments as well as with the diverse cultures that exist within this vast country. Such a strategy departs from a growth model where the multinational perspective from headquarters determines the strategy for wholly owned or majority-controlled enterprises, and then leverages its capital expertise, marketing know-how, and branding.

A few of the drivers for a company to change its operating model in China include:

- **The confidence in the government and the state capitalism model in delivering growth and social stability.** The success and consistency of China's growth has demonstrated that the government has the capabilities, patience, and influence to actualize its vision for the country. CPG companies must be sufficiently aligned with this vision.
- **Increased competitiveness of domestic companies.** Formerly state-owned Nice Group and Guangzhou Liby Enterprise Group enjoy 35% of the powdered and liquid detergent sector, with Unilever and P&G controlling 8.5% each.⁶⁹ By targeting rural consumers and filling product gaps, beverage maker Hangzhou Wahaha has successfully positioned itself against competitors such as Coca-Cola and PepsiCo and created a \$5.2 billion business.⁷⁰

- **Divergent and increasingly sophisticated consumer segments demanding value and quality based on their local standards.** Attitudes about food and other consumer products vary widely across China. Even Guangzhou and Shenzhen, tier 1 cities only two hours apart, are very different from each other in prevalent language and lifestyle.⁷¹ Segmentation is far more complex than simply income strata.⁷²

Improving their understanding of Chinese priorities and behaviors has helped leading CPG companies to penetrate the country's many different consumer segments. These recent breakthroughs, however, also illustrate the likely gaps in understanding for many multinationals.

McCormick's Gordon Stetz points to urban eating habits as an example of a cultural insight: "A great deal of consumption occurs in wet markets [open food markets]. We realized we were not reaching those consumers, so we designed products to display at the point of sale in these markets. That way, people could select flavorings to go with their fish or their chicken. These products, which are intended for daily consumption, have a small packet and price point."

Truly filling these gaps requires a comprehensive local perspective of institutions, interests, and priorities. Product localization is only a narrow slice of this strategy. For example, indigenization might spur a CPG company to co-develop a product with a local partner and, at the same time, take appropriate steps to reduce the risk of that partner becoming a competitor. Mutually beneficial collaboration with Chinese stakeholders can, in other words, provide significant opportunities for multinationals' growth and profitability.

Implications for commercial operations

As they move to China's interior, CPG companies will need to apply the twin lenses of indigenization to their operations.

In the past, many multinationals outsourced distribution to local companies in order to reduce costs and move more quickly. Multinationals recognize that further interior penetration will compound the challenges they have experienced with this model, and many are trying to better manage the range of issues involving their distributors and suppliers in China. For example, many local distributors under-invest in service levels and quality.⁷³ Multinationals could monitor these distributors more closely as well as help them recognize the value of satisfying multinational interests in this area.

Factoring in the Twelfth Five-Year Plan should spur companies to consider how they can better collaborate to improve in areas like infrastructure and environmental protection, for the mutual benefit of the region and the company. Simply waiting to react to the new local policy—which invariably must be implemented in a couple of weeks—is a no-win situation.

Investments by the government and private industry will naturally drive distribution improvements that CPG companies can leverage. As General Mills' Don Mulligan notes, "Our main products in China are frozen, so we need a supply chain with frozen food capabilities. Urbanization has provided more middle-class consumers for the retailers to build a network around. The retail trade built the frozen infrastructure, which was the only way to do it economically. No one company could have done that."

At the same time, the Twelfth Five-Year Plan's sustainability, energy efficiency, and green technology agenda items will add costs and complexity to multinationals' manufacturing and supply chain activities—and it won't just be following the new rules that will be the challenge. Any initiatives in this area should closely assess the expectations of external stakeholders. For example, does

the fossil fuel usage in a multinational's revamped supply chain plan meet the 15% target in the national plan? How about the provincial target, if it is different?

The Five-Year Plan's heavy promotion of agricultural mechanisms, produce processing, and modernization of the agricultural sector could provide some of the needed improvements and could aid CPG companies' supply chain. However, this will also add more regulation (e.g., related to food safety), while at the same time helping farmers improve their efficiency and income. It will be interesting to see the strategies leading companies use to bring innovation to this extremely important sector of the population.

Furthermore, how can a company solve supply chain issues and support the Five-Year Plan's social agenda? Starbucks' purchase of coffee farms in Yunnan, a province of tea drinkers, is one possible answer, and has the added benefit of helping Starbucks to meet growing demand for high-quality coffee in China.⁷⁴

Implications for talent management

As CPG companies move inland, they will be forced to adjust their approaches to talent. Current talent management programs are not equipped to handle the size and range of expansion currently underway. And local companies are now luring top-performing candidates away from multinationals through improved salaries, benefits, and appeals to patriotism.⁷⁵

Past practice emphasized hiring expatriates and, secondarily, recruiting English-speaking locals with technical skills from coastal universities. Now, 63% of CPG CEOs are changing their talent strategies to position themselves for rapid growth in emerging markets.⁷⁶

The indigenization approach to talent is far more inclusive. Now companies are asking, "How do we find people who can still be highly effective even if they do not fit the usual profile?" and "How do we develop leaders who can effortlessly cross cultural boundaries and share our company's

values and definition of excellence?” Furthermore, companies are restructuring developmental paths and reporting structures to improve talent mobility and to give Chinese talent greater visibility internally.

In addition, companies recognize the need to better unleash the capabilities within their existing talent pools. As Lorna Davis, president of Kraft Foods China, says, “Whichever company can make a real connection with its people, it will get a level of bonding and performance unlike anything they have seen before.”⁷⁷ So, rather than continue to struggle with an endless search for talent, companies may try to unleash the hidden talent that may already exist within.

These shifts will soon change company culture, as Unilever CEO Paul Polman notes: “Within ten years, 70% of our business will come from the Far East. That shift eastward has tremendous implications for our company’s structure and culture. The values at the heart of our company certainly won’t change, but our culture and business model will need to evolve to reflect a changing customer demographic.”⁷⁸

The next stage of success

To succeed in China, CPG companies need to comprehensively evaluate the implications of the Twelfth Five-Year Plan and adopt indigenization strategies and tactics. This next stage of China growth will create significant opportunities and challenges for most CPG companies.

In sustainability reporting, assurance of data gains momentum

A third-party view can address partner and investor concerns

Disclosure on sustainability, particularly greenhouse gas emissions, continues to spread through the corporate world, and the information flow—whether through Bloomberg terminals, supplier sustainability scorecards, or annual reports—keeps growing. In 2010, 70% of S&P 500 companies submitted voluntary disclosures to the Carbon Disclosure Project (CDP), up from 56% in 2007.⁷⁹

In parallel, the number of sustainability reports issued by companies disclosing an array of environmental and social metrics in CorporateRegister.com's global sample rose from 823 in 2000 to over 5,000 in 2010 (see Exhibit 29). The Carbon Disclosure Project has been working with investors, corporations, and regulators toward improving the reliability, transparency, and relevance of greenhouse gas emissions disclosure, which in turn will support the work of assurance and verification professionals.

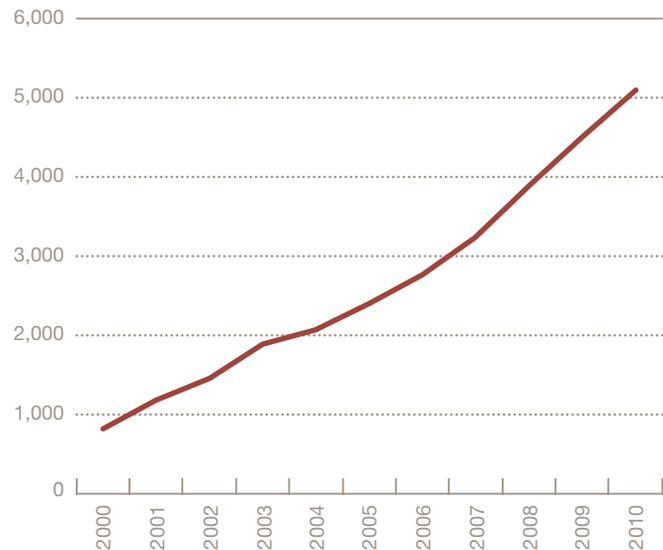
For the fourth year in a row, PwC has analyzed the financial performance of CPG companies alongside sustainability reporting performance. Reporting companies in our study include those that establish sustainability strategies, report on them, and achieve recognition for these activities through well-known sustainability indices. Non-reporting companies report only standard financial data. A company that reported sustainability data at any time during the five-year reference period was included in the reporting group.

Our most recent analysis examined 64 large CPG companies (\$4 billion or more in annual revenues). Of these 64 companies, 57 (89%) qualified as sustainability reporters, a 38% increase over the prior year. Clearly, sustainability reporting has advanced in this sector.

This year's study, as in previous years, found notable differences between the performance of reporting and non-reporting groups (see Exhibit 30):

- **Gross margin.** Reporting companies continue to trend noticeably higher than non-reporting companies in median gross margin. Over the past five years, reporting companies' gross margins have been higher, on average, than those of non-reporting companies.

Exhibit 29
Global growth in reports



A per-year count of all reports issued across all sectors and countries. Occasionally a company may produce two reports in one year, so these figures are not directly related to the number of reporting companies.

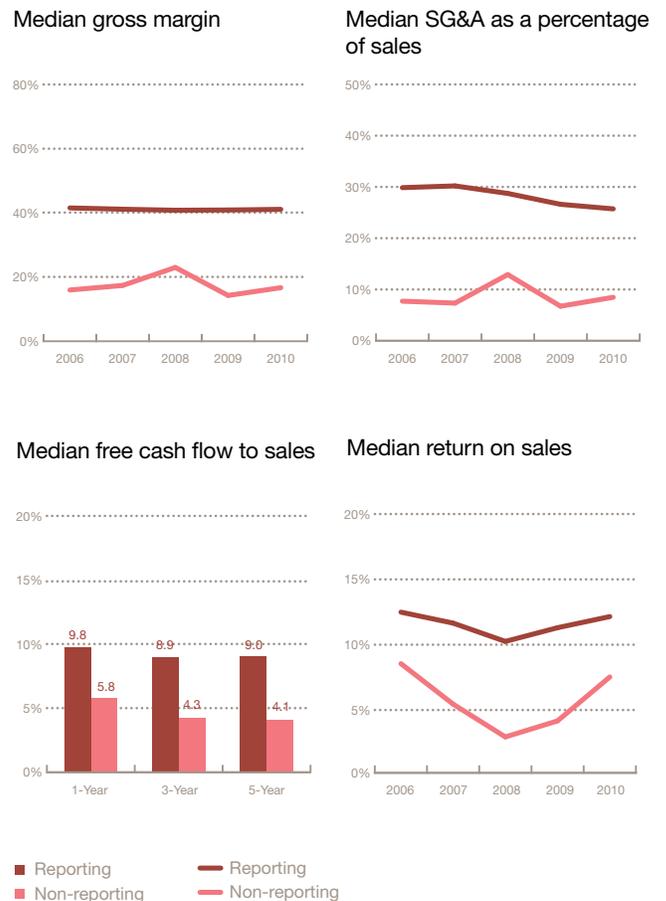
Source: CorporateRegister.com Ltd. (Copyright 2011).

- **SG&A spending.** Strong gross margins were supported by impressive SG&A spending, with the reporting group recording higher average median SG&A spending as a percent of sales.
- **Free cash flow to sales.** Higher margins also helped reporting companies to produce more cash than their non-reporting counterparts, as evidenced in their notably higher free cash flow to sales performance over that of non-reporters during the past one-, three-, and five-year periods.
- **Return on sales.** At the reporting companies, strong gross margins have also continued to drive substantially higher return on sales over non-reporters during the five-year period.

Clearly, there's a correlation between sustainability reporting and performance on key metrics. But while reporting companies outperform their non-reporting counterparts, cause-and-effect relationships are less clear. It's hard to determine whether reporting companies perform better *because* of their reporting efforts, or whether they're able to focus more of their attention on reporting activities because they're *already* performing well. Similarly, it is difficult to understand whether reporting is an extension of good management practices or whether companies are able to report because they are already effectively managing the issues they are reporting.

The big trend we are seeing among companies in the CPG sector and other industries centers on assurance. We are aware that many companies are now looking into assurance, getting a third-party view on some or all of the sustainability metrics they're reporting. Indeed, over 60% of the CDP Global 500 respondents already have their greenhouse-gas emissions data assured in some form.⁸⁰ And of the 57 companies that qualified as sustainability reporters in our study this year, about 18% already have some portion of their sustainability metrics validated by third-party assurers.

Exhibit 30
 Performance of reporting vs. non-reporting companies



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

In sustainability reporting, assurance of data gains momentum

A third-party view can address partner and investor concerns

Assurance can offer important advantages, as shown in Exhibit 31.

The CEO of one prominent consumer apparel company put it this way: “As the Walmarts and Targets of the world become more powerful, they are demanding that they get what they ask for. They won’t accept our word, but need third-party verification.”⁸¹

Given the boom in sustainability reporting and the benefits of assurance, use of third-party assurers will likely continue to gain momentum.

Exhibit 31

The value of assurance

Trust and credibility	<ul style="list-style-type: none">• Increased management transparency and accountability and, as a result, opportunity to build trust and enhance credibility with stakeholders
Management comfort	<ul style="list-style-type: none">• Comfort to management with respect to existing management systems and processes• Knowledge that decisions and disclosures are based on accurate and reliable information• Gives a strong message of the importance of accuracy and completeness to those involved in the internal data collection process
Continuous learning and process improvement	<ul style="list-style-type: none">• Provides recommendations on how to improve reporting systems and processes, as well as procedures for data collection and target setting• Helps drive continuous improvement in sustainability reporting• Facilitates a sharing of best practices and knowledge
Key stakeholders	<ul style="list-style-type: none">• Increased credibility in reported data resulting from third-party assurance can enhance trust and promote stability• Strengthened relationships with customers, employees, shareholders, suppliers, neighbors, and regulators• The Dow Jones Sustainability Index and the Carbon Disclosure Project both look for some level of independent third-party assurance as part of their performance assessments
Risk management	<ul style="list-style-type: none">• Reduces the risk of material misstatement and inaccurate reporting

Source: PwC.

Green products: Applying ROI discipline to targeting business opportunities

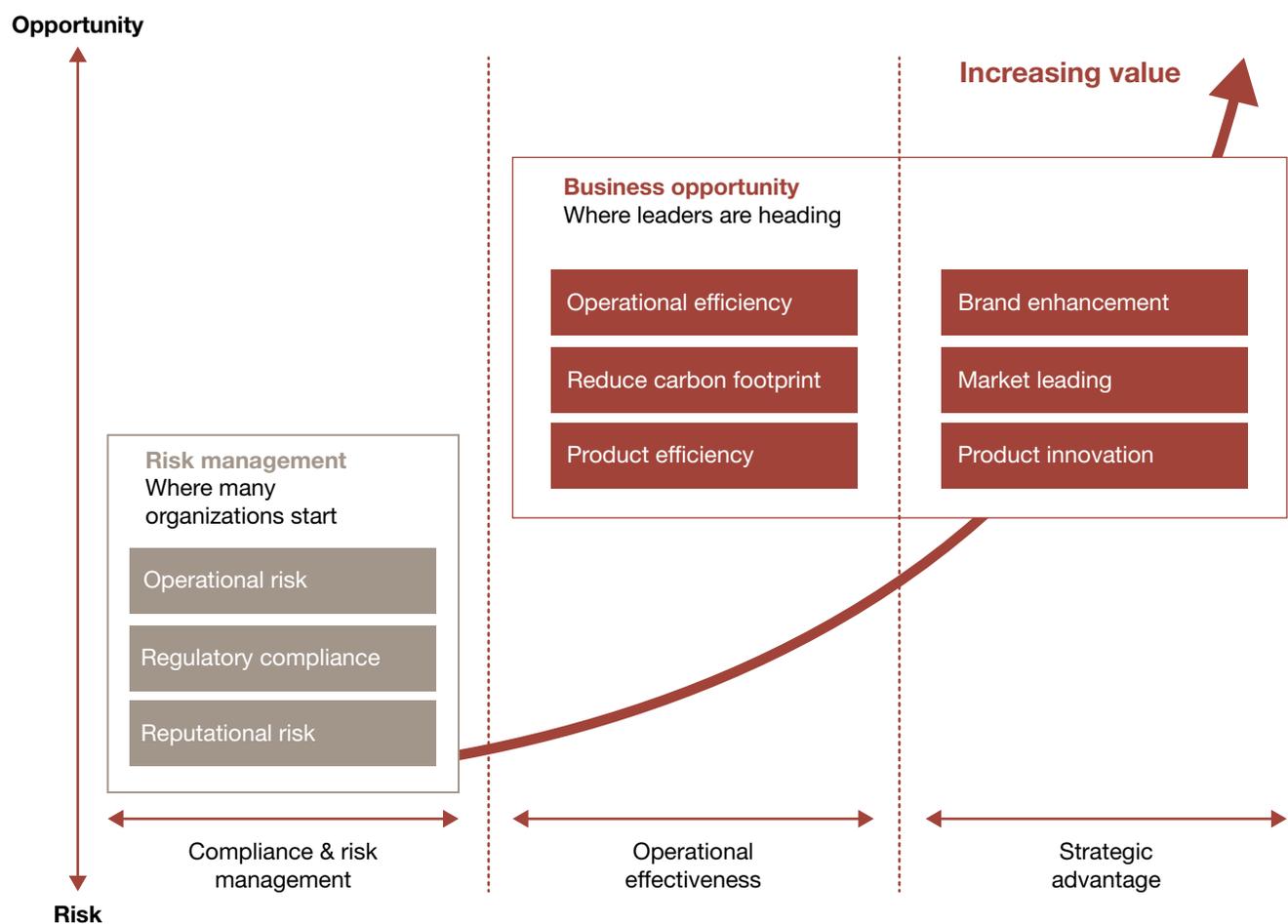
The focus on sustainability broadens beyond efficiencies to brand equity and revenue opportunities

“We think of sustainability not just in terms of our growth strategy, but as something we have to do to compete,” says Coca-Cola’s Duane Still, and it’s a sentiment echoed by many other C-suite executives in the food, beverage, and consumer products industry. Indeed, in PwC’s *14th Annual Global CEO Survey*, 64% of all CEOs surveyed and 70% of consumer product CEOs surveyed agreed with the statement that developing products or services that are environmentally friendly is an important part of their innovation strategy.⁸²

What’s driving executives’ interest in sustainability? Increasingly, it is the recognition that sustainability can be an important source of value creation by enhancing brand equity and revenue opportunities from new sustainable goods and services. This is a significant shift from the traditional focus on efficiency, cost reduction, and risk management (see Exhibit 32).

Exhibit 32

A shifting focus from managing sustainability risks to capturing market opportunities



Source: PwC.

Green products: Applying ROI discipline to targeting business opportunities

The focus on sustainability broadens beyond efficiencies to brand equity and revenue opportunities

In the CPG industry, demand for products with sustainable attributes is coming not just from the traditional drivers of environmental regulations and pressure from non-governmental organizations, but increasingly from consumers and retailers. For example, in a recent survey of consumers in four developed and four emerging markets, the majority of the respondents expect companies to be actively engaged in environmental initiatives, including reducing toxins in products, increasing recycling, and responsibly managing water.⁸³ Similarly, many large retailers have aggressive sustainability goals, supported by specific policies and procurement guidelines.

In response to these market forces, more companies at every step of the value chain—from raw material and packaging suppliers to transport vendors to manufacturers to retailers—are incorporating sustainability into their business strategies. Yet developing a sustainability strategy and communicating it to consumers is not easy. Complexities in consumers' needs, interests, and buying behaviors make it difficult for companies to know with certainty what consumers want and how much they're willing to pay.

The complex consumer

When selecting retailers or brands, consumers weigh a wide array of sustainability factors, ranging from “reduces waste” and “buys products from local producers” to “supports fair trade,” “has energy-efficient store operations,” and “focuses on animal welfare.”⁸⁴ Consumers are also more self-interested than they might let on. For instance, respondents in a survey said that it was more important for companies to offer good value than to be “environmentally conscious.”⁸⁵ Consumers' interest in (and willingness to pay for) value can also vary considerably by products across regions and with economic cycles.

Moreover, although consumers may have good intentions to buy green products, barriers often get in their way. These include higher prices for green products, a limited selection of items to choose from in stores, difficulty finding products (because green offerings may be stashed in specialty sections of a grocery store rather than on the main shelves),

and confusing product labeling or marketing messages. Disappointing experiences with a product marketed as green (a “natural” household cleaner that doesn't clean as well as a conventional one) can scare consumers away. And supposedly green products that turn out not to be can leave consumers jaded about “green washing.”

Further, while many consumers say they would be willing to pay a premium for green products, how much they actually shell out at the cash register can be another story entirely and can fluctuate depending on the product itself. One PwC study showed that consumers are less willing to pay a large premium for everyday items that have a known price (such as a cup of coffee) compared to items possessing indulgent qualities (such as a high-end chocolate bar).⁸⁶ Don Mulligan of General Mills highlights this challenge of balancing sustainability aspirations with pricing realities: “In today's economic environment, the hurdle's higher because you are still seeing tendencies based on finding value, so you really have to be sure your sustainability actions continue to provide the right price point for the consumer.”

Jon Moeller of P&G adds, “The value from sustainable products to the consumer is an ‘and’ value. If consumers can get the product efficacy that they desire and, at the same time, be sustainable, that's a very strong proposition.”

Applying ROI discipline

Though the global economy hasn't fully recovered from the Great Recession and consumers continue to be price sensitive, the key tenets of becoming green in the corporate world have not changed. Companies continue to pursue sustainability agendas to achieve growth and operational efficiencies, protect their market share, and manage risk by meeting or exceeding consumer expectations of environmental performance.

Sunny Delight is making “the biggest single investment as a business since we bought Sunny D from P&G six and a half years ago,” says CFO Bill Schumacher, referring to a packaging change for their gallon bottle that will reduce raw material costs, reduce distribution costs, allow more

Green products: Applying ROI discipline to targeting business opportunities

The focus on sustainability broadens beyond efficiencies to brand equity and revenue opportunities

product to be displayed on retailers' shelves, and fit better in household refrigerators. Schumacher adds, "When you look at the entire supply chain, we've developed a bottle that we think is fundamentally better for everybody—the consumer, the retailer, the environment, and our company. It's a part of managing that margin structure which will put us in a position to maintain the investments that we are making in our brands."

To stay relevant to consumer needs and target sustainable innovation strategies that drive growth and brand value, companies should consider:

- Developing a deeper understanding of consumers' preferences and demands for sustainability, and their willingness to pay premium prices
- Aligning consumer priorities with product innovation and growth initiatives
- Assessing all sustainability initiatives through a prioritization framework
- Applying advanced analytics to track and measure the progress of sustainability initiatives through active business cases and business intelligence, in order to measure and manage realized value
- Collaborating with value chain partners to articulate the value proposition for enhancing brand equity, and to generate revenue growth
- Making targeted investments to ensure the highest possible return without losing overall market share and/or adding to the overall cost base

Using technology to crack the consumer code

To demystify consumers' attitudes, needs, and behaviors regarding sustainability, companies are already using standard methods such as online or in-person surveys, including interviewing shoppers about their green attitudes and purchases as they exit grocery stores. Focus groups and third-party consumer research provide additional insights.

But digital technology can help in this effort. Monitoring blogs, wikis, and social network sites can allow companies to tap into consumers' attitudes and concerns about sustainability, and to monitor what consumers are saying about particular food and beverage retailers. Improved analytics capabilities may also enable companies to use more advanced segmentation techniques and "propensity to buy" models to determine which green products will resonate most powerfully with which segments of the consumer base, and thus will command premium pricing.

Moreover, mobile apps may help companies track consumers' purchases (for example, identifying who is willing to spend the most on green products) as well

as their presence in retail stores. Equipped with such data, firms could transmit product information and special offers based on individual consumers' past buying behavior.

Finally, barcode scanning technology, along with handheld-device applications, may enable companies to convey the sustainability information shoppers are seeking. With some products today, consumers can scan a special barcode on the product to see information about the item's carbon footprint or other sustainability attributes. Through the Microsoft Tag platform, businesses can post Tag barcodes in their retail locations and consumers can scan or snap a picture of the Tag to download information about the business to their mobile device. One survey showed that the top reasons that consumers scan barcodes are to compare prices, to read product reviews, and to receive special offers. Moreover, grocery items make up the largest percentage of products scanned and purchased.⁸⁷ As sales of smartphones and use of mobile barcode scanning continue to grow, companies will likely increase their reliance on such technologies to not only gather information from consumers but also to communicate with those consumers.

Green products: Applying ROI discipline to targeting business opportunities

The focus on sustainability broadens beyond efficiencies to brand equity and revenue opportunities

Note that “highest possible return” will mean different things to different stakeholders, even within the same company. Applying a consistent ROI discipline throughout the organization will require weighing the financial return that can be quantitatively measured in a discrete period of time against the ever-important brand reputation that speaks to long-term strategic value.

Take, for example, P&G’s Tide Coldwater line of laundry detergent, which performs optimally at lower wash temperatures and thus reduces electricity use during the wash cycle. From the consumer’s standpoint, the savings associated with not having to heat the water more than pays for the cost of the detergent, which is offered at a price consistent with Tide’s other detergent varieties. P&G’s Jon Moeller describes the method for measuring the return for this product through a commercial approach, noting, “We made an investment to research and develop the product, and the return is measured based upon the profit generated from this product.”

Contrast that with Clorox’s Green Works line of laundry and home cleaning products, which is known as being environment friendly. Sales in 2008, the initial year of launch, were \$100 million, but have since declined to about \$60 million a year. Focusing on the short-term financial returns might cause a shift away from this brand, but Clorox sees the longer-term value. “We believe the fundamentals of the category and this sustainability mega-trend are real,” says Clorox spokesperson Dan Staublin, “and the key, really, is to strike the right value proposition.”⁸⁸

Given that strategic priorities of all types must fight for funding, only those innovation initiatives that have high ROI are likely to retain their support at the top of the organization.

Putting the ROI-driven approach to work

Price-sensitive consumers and the slow pace of economic recovery have many CPG companies questioning how they can justify pursuing a sustainability agenda around growth and product innovation. Companies that make targeted investments in sustainability initiatives will stand the best chance of creating long-term value and revenue growth.

Shifting priorities away from sustainability initiatives may seem rational in the current environment. But before decisions and investments are made, companies must be able to clearly articulate the ROI and how they align with the broader growth strategy.

The revenue proposition for CPG companies is simple: meet downstream sustainability demand at a reasonable cost with high performance. However, the need for rigor lies in applying ROI discipline to identify and prioritize the sustainability demands/preferences that drive consumers’ purchase decisions.

Water, water . . . no longer everywhere

Evidence is growing that, drop by drop, the supply and quality of water worldwide are on a steady decline. The downward trend in the availability of clean water stems from converging forces that include aging water-distribution infrastructure, population growth and urbanization, pollution, and climate change. By 2030, an estimated 3.9 billion people—47% of the world population—are expected to be living in areas with high water stress (mostly in countries that are not members of the Organisation for Economic Co-operation and Development⁸⁹), and demand for water will outstrip supply by 40%.⁹⁰

For retailers and CPG manufacturers, water scarcity and quality problems present daunting challenges. To feed an additional 2.3 billion people by 2050, worldwide food production will have to increase by 70% over current levels.⁹¹ As agriculture is the predominant user of water globally, food production will be a main contender in the quest for sufficient supplies of clean water. The problem will be exacerbated as companies expand into emerging markets, given that agriculture accounts for a significantly higher percentage of water usage in low- and middle-income countries, as compared to high-income countries.

Water scarcity has serious implications for business. Water-related business risks take three forms:

- **Physical**, such as disruptions to or declines in water supplies needed for production
- **Reputational**, including conflicts with local communities over access to water
- **Regulatory and legal**, as when a company loses its license to operate because of changes in water rights and wastewater treatment requirements

Many companies are already contending with these risks. In the *CDP Water Disclosure 2010 Global Report*, 39% of businesses surveyed reported experiencing detrimental impacts related to water.⁹²

Water-management responses

A few CPG companies have taken promising steps to better manage water supplies:

- Unilever developed a water-management plan that includes working with farmers to reduce water used for crops, reducing water use in internal manufacturing operations, designing products that require less water

during use, and helping consumers understand how they can save water.⁹³

- In 2009, Coca-Cola partnered with communities and non-governmental organizations to focus on watershed protection, conservation, and accessibility to clean water and sanitation. The effort replenished the equivalent of 22% of the water used annually in Coke's finished beverages.⁹⁴
- Over the past decade, Nestlé has reduced its total water withdrawals by over 30%, more than doubled the water efficiency of its internal operations, and made significant reductions in the quantity of wastewater discharged into the environment.⁹⁵
- The Indian arm of PepsiCo became the first of the company's global units to put more water back into the environment than it consumes. The beverage giant achieved "positive water balance" through actions such as conservation in agriculture (e.g., using direct seeding technology in place of more water-intensive paddy transplantation), community programs like construction of check-dams and recharge ponds, and rain or roof-water harvesting.⁹⁶

Companies that are just starting to develop a water-management plan should address these questions:

- How—and how much—does our business rely on water?
- When considering our direct operations and our supply chain, how will we be affected by changes in the following: water availability and quality, price volatility, reliance on energy sources that require large amounts of water, changing consumer preferences, and new regulations?
- Who will be responsible for water governance in our business, and what will their roles and performance metrics be?
- What are the water-related opportunities on which we can capitalize (e.g., creating additional supply through recycling technologies or reducing demand through conservation technologies)?

With a solid water-management plan in place, executives will gain an understanding of water-related risks throughout the business. They will have greater insight into which water-related goals are most feasible given the company's operations, and which goals, if reached, will make a real difference.

Section 3 Spotlight on regulation

Federal regulatory changes could have major impacts on CPG companies. Fundamental tax reform, for instance, is back on the agenda in Washington. The United States has one of the highest combined federal and local corporate tax rates in the world, but it's not clear whether the final plan will include net tax relief for corporations. New food safety legislation, meanwhile, could raise compliance costs on food companies. Many food companies are now taking stock of how they and their suppliers need to adjust operations not just to comply, but also to create a stronger food safety system.

Safety first, again: New risks, new legislation for food companies

Food industry steps up internal and supplier evaluations

The food safety landscape in the United States is being reshaped by many forces—most recently by President Barack Obama’s signing of the Food Safety Modernization Act (FSMA), which represents the most significant changes in food law in over 70 years. To maximize food safety and ensure compliance with new regulations, food company executives will need to understand these forces, assess their company’s ability to comply with FSMA regulations, and rethink their food safety practices.

A confluence of powerful forces

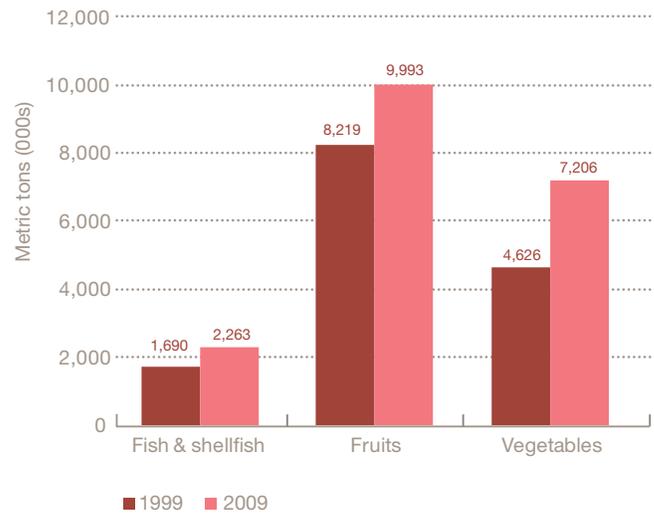
The changes reshaping the food safety landscape are buffeting companies from several directions. Consider consumers’ rising expectations and demands. Today, people expect the packaged foods they buy to be safe, even if they don’t cook the products according to the instructions on the packaging. In addition, consumers want their favorite foods to be available at any time, even when a fruit or vegetable is out of season.

To deliver those strawberries or avocados that North American consumers want in January (at manageable prices) and to obtain ingredients available only overseas, food companies are further globalizing their supply chains. In the United States, food imports have reached new heights. According to the US Department of Agriculture, imported fruits rose from 8.2 million metric tons in 1999 to almost 10 million in 2009. Importing of vegetables, fish, and shellfish showed major increases as well (see Exhibit 33). Today, imports account for as much as 15% of the US food supply, including 80% of the seafood and about 60% of the fresh produce that Americans consume.⁹⁷

At the same time, food production and distribution have become increasingly centralized, in some regions through the consolidation of farms. Combine centralization with supply chain globalization and the risk of major outbreaks of food-borne illnesses can skyrocket. Indeed, such outbreaks, along with recalls of food products, have recently made food safety a hot issue in the United States. With centralization, safety lapses at any one farm or processing plant can make large numbers of people sick, sometimes fatally. The federal Centers for Disease Control

Exhibit 33 Import growth

(Volume of imported seafood, fruits, and vegetables, 1999 vs. 2009)



Source: USDA data.

and Prevention estimate that there are 48 million cases of food-borne illnesses in the country each year, resulting in 128,000 hospitalizations and more than 3,000 deaths. Outbreaks can ruin a company’s reputation, slash its stock price, and even force it into bankruptcy. Product recalls are also expensive, costing the food industry millions of dollars. As Kellogg Company CFO Ron Dissinger notes, “Recent product recalls have driven a heightened awareness of food safety within our company.”⁹⁸

Yet even as globalization and centralization accelerate, many retailers and restaurants are coming under increasing pressure to use locally grown foods. This can create risk when local foods are not grown, processed, or handled by people knowledgeable about food safety.



Through modern epidemiological advances, we now know more about what causes food-borne illnesses (including which pathogens affect specific foods), how such illnesses spread, and how to prevent them. Advances in testing technology have transformed the food safety landscape by enabling food companies and regulators to find food-borne illnesses faster and more easily than ever and connect them back to specific food sources.

The FDA Food Safety Modernization Act

All of these forces have complicated the safety picture for food companies, and the signing of the FSMA in January 2011 stepped up the complexity. Designed to build a new system of food safety oversight, with an emphasis on prevention,⁹⁹ the FSMA has key provisions including increased Food and Drug Administration (FDA) inspection frequency, expanded records access, import certification authority, and mandatory recall authority.¹⁰⁰ The law also requires all registered food facilities to re-register with the FDA on a biennial basis.

Though the law has been signed, the FDA is still writing regulations, and whether Congress will provide the \$225 million appropriation¹⁰¹ that the FDA has requested to begin implementing the law remains uncertain. Executives are also considering the cost implications of compliance with the new law, including user fees for the voluntary qualified importer program, re-inspections, recalls, and export certification.¹⁰²

In an industry already struggling with tight margins, compliance costs could put an even tougher squeeze on food companies. To be sure, executives acknowledge the good intent behind the new law. For example, Don Mulligan of General Mills notes, “We’re strong supporters of the new US food safety legislation. We think it sets the right standards for the industry. To the extent that it improves the safety of the entire food chain in the US, that’s a net benefit to everybody who plays in our space.” But executives are also aware of the challenges that the new regulation may present.

For all food companies, there’s not much time to prepare: Compliance with many sections of the law (such as giving the FDA access, upon request, to all records related to a food product) must be demonstrated immediately. For other sections, the FDA’s timeline calls for compliance within 180 days, 270 days, and in half-year increments up to 2.5 years.¹⁰³

How food companies are responding

Despite the uncertainties surrounding funding of the FSMA, many companies are acting now to anticipate the new regulations, safeguard their brand, and avoid potential costs (such as fees that companies must pay for required re-inspection of a facility by the FDA). While the FDA may not currently have the funding to fully enforce the new regulations, it has the funding to write them.

Assessing ability to comply with the new law

Industry executives are taking stock of how well positioned they are to comply with new regulations. Bob Reinhard of Sara Lee’s Food Safety, Quality & Regulatory Affairs group says, “The Act provided another opportunity to educate our organization. Executive management wants to understand how we are making sure that we meet the standards that they, our leaders, and our employees and customers expect of our brands and our products. Additionally, the operations and sales and marketing sides of the business have been engaged in the discussion. They’ve learned even more about food safety over the past few years, but the passing of the Act definitely increased our discussions about the impact food safety has on our business.”¹⁰⁴

Companies are also seeking advice from experts on what the FSMA really means for them and what outcomes it will likely have. Many are examining their food safety records for completeness and accuracy as they consider the FDA’s expanded access to those records. Says CFO Bert Alfonso of The Hershey Company, “We are actively engaged with GMA and outside counsel to fully understand all aspects

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of the FSMA. This includes the records access provisions. Corporate and manufacturing plant quality assurance professionals are reviewing recordkeeping practices and providing employee training on the importance of complete and accurate food safety records.¹⁰⁵ Executives are also mulling over how much they need to modify their food plans or whether they should write new ones altogether.

Stepping up supplier evaluation

Owing to globalization of the supply chain, many companies use numerous foreign suppliers. As provisions of the FSMA require companies to document for the FDA how they're verifying the safety of what they receive from these suppliers, executives are exploring how they might strengthen their supplier evaluation processes and/or build supplier verification programs—a move that carries its own costs. As Coca-Cola's Duane Still notes, "The new food safety standards are prompting us to take a fresh look at our partners within the supply chain so that we can identify and strengthen our relationships with suppliers who have the same high quality standards and commitments as our own, which may impact the availability and cost of our supplies."

To bring suppliers into the food safety picture, more companies are asking suppliers to obtain third-party inspection certification. Traditional supplier performance metrics—such as speed of delivery, price, and a supplier's financial soundness—are no longer sufficient. But certification has limitations. For one thing, it hasn't always prevented food safety failures, perhaps because accreditation programs have proved inconsistent in their execution. For example, Peanut Corporation of America, which had received a good score from a third-party certifier, shipped products contaminated with salmonella, leading to one of the largest food recalls in US history.¹⁰⁶ Moreover, with the FSMA in place, the FDA will likely require more rigorous inspection processes. Indeed, the FDA now has the authority to build its own accreditation program and to review third-party inspectors. Its expectations and standards will probably exceed those currently in place. Finally, all this verification takes time: Food companies

must examine each supplier's food safety practices and confirm compliance with US food safety requirements—a difficult task when a company has many suppliers and is striving to complete the work in the 18- to 24-month time-frame laid out by the FSMA.

Establishing a food safety/FSMA steering committee

To better manage the uncertainties associated with new risks and FSMA regulations and consequences, some companies are establishing food safety/FSMA steering committees. Steering committees may be combined with or remain separate from an organization's food safety department. In an effective committee, members comprise the heads of finance, legal, public relations, quality assurance, food safety, and business units or product categories identified as carrying the highest risk of safety failures (e.g., fresh produce).

The committee meets regularly with the company's quality assurance and food safety experts to stay on top of what the experts are doing, where the major food risks reside within the company, whether the business's risk profile is changing, and how the company is managing its vendors. Members consider whether FSMA requirements may differ from what the company is already doing in the area of food safety, and discuss strategies for complying with timetables laid out in the act. Committee members also actively seek to educate themselves on the subject—for example, by attending related conferences.

A food safety/FSMA steering committee creates critical benefits for an organization. Perhaps most important, it puts food safety under the umbrella of enterprise risk management, enabling key members throughout the organization to understand what's happening in food safety. Through the steering committee, risk experts can begin reviewing food safety practices throughout the organization, flag potential risks, and, if necessary, develop new and better strategies for mitigating those risks. Such moves suggest increasing attention to companies' efforts to strengthen their food safety programs (see the sidebar "Seven steps to creating a food safety culture").

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Another benefit of having a food safety/FSMA steering committee is that, because the committee comprises leaders from a wide range of functions in the organization, those proposing new changes stand a far better chance of obtaining the approvals and funding needed to execute new strategies. A CFO who has participated in food safety discussions and strategy sessions will likely be more willing than a less well-informed CFO to liberate funds for development of, say, a new food plan.

What companies should be doing

While the steps that food companies are taking to stay ahead of FSMA regulations are laudable, companies will need to do more to navigate successfully in the new food safety landscape. In particular, executives must:

- **Carefully examine their food plans.** For example, in developing food plans, many companies use the hazard analysis and critical control point (HACCP) requirements for criteria such as identification of preventive controls, validation of those controls, and food defense. But the FSMA's plan requirements go beyond HACCP.

Seven steps to creating a food safety culture

1. **Start at the top.** C-suite executives must lead by example and make food safety a core value.
2. **Align leadership.** Ensure that leaders' decisions reinforce the goal of continuous improvements in food safety—even when shifting production to countries with relatively weak safety standards or lax enforcement.
3. **Establish enabling processes and systems.** Regularly assess risks and set up processes and systems (such as internal multidisciplinary teams and external audits for controlling them) both inside the company and at every link in the supply chain.
4. **Hold everyone accountable.** Ensure that every employee, department, and team is committed to the same food safety objectives, and is held accountable for meeting those objectives.
5. **Train.** Use formal and informal training to develop the skills needed to achieve desired food safety outcomes. Consider providing training for suppliers and requiring routine refresher training.
6. **Communicate strategically.** Identify critical audiences for communications (employees, regulators, suppliers) and determine the best means to deliver key messages to each. For example, employees may respond best to town hall meetings, while suppliers may need education and training. Communicate a consistent message to each audience.
7. **Use the right metrics and incentives.** As part of annual reviews of organizational and individual employees' performance, use a balanced scorecard to augment financial metrics (cost savings, efficiencies, yields, capacity) with quality and safety metrics (consumer complaints, preventive maintenance).

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- **Inject more rigor into how they document testing procedures.** Companies cannot test their way to food safety, but a good testing regime is critical because it provides a path toward understanding and documenting the risks that the company's testing programs are addressing. Executives must use this information to sharpen their focus on preventive controls.
- **Challenge the assumption that the company is adequately managing food safety risk.** The food safety landscape is complicated. Even the most effective food safety teams must ensure that they are considering emerging risks, looking for what could be coming around the corner, and collaborating with key parts of the business, including supply chain management, procurement, new product development, and business development.
- **Anticipate and develop strategies for mitigating new risks.** These include the possibility that the FDA will put greater criminal penalties into the regulations it develops for the FSMA.
- **Address risk holistically.** Companies need to examine every link in their supply chain and their own facilities for the presence of risk and develop mitigation strategies. For example, what will the business do if a trusted major supplier switches to a new vendor with unknown or questionable food safety practices?

Not “business as usual”

Given the increasing complexities and uncertainties altering the food safety picture, executives cannot assume that it's business as usual in the sector. Instead, they need to anticipate what the new regulatory environment and other changes will mean for their companies. They must also take active steps to encourage accountability for food safety throughout their organizations and in their supply chain partnerships.

Tax reform on the agenda

US policymakers take a hard look at corporate tax reform

Fundamental reform of the US tax system, a perennial subject of back-burner debate, is now working its way front and center in Congress and the White House. Even if a major reform package does not get voted on this year, CPG companies should start to engage in the political process now so they can influence the eventual outcome. P&G's Jon Moeller says, "There is a high need for engagement. We are trying to ensure that US domicile companies are wholly competitive with their international competitors, which ensures that American companies have every opportunity to maximize growth, raise capital, and create jobs. It is critically important—not just for our company or other companies, but for our country. At stake is nothing less than American industry, American jobs, and American standard of living."

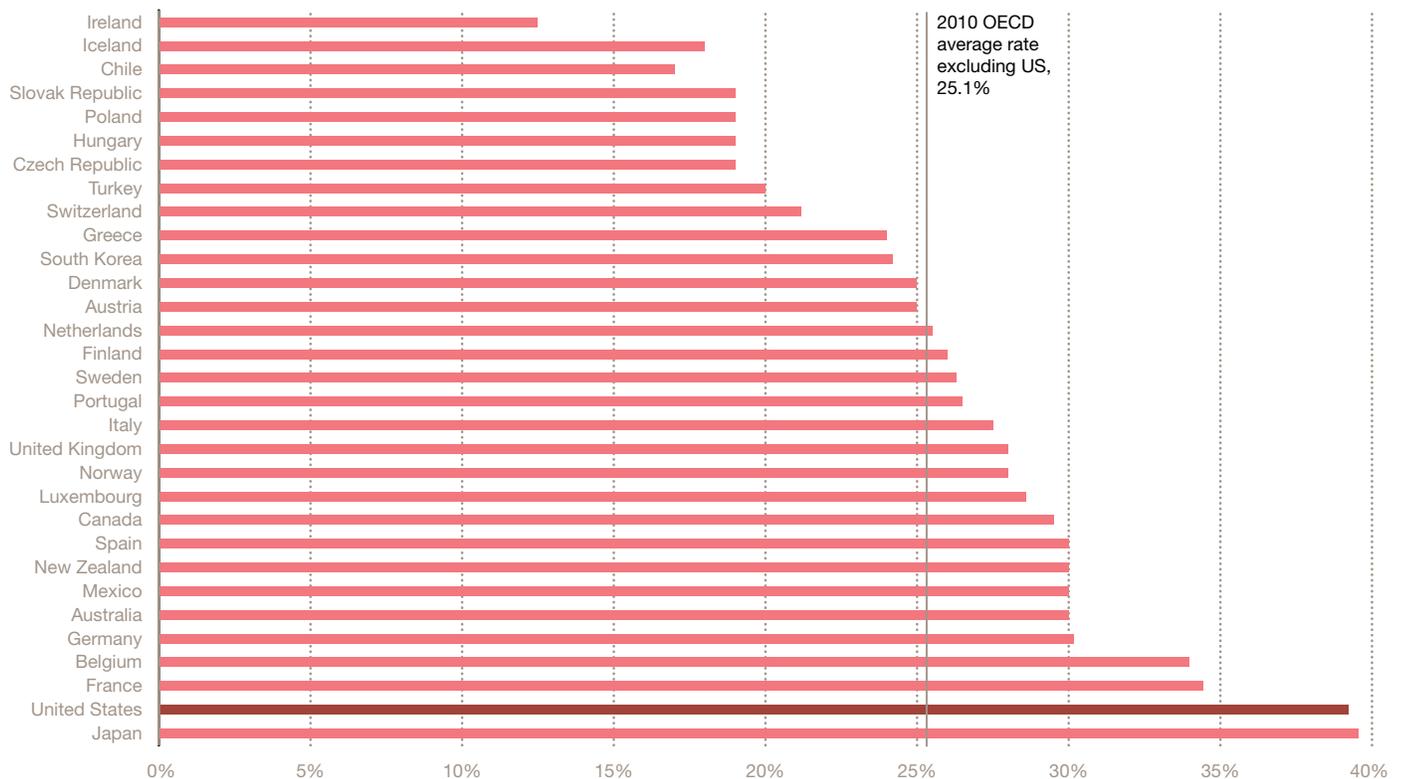
The international context

Many analysts argue that the US tax system needs reform in order to raise the relative competitiveness of US companies and to make the United States a more attractive location for investment by both US and foreign companies. These arguments have been building over the past decade and are taking on increased importance now that the country is contending with slow economic growth and continued high rates of unemployment following the recent recession.

Comparisons of corporate tax rates begin to illustrate the competitive obstacles facing US multinationals. The United States has the second highest combined federal and local corporate tax rate among the 34 countries of the Organisation for Economic Co-operation and Development

Exhibit 34

OECD corporate tax rates (combined federal and local), 2010



Source: Taxation of corporate and capital income, Table II.1. Corporate tax rates, @ OECD, 2010.

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(OECD)—more than 50% higher than the average of other OECD countries, as shown in Exhibit 34. And the gap is bound to grow, as a number of other countries, including Canada and the United Kingdom, have enacted corporate tax reductions for 2011 and future years.

The United States departs from most other advanced economies in another way: It taxes the active foreign earnings of overseas operations of US companies when the earnings are remitted home. All other G7 countries, and 26 of the 34 OECD countries, have “territorial” tax systems that generally exempt dividends received by their multinational companies that are paid out of the active foreign earnings of their subsidiaries (see Exhibit 35). Each of the OECD countries with a foreign tax credit system has significantly lower statutory corporate tax rates than the United States. Some countries limit dividend exemption to substantial shareholders, or to treaty countries that impose corporate income tax above a minimum rate. France, Germany, Belgium, and Japan exempt 95% rather than 100% of foreign dividends.

Exhibit 35

Home country tax treatment of foreign-source dividend income received by resident corporations

Exemption			Foreign tax credit
Australia	Germany	Portugal	Chile
Austria	Hungary	Slovak Republic	Greece
Belgium	Iceland	Slovenia	Ireland
Canada	Italy	Spain	Israel
Czech Republic	Japan	Sweden	South Korea
Denmark	Luxembourg	Switzerland	Mexico
Estonia	Netherlands	Turkey	Poland
Finland	New Zealand	United Kingdom	United States
France	Norway		

Source: PricewaterhouseCoopers, Worldwide Tax Summaries: Corporate Taxes, 2010/11.

Deficit fears

The extent and impact of tax reform may be shaped by concerns over the US budget deficit. The Congressional Budget Office (CBO) projects the deficit for 2011 will be \$1.5 trillion, or 9.8% of GDP, up from \$1.3 trillion in 2010, or 8.9% of GDP.

Under the official CBO baseline, based on current law, deficits would decline to 3% of GDP in 2015 and increase to 3.2% of GDP in 2021. But these “current law” projections incorporate a degree of fiscal stringency that neither political party currently advocates, including not extending any of the individual tax reductions in effect since 2001 that are due to expire at the end of 2012. Under an alternative baseline representing current policy (taxes maintained at 2011-equivalent levels and discretionary spending growing with the overall economy), the deficit would exceed \$1 trillion in every year, reaching \$1.9 trillion, or 8% of GDP, in 2021.

Many analysts thus believe that current tax and spending policies are unsustainable. They argue that the country needs budget solutions involving a mix of reduced spending and higher taxes to avoid a fiscal crisis.

The bid for revenue neutrality

Ongoing deficits thus could limit the extent of reform in providing net tax *relief* to corporations. The Obama Administration, for instance, is taking the stand that business tax reform must be revenue neutral, meaning that business tax cuts must be fully offset by other business tax increases, not by increases in other taxes or reductions in spending. Changes that reduce tax burdens and increase international competitiveness, such as a lower statutory corporate tax rate, then would need to be offset by other changes that increase tax burdens by an equivalent amount—for example, by limiting certain deductions or eliminating tax credits.

The bipartisan National Commission on Fiscal Responsibility and Reform recommended lowering the corporate tax rate to a range of 23% to 29% and putting in place a territorial system for foreign-source dividends. The Fiscal Commission would eliminate more than 75 corporate “tax expenditures” and 30 business tax credits, although it lists by name only a few tax expenditures, including the last-in, first-out inventory accounting method.

Even revenue-neutral reform proposals merit careful evaluation and consideration by US companies. As a practical matter, each company will need to calculate how alternative reform scenarios affect its own bottom line. And if executives can identify opportunities for reforms that a united business community could advocate, the odds of legislative enactment will be higher.

Consumption taxes on the horizon?

Although the Fiscal Commission plan included higher gasoline taxes to assist in deficit reduction, it did not propose a new revenue source, such as a broad-based consumption tax. One Fiscal Commission member, Andy Stern, did propose an alternative recommendation that included a 10% to 15% value-added tax (VAT); however, the proposal was not supported by other members of the commission.

In contrast to the Fiscal Commission, one influential deficit reduction plan designed by a task force co-chaired by former Senator Pete Domenici and former CBO director Alice Rivlin for the Bipartisan Policy Center, a Washington think tank, calls for a 6.5% “debt-reduction sales tax.” The tax would operate in the same manner as a VAT, with tax collected at each stage of production and a credit given for prior taxes on production inputs. This consumption tax would phase in at a 3% rate in 2012 and would raise an estimated \$3 trillion in revenue between 2012 and 2020.

An alternative approach proposed last year by Rep. Paul Ryan (R-WI), chairman of the House Budget Committee, is an 8.5% subtraction-method VAT (also referred to as a business activities tax) as a replacement for the corporate income tax. Like a VAT, but unlike the corporate income tax, the tax in Ryan’s 2010 proposal would be border adjustable—levied on imports to the United States and refunded on exports from the United States. The consumption tax was not included in Rep. Ryan’s “Path to Prosperity,” adopted as the House budget plan for 2012.

At the state level, California’s Commission on the 21st Century Economy recommended the repeal of the state’s corporate franchise tax and its replacement (along with other funding of tax reform) by a 4% “business net receipts tax.” This subtraction-method VAT would apply to the net receipts (gross receipts minus purchases from other firms) of almost all entities doing business in the state. While not adopted by the California Legislature, this proposal has

Tax reform on the agenda

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been discussed in the context of tax reform in other states, and could result in states adopting some form of VAT before the federal government does. Several other states in recent years have already replaced their corporate income taxes with taxes based in whole or in part on gross receipts —e.g., the Ohio Commercial Activity Tax, the Michigan Business Tax (repealed earlier this year), and the Texas Franchise Tax (aka “Margin Tax”).

Vigilant and engaged

While Congress is sharply divided along party lines, tax reform could be a sufficiently compelling issue to make legislators find common ground, as happened with the 1986 Tax Reform Act. And if not this year, tax reform is a strong possibility at some point in the near future.

One lesson from 1986 is that those companies and industries that become knowledgeable and participate in legislative policy development early on stand to make a greater contribution to the final product. CPG companies can provide valuable input to lawmakers by modeling the impact of alternative reform options on their competitive position and their ability to increase investment and employment in the United States. P&G is one CPG company that has been very active in the reform discussion. The company’s CFO, Jon Moeller, advises, “I would encourage others to simply be active participants in the dialogue, whether that’s at a local level with their senator or representative, or as a member of an industry group, or individually as circumstances warrant.” To make a difference, CPG companies have to be part of the conversation.

Harvest the benefits of corporate inventory donations

Reaping the tax benefits of corporate inventory donations can be difficult for many retail and consumer products companies because of the documentation required to support an enhanced income tax deduction. Here is a short guide to making the most of these donations.

Companies often make charitable contributions of inventory to tax-exempt organizations in order to manage storage and handling or disposal costs associated with excess product. For example, a food and beverage company may donate canned goods nearing expiration to a tax-exempt organization providing food to needy children. Similarly, a household products company may donate returned merchandise to a tax-exempt organization providing shelter to homeless families. In addition to savings associated with disposal costs, the companies in these examples may be entitled to an enhanced charitable contribution deduction, assuming the donations are structured correctly and the requisite documentation can be obtained.

In general, a company is entitled to deduct the fair market value of donated property. When ordinary income property (such as inventory) is involved, the deduction typically is limited to the company's basis in the property. However, charitable contributions of inventory used to care for the ill, the needy, or infants may result in an enhanced deduction.¹⁰⁷ The enhanced deduction is equal to the company's basis in the contributed inventory, *plus half of the profit that would have been recognized if the inventory had been sold at its fair market value on the date of contribution (not to exceed two times the company's basis in the contributed inventory)*.¹⁰⁸

Some companies are unable to claim the enhanced charitable contribution deduction because they cannot efficiently capture the information necessary to document the deduction. This often occurs when a company's business operations are in multiple locations, when a company's management is highly decentralized, when a vertically integrated group of companies has significant intercompany transfers of inventory, or when a company's ERP system is inadequate.

A company facing obstacles like these would ideally implement new policies and procedures and purchase a new ERP system or develop software designed to document qualified inventory contributions. Unfortunately, this type of solution may prove to be extremely time-consuming and very costly to implement, especially when a company's business operations are in multiple locations. In lieu of waiting until the new system or software has been fully integrated, companies should consider using statistical sampling in order to secure additional tax benefits in the interim. Tax benefits obtained in interim years could then be used to finance the cost of the new system or software. A company contemplating the use of statistical sampling may also want to consider entering into a pre-filing agreement with the IRS. Such an agreement would provide certainty with respect to the company's approach to gathering information needed to document the enhanced charitable contribution deduction.

Given the significant role that charitable contributions of inventory can play in helping a company achieve its financial goals, retail and consumer products companies may want to evaluate more regularly, and manage more closely, their charitable contributions strategies. Issues to consider in evaluating a company's charitable contributions strategies include:

- The timing of contributions
- The mix of cash and product to be contributed
- The type of product to be contributed
- The nature of the organization to which contributions will be made
- The approach to be used in gathering supporting documentation

Decisions made in this regard will directly impact a company's ability to claim and support enhanced income tax deductions associated with donations of inventory.

Financial performance metrics

- Retailer performance data
- Manufacturer performance data
- Size-specific data
- Sector-specific data

Retailer performance data

This section contains charts illustrating the 2010 performance of retailers in the CPG industry as a whole, relative to the population of manufacturers in our performance database.

The primary macroeconomic trends affecting the marketplace have been signs of a recovery. Retailers and manufacturers alike experienced positive net sales growth and EBIT growth during 2010, at almost identical levels. However, retailers have felt the impact of the recovery more quickly than manufacturers, as demonstrated by their stronger one- and three-year shareholder returns. Retailers have historically been trendsetters, as demonstrated during the recession, when their shareholder returns lagged manufacturers' returns.

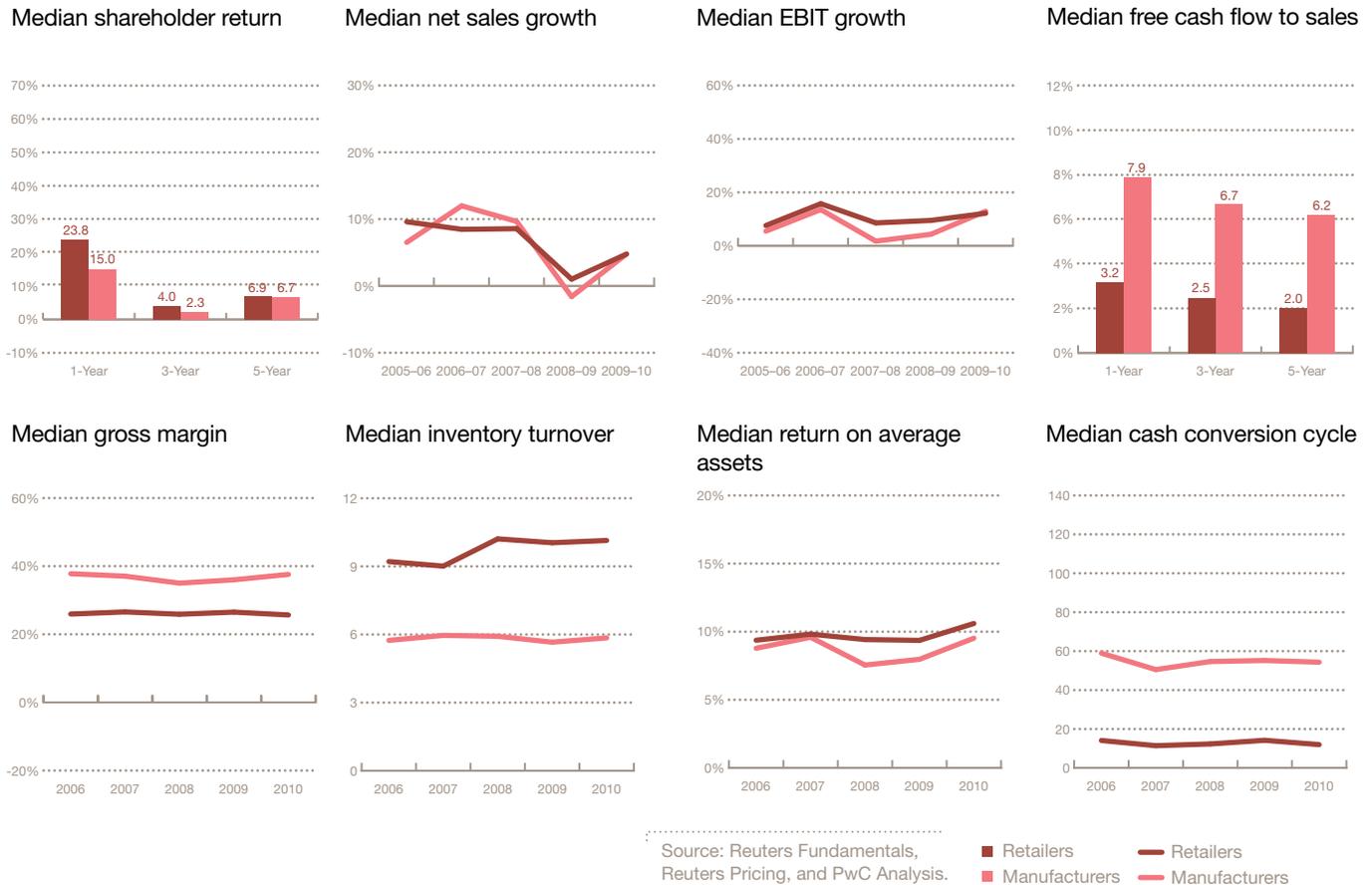
Although retailers' shareholder returns were stronger and net sales growth was on par with manufacturers' in 2010, they had to work harder for this growth, as shown by retail-

ers' slight median gross margin erosion (26.5% in 2009 to 25.7% in 2010) compared to a slight improvement for manufacturers (36% in 2009 to 37.6% in 2010). One driver may be consumers' focus on lower-cost options, including retailers' private labels, during challenging economic times.

Retailers have consistently had quicker cash conversion cycles compared to manufacturers (12 days versus 54 days, respectively), given their ability to collect from consumers at the point of sale yet benefit from 30- to 60-day payment terms with manufacturers. This trend continued during 2010. Both manufacturers and retailers were able to reduce their conversion cycles in 2010, from 55 days for manufacturers, and impressively, from 14 days to 12 days for retailers.

Although the 2010 results for both retailers and manufacturers are improved over the prior year, many are still questioning whether these trends can continue through 2011 as input costs increase and consumer confidence remains shaky.

Exhibit 36
Retailers: Comparison to manufacturers data



Manufacturer performance data

In 2010, the manufacturing sector appeared to rebound from the long, slow recession. Across the board, financial performance generally improved over 2009, with some specific metrics making significant improvements. As the global economy continues to grow, companies are continuing to look for ways to drive top- and bottom-line financial performance improvements.

Overall, median one-year total shareholder return was strong, at 15%. To some extent, this reflects overall market sentiments. Net sales growth reversed its two-year trend of declines and turned positive for all quartiles. Looking ahead, it will be interesting to see how much appetite consumers and business customers have for initial price adjustments in light of continually increasing raw material costs.

Likewise, median EBIT growth overall improved from 4.3% to 12.9%. More importantly, the bottom quartile nearly had a positive EBIT growth, improving significantly from a negative 25% to a negative 1%. Clearly, the financial stress has started to ease for some of the weaker performers.

Underlying the strong overall performance was solid performance in margin improvement as well as liquidity management. The median gross margin improvement, while

small, was impressive. Given the commodity price changes at the end of the year, it's clear that the previous year's cost management work paid off in improved results. As cost pressures continue, companies will need to maintain their pressure on this performance lever and find new ways to achieve sustainable cost and margin improvements. Likewise, median SG&A was nearly flat from the previous year. It remains to be seen what investment decisions are going to be made, but as liquidity in the marketplace begins to open up, we could see additional investment in R&D, technology, and, of course, market expansion. While this expenditure will put pressure on SG&A as a percentage of sales, improved innovation processes as well as analytics can drive more focused spend and, hopefully, improve returns on invested capital and shareholder return.

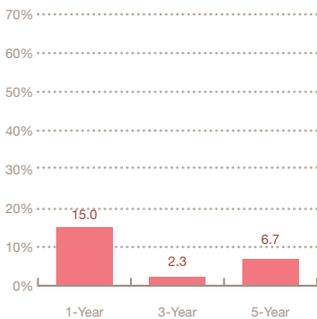
From a pure cash management standpoint, the sector continued to make strides in improving inventory turns and total cash conversion cycle. Most interesting, though, was the change in the short-term/long-term debt ratio. It appears that a significant portion of the sector was able to take advantage of record low interest rates and capture some capital. For the bottom-performing quartile, this was a significant drop from 51.7% to 32.9%. This could be another sign of the continued move toward investment and long-term focus.

Exhibit 37

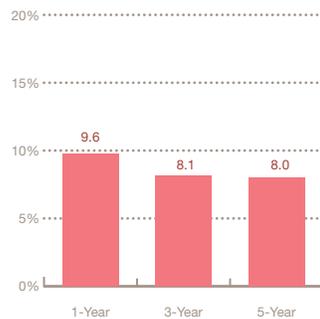
Overall CPG industry, manufacturers (companies > US\$50M)

Return metrics

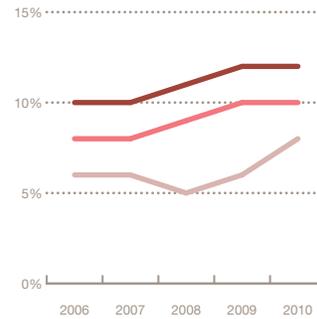
Median shareholder return



Median return on invested capital

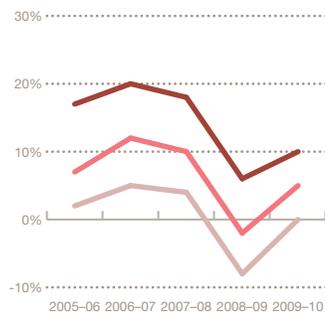


Return on market capital



Growth metrics

Net sales growth

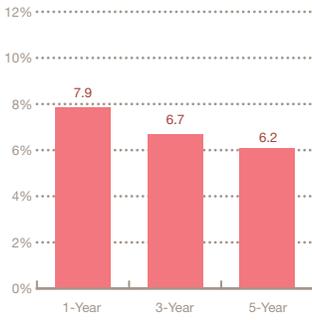


EBIT growth

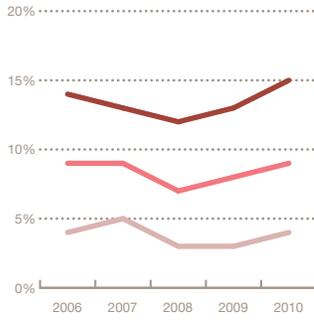


Income statement metrics

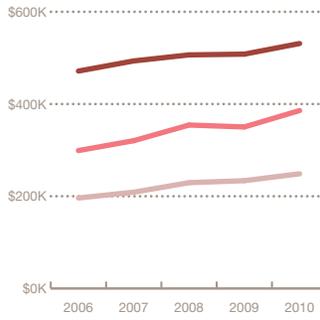
Median free cash flow to sales



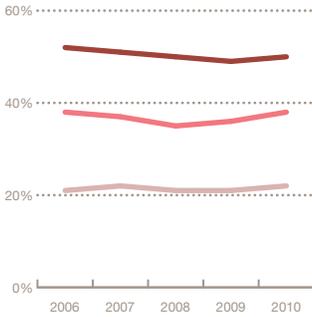
Return on sales



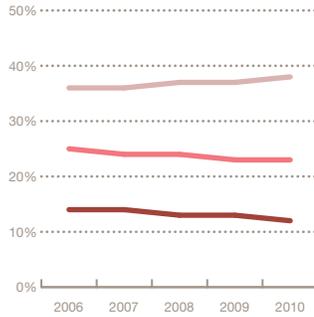
Sales per employee



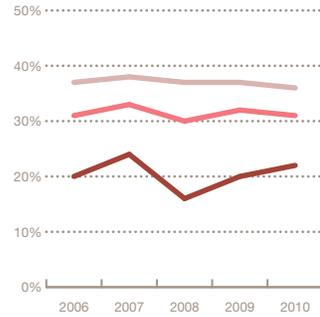
Gross margin



SG&A as a percentage of sales

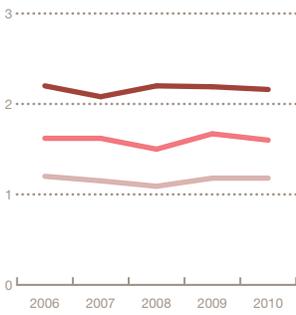


Effective tax rate

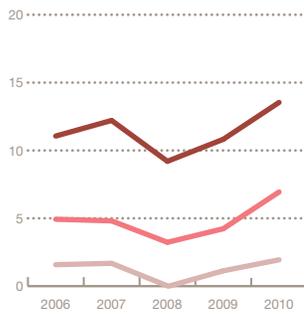


Liquidity metrics

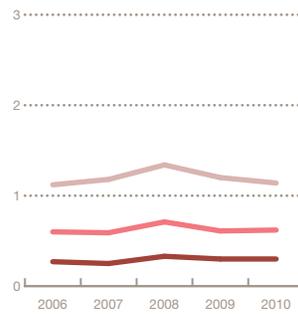
Current ratio



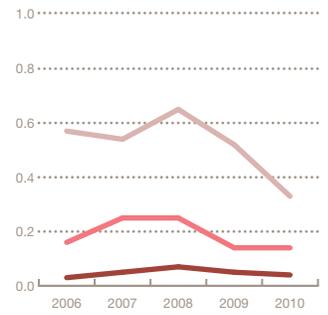
Interest coverage ratio



Debt-to-equity ratio



Short-term debt to long-term debt ratio

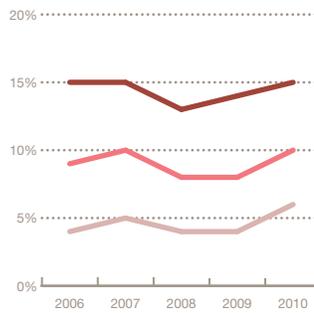


Balance sheet metrics

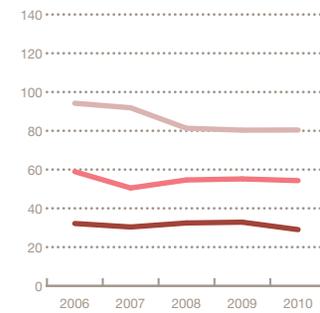
Inventory turnover



Return on average assets



Cash conversion cycle



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

- Top quartile
- Median
- Bottom quartile

Size-specific data: Large, medium, and small manufacturers

This section includes charts analyzing the performance of large, medium, and small manufacturers.

More so than previous years, 2010 showed a good deal of consistency in financial performance across all sizes of manufacturing companies. In particular, for each of the previous two years, there was a notable difference in small companies' one-year median shareholder return—swinging from a significantly worse return in 2008 (negative 48% compared to negative 8% and 27% for medium and large companies, respectively) to a significantly better return in 2009 (60% compared to 19% and 26% for medium and large companies, respectively). The 26.6% return in 2010 for small manufacturers tracks more closely with the return for larger manufacturers, indicating that investors were not swayed by a company's size over the past year, as they have been in past years. That trend is more in line with long-term perspectives, as demonstrated by the five-year return measures.

Another notable trend appears in the liquidity metrics. In 2009, there was a clear distinction in the median short-term/long-term debt ratio, with small companies having a

much higher ratio. This gap narrowed in 2010, with little distinction among the size categories. Although this suggests that credit was more available to smaller companies during 2010, many in the industry believe that a credit crunch continues for companies of all sizes.

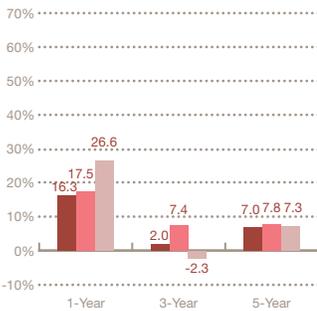
Some distinctions can be found among the size categories, notably within net sales growth. Although each size saw net sales growth in the range of 3% to 5% during 2010, there is a marked difference in growing a \$4 billion company by 5% versus one with sales under \$50 million. Also, this growth was nearly flat from the prior year for small companies, whereas large and medium companies recovered from negative and flat growth in 2009. One contributing factor may be the focus on growth in emerging markets, where a larger company may be able to use its higher free-cash-flow-to-sales performance to invest in new regions more quickly and with more immediate returns.

Finally, median gross margin percentages improved for small and medium companies and declined slightly for large companies. This is one metric to watch during 2011 as companies face rising input costs. Many will be tested on their ability to pass on higher costs to the consumer or employ other commodity risk management levers to maintain these margins.

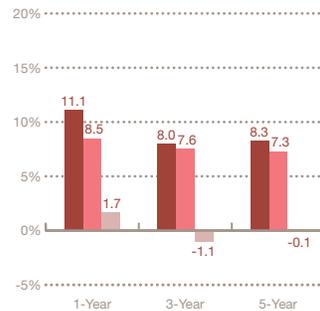
Exhibit 38 Size-specific data, all sectors

Return metrics

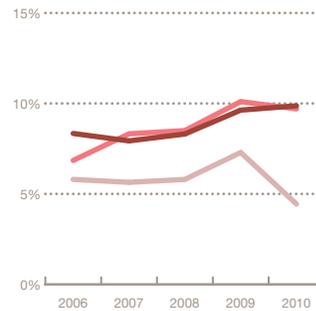
Median shareholder return



Median return on invested capital

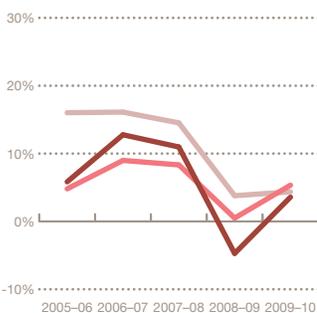


Median return on market capital

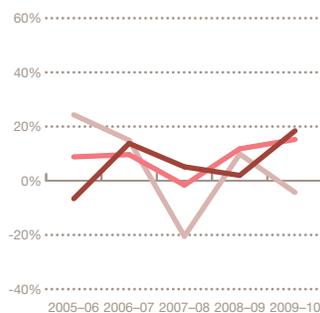


Growth metrics

Median net sales growth

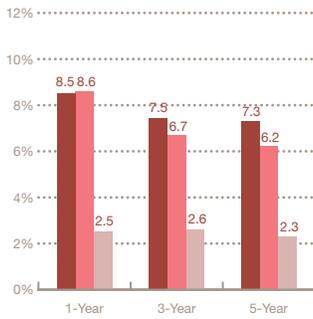


Median EBIT growth

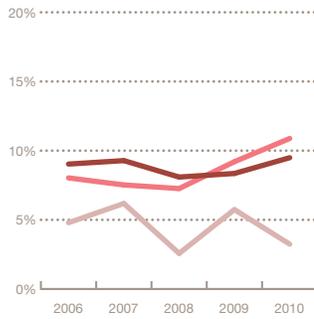


Income statement metrics

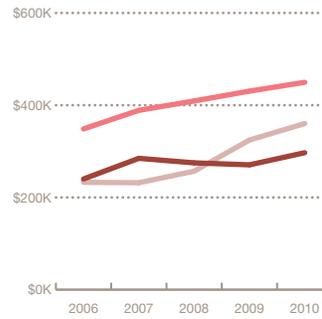
Median free cash flow to sales



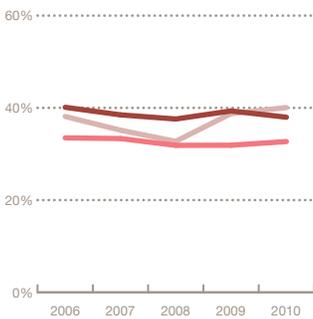
Median return on sales



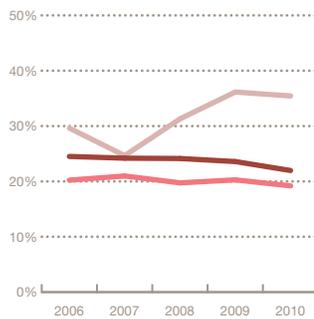
Median sales per employee



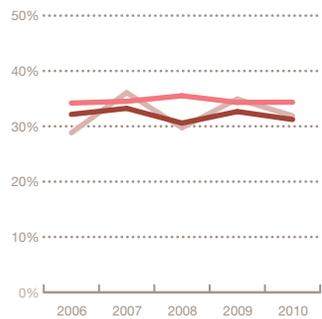
Median gross margin



Median SG&A as a percentage of sales

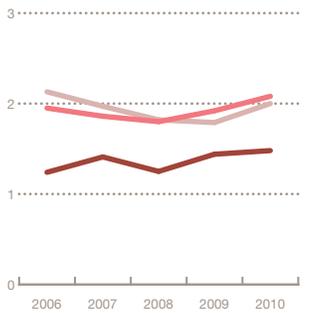


Median effective tax rate

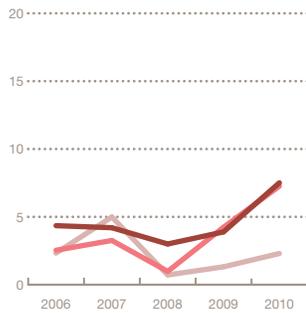


Liquidity metrics

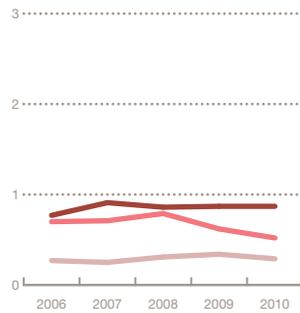
Median current ratio



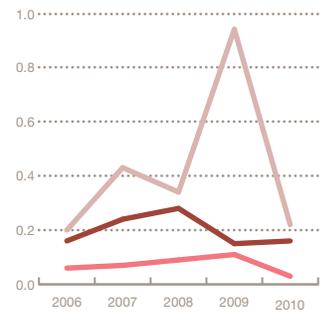
Median interest coverage ratio



Median debt-to-equity ratio

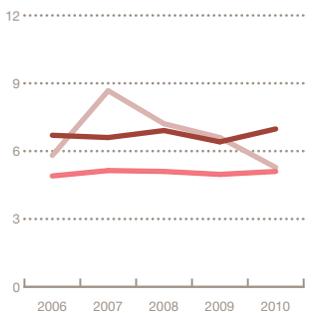


Median short-term debt to long-term debt ratio

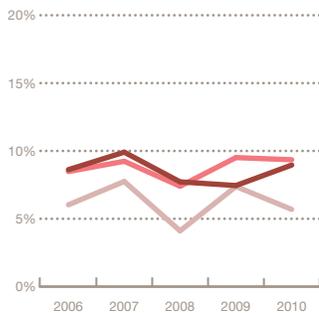


Balance sheet metrics

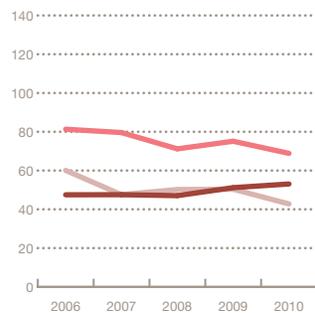
Median inventory turnover



Median return on average assets



Median cash conversion cycle



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

- Large manufacturers
- Medium manufacturers
- Small manufacturers

Size-specific data: Very large manufacturers

This section includes charts analyzing the performance of the largest of the large manufacturers, those with reported net sales of greater than \$10 billion in the latest reported fiscal year. For these companies, performance improved across many measures, a welcome change from the more difficult prior year, in the midst of recession.

Specifically, very large companies saw positive net sales and EBIT growth of 4.8% and 6.7%, respectively—much improved over the prior year’s negative and flat growth in these metrics—as well as improved median return on sales.

Interestingly, these companies’ one-year median shareholder return—a metric that the very large group generally dominates—did not measure up to the return posted by other size categories. Were investors more inclined to put their money in companies that distributed more readily via dividends during 2010? A closer look at the dividend ratio shows that large companies paid a higher dividend per share than very large companies over the past year. Investors seemed to be swayed by this; however, that may be a narrow view because the very large companies may

be using excess cash (as demonstrated by their superior free-cash-flow-to-sales percentages) to invest in innovation and international expansion, actions designed to lead to stronger future performance.

Another improved metric for very large companies was sales per employee, a productivity measure. Although there was a dip in this metric in the prior year, very large companies took action during 2010. Some of the improvement likely stems from headcount reductions, but increased sales per employee coupled with strong net sales growth indicates other actions also contributed. For example, mobile and digital technologies have proliferated in the workplace in ways that improve productivity.

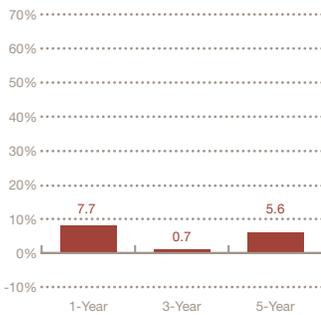
All in all, improved financial results for very large companies signal that they have responded to tough economic times by launching initiatives such as international expansion and divestiture of non-core brands—and the returns are starting to materialize. As with their smaller counterparts, the challenge for these companies in the coming year will be to respond to higher input costs as well as continued volatility in the economy.

Exhibit 39

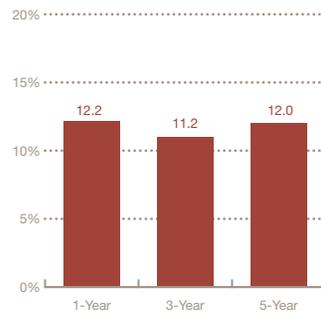
Very large manufacturers, all sectors

Return metrics

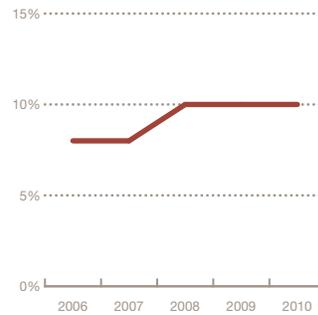
Median shareholder return



Median return on invested capital



Median return on market capital

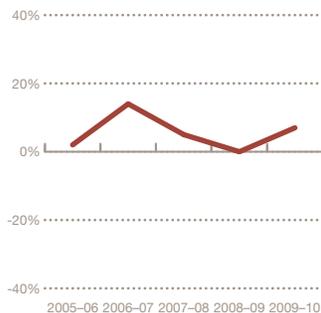


Growth metrics

Median net sales growth

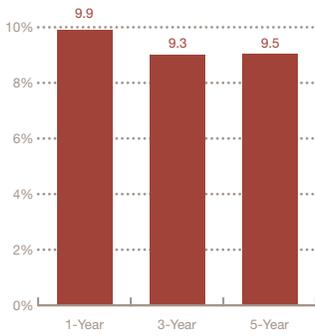


Median EBIT growth

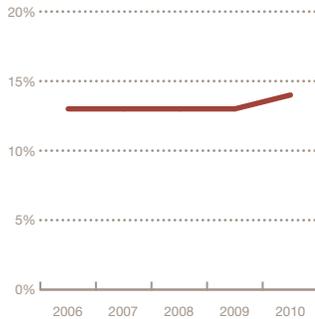


Income statement metrics

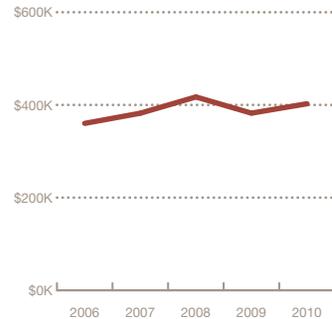
Median free cash flow to sales



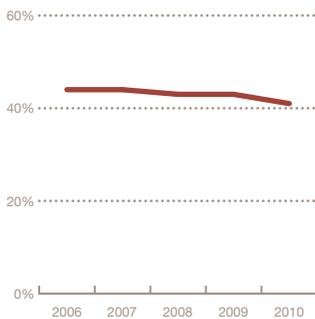
Median return on sales



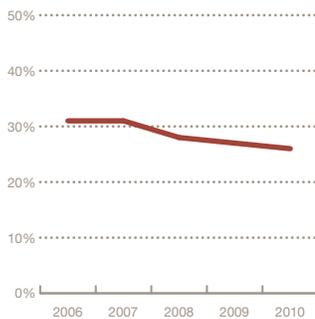
Median sales per employee



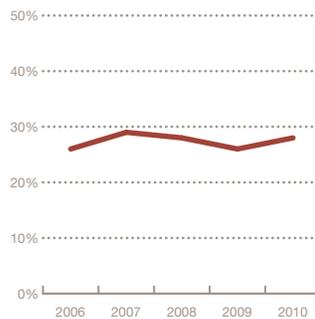
Median gross margin



Median SG&A as a percentage of sales

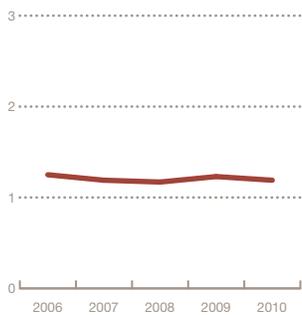


Median effective tax rate

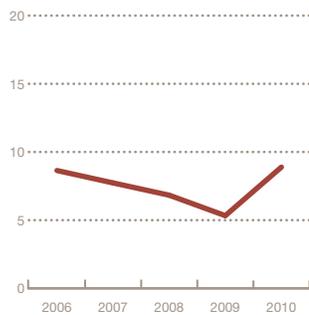


Liquidity metrics

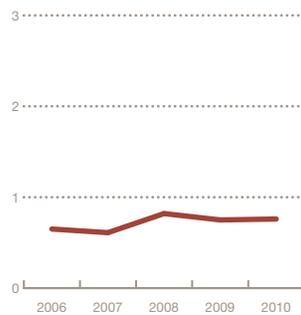
Median current ratio



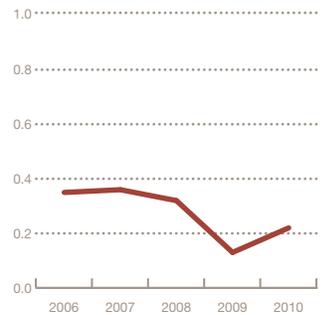
Median interest coverage ratio



Median debt-to-equity ratio

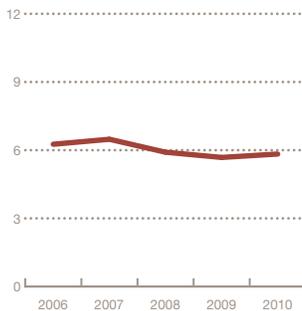


Median short-term debt to long-term debt ratio

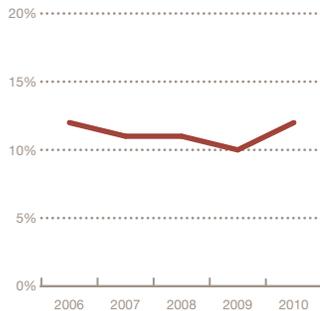


Balance sheet metrics

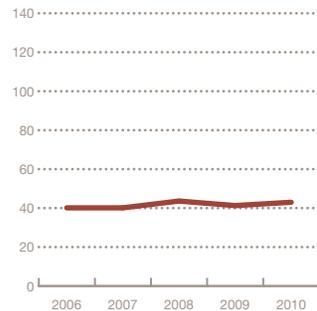
Median inventory turnover



Median return on average assets



Median cash conversion cycle



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

■ Very large manufacturers
 — Very large manufacturers

Sector-specific data: Food, beverage, and household products

This segmentation of our industry data breaks the companies into three groups; companies that produce primarily household products, companies that produce primarily foodstuffs, and companies that produce primarily beverages. The comparisons in the graphs are all written based on median values.

On the surface, all three segments showed similar improvements in shareholder return. Each sector reflected a one-year shareholder return significantly improved over the three- and five-year medians. Similarly, each of the sectors showed an uptick in net sales growth after two years of declining growth rates. Most importantly, the beverage (5.6%) and household products (3.3%) median net sales increases were both positive rather than negative, as they were from 2008 to 2009. Underlying the consistent improvements in shareholder return and net sales growth, however, were some varied results across several key metrics.

For the household products sector, there was significant improvement in EBIT growth, to 15.4%. The impressive point of this improvement was that it took place in spite of a small reduction in median gross margin, from 49.5% to 47.5%. The household products sector was able to counteract this with flat SG&A spending and strong sales growth. Additionally, the sector saw significant improvements in ef-

fective tax rate (from 32.8% to 29.4%), fueling bottom-line improvements. Similarly, tight management of cash through the economic downturn resulted in a 7% improvement in the median cash conversion cycle for household products companies that also fueled the EBIT growth.

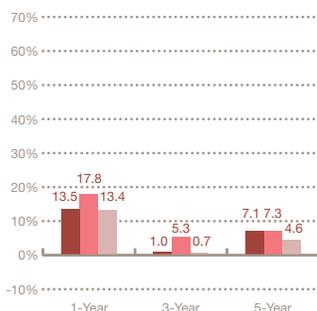
For the food sector, 2010 was a strong year, with positive results relative to productivity and cash conversion cycle. Median sales per employee grew nearly 10%, the first time any sector in our analysis has moved above \$400,000 of net sales per employee. Additionally, the median cash conversion cycle fell from 50.9 days to 45.8 days, a significant reduction that generated cash for investment and bottom-line growth. However, there were signs of a challenging environment versus other sectors. Net sales growth did not improve for the food sector to the extent that it did for the beverage and household products sectors. This is likely due to the fact that consumers continued to trade down in the sector. Similarly, the food sector's median free cash flow as a percentage of sales continued to lag the beverage and household products sectors for the one-year period.

The beverage sector continued overall strong performance, with significant improvements in net sales growth, gross margin (43.1% to 47.1%), and SG&A (29.7% to 27.7%) able to offset a very poor year from the perspective of the cash conversion cycle (rising from 38 days to 46.1 days). Overall, it is likely that input cost increases and pricing pressures will continue to impact the beverage sector moving forward.

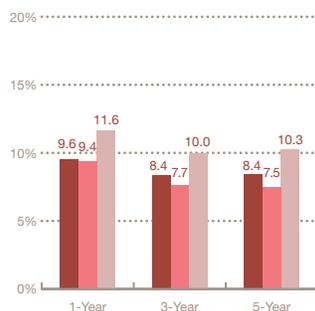
Exhibit 40 Sector-specific data, all sectors

Return metrics

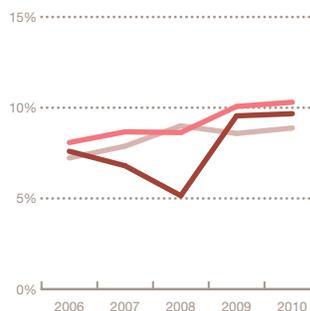
Median shareholder return



Median return on invested capital

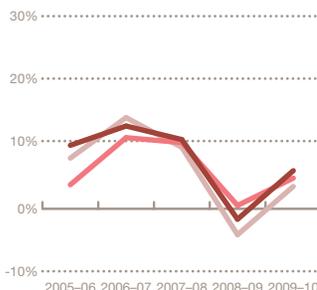


Median return on market capital

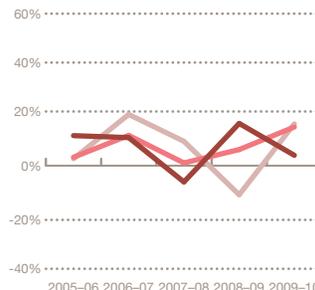


Growth metrics

Median net sales growth

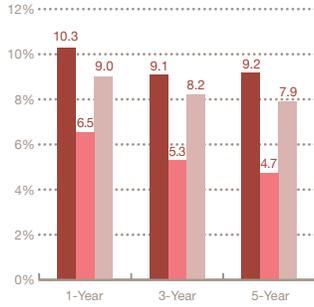


Median EBIT growth

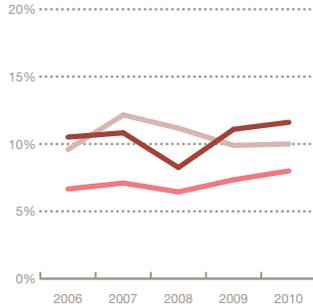


Income statement metrics

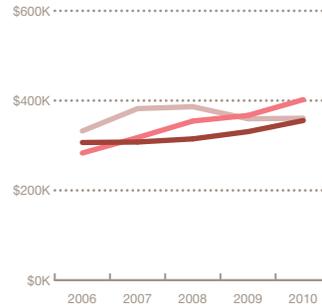
Median free cash flow to sales



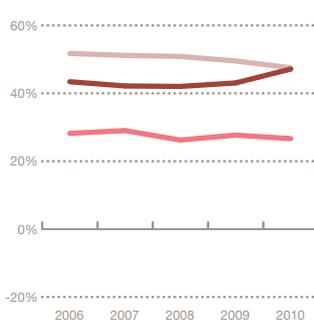
Median return on sales



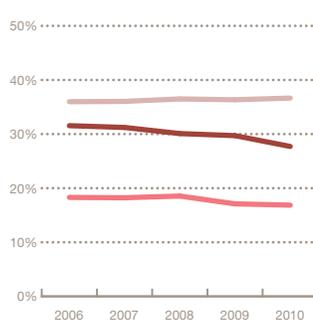
Median sales per employee



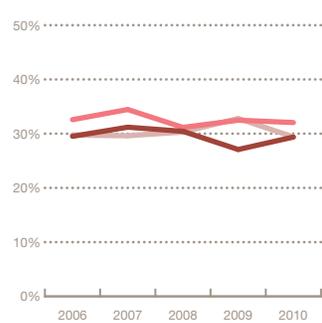
Median gross margin



Median SG&A as a percentage of sales

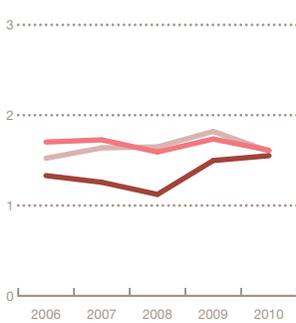


Median effective tax rate

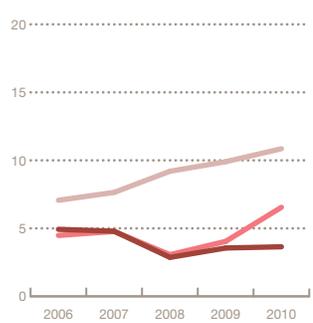


Liquidity metrics

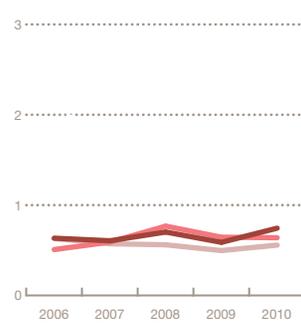
Median current ratio



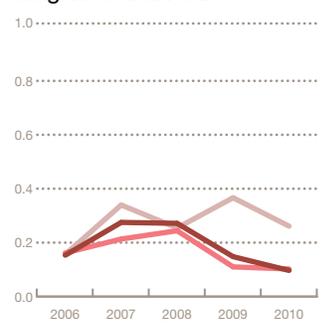
Median interest coverage ratio



Median debt-to-equity ratio

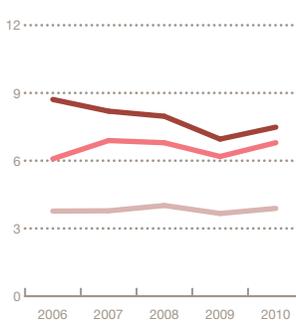


Median short-term debt to long-term debt ratio

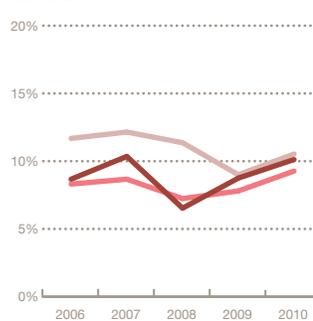


Balance sheet metrics

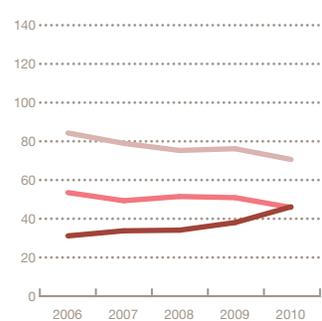
Median inventory turnover



Median return on average assets



Median cash conversion cycle



Source: Reuters Fundamentals, Reuters Pricing, and PwC Analysis.

- Beverage
- Food
- Household products

Appendix A: Financial performance metrics methodology

In the Financial Performance Metrics section we present key industry metrics, some of which are discussed throughout the report, based on an analysis of financial data for a set of CPG manufacturers and retailers (see Appendices B and C). In this appendix, we describe the data sources used and the data preparation steps taken to produce these metrics.

traded companies. The report uses restated data that accounts for mergers, acquisitions, divestitures, and accounting changes. All data used to construct financial metrics is “as reported” by the companies. Additionally, the study team collected financial data for private-sector manufacturers through a survey administered by the GMA.

Data sources

Reuters Fundamentals data was the primary source of data for the analysis presented in the Financial Performance Metrics section of this report. This Reuters dataset includes annual financial data from 2005 through 2010, by fiscal year, for publicly

Exhibit 41
Primary manufacturer NAICS codes by sector

Sector	NAICS code	NAICS description
Beverage	312111	Soft drink manufacturing
Beverage	312112	Bottled water manufacturing
Beverage	312120	Breweries
Beverage	312130	Wineries
Beverage	312140	Distilleries
Food	311211	Flour milling
Food	311225	Fats and oils refining and blending
Food	311230	Breakfast cereal manufacturing
Food	311312	Cane sugar refining
Food	311320	Chocolate and confectionery manufacturing from cacao beans
Food	311330	Confectionery manufacturing from purchased chocolate
Food	311340	Non-chocolate confectionery manufacturing
Food	311411	Frozen fruit, juice, and vegetable manufacturing
Food	311421	Fruit and vegetable canning
Food	311511	Fluid milk manufacturing
Food	311514	Dry, condensed, and evaporated dairy product manufacturing
Food	311520	Ice cream and frozen dessert manufacturing
Food	311611	Animal (except poultry) slaughtering
Food	311612	Meat processed from carcasses
Food	311615	Poultry processing

Sector	NAICS code	NAICS description
Food	311812	Commercial bakeries
Food	311823	Dry pasta manufacturing
Food	311911	Roasted nuts and peanut butter manufacturing
Food	311919	Other snack food manufacturing
Food	311920	Coffee and tea manufacturing
Food	311942	Spice and extract manufacturing
Food	311999	All other miscellaneous food manufacturing
Household Products	311111	Dog and cat food manufacturing
Household Products	311119	Other animal food manufacturing
Household Products	322291	Sanitary paper product manufacturing
Household Products	325412	Pharmaceutical preparation manufacturing
Household Products	325611	Soap and other detergent manufacturing
Household Products	325612	Polish and other sanitation good manufacturing
Household Products	325620	Toilet preparation manufacturing
Household Products	335912	Primary battery manufacturing

Source: PwC.

Company choice

The companies analyzed in the Financial Performance Metrics section were identified as companies that operate in the CPG manufacturing or retail industries. This designation is generally based on a company’s primary industry, identified using the North American Industry Classification System (NAICS) as designated by each company and reported in Reuters.

Manufacturers

A core group of NAICS codes was used to categorize companies according to CPG industries, including food, beverage, and household products manufacturing activities. After reviewing this list, we excluded a handful of companies, either because they predominantly do business outside the United States or because their primary activities did not align with the CPG sector. Additional food, beverage, and household products companies were included in the analysis based on the nature of their products, given diverse manufacturing activities.

Exhibit 41 lists the manufacturer NAICS codes and NAICS code descriptions by sector used in the Financial Performance Metrics section of this report.

Retailers

A group of core NAICS codes that represent GMA retail activities were identified and used to generate a list of retail companies for inclusion in the analysis.

Exhibit 42 lists the retailer NAICS codes and NAICS code descriptions used in the Financial Performance Metrics section of this report.

Exhibit 42
Primary retailer NAICS codes

NAICS code	NAICS description
424410	General line grocery wholesalers
445110	Supermarkets and other grocery (except convenience) stores
445120	Convenience stores
445299	All other specialty food stores
446110	Pharmacies and drug stores
446120	Cosmetics, beauty supplies, and perfume stores
446191	Food (health) supplement stores
446199	All other health and personal care stores
447110	Gasoline stations with convenience stores
452910	Warehouse clubs and superstores
452990	All other general merchandise stores
453910	Pet and pet supplies stores

Source: PwC.

Data preparation and metric construction

The following data preparation steps were necessary before calculating financial metrics.

Currency exchange rates were applied to financial data fields denominated in non-US currencies. Conversions were computed based on the annual averaged exchange rate for each fiscal year operating period.

Companies that changed their reported fiscal year starting and ending dates for at least one of the reporting periods resulted in duplicate data across fiscal years. The duplicate fiscal year observation was removed by annualizing the reported financials where necessary.

Data elements associated with companies that have reporting periods markedly different from the standard length of a calendar year (i.e., 12 months or 52 weeks) were either annualized or dropped.

Data used to calculate metrics presented in this report was compared with 10-K filings for selected firms to check for inconsistencies. The quartiles were determined based on the companies with reported data for each financial metric. Definitions for each metric can be found in Appendix C.

Data reporting

Reported results utilize median figures in order to reduce the effect of performance outliers on the overall metrics. When the count of companies with reported data is large enough, we also report quartile figures at the 25th and 75th percentile observations.

In the industry benchmark, firms with more than US\$10 billion in net sales in their most recent reported fiscal year are highlighted in a separate “very large” grouping, but are also included in the “large manufacturers” results.

Other size-based segmentations were defined using the benchmarks noted in Exhibit 43.

Exhibit 43 Size segmentations for financial reporting metrics

Very large manufacturers	net sales > \$10B
Large manufacturers	net sales > \$4B
Medium manufacturers	\$500M < net sales <= \$4B
Small manufacturers	\$50M < net sales <= \$500M

Source: PwC.

Companies with net sales of less than \$50 million for the most recent reported fiscal year were excluded.

Counts for the number of manufacturers included in each size- and industry-based segment are included in Exhibit 44.

Exhibit 44 Manufacturing companies by industry size and segment

	Small	Medium	Large (Very large)	Total
Beverage	8	10	16 (10)	34
Food	22	27	30 (17)	79
Household products	7	10	18 (10)	35
Total	37	47	64 (37)	148

Source: PwC.

Appendix B: Manufacturer company list

AgFeed Industries, Inc.
Agrida Corporation (ADR)
Ajinomoto Co., Inc.
Alberto-Culver Company
American Dairy, Inc.
American Italian Pasta Company
Anheuser-Busch Companies, Inc.
Anheuser-Busch InBev NV
Archer Daniels Midland Company
Ascendia Brands, Inc.
Associated British Foods plc
Avon Products, Inc.
B&G Foods, Inc.
Bare Escentuals, Inc.
BASF SE (ADR)
Basic American Foods, Inc.
Birds Eye Foods, Inc.
Bridgford Foods Corporation
Brown-Forman Corporation
Bunge Limited
Bush Brothers & Company
Cadbury plc (ADR)
Cagle's, Inc.
Campbell Soup Company
CCA Industries, Inc.
Chiquita Brands International, Inc.
CHS Inc.
Church & Dwight Co., Inc.
Coca-Cola Bottling Co. Consolidated
Coca-Cola Enterprises Inc.
Coca-Cola FEMSA, S.A.B. de C.V. (ADR)
Coca-Cola HBC S.A. (ADR)
Coffee Holding Co., Inc.
Colgate-Palmolive Company
ConAgra Foods, Inc.
Constellation Brands, Inc.
Corn Products International, Inc.
Cott Corporation (USA)
Craft Brewers Alliance, Inc.
Cuisine Solutions, Inc.
Dakota Growers Pasta Co., Inc.
Darling International Inc.
Dean Foods Company
Del Monte Foods Company
Del Monte Pacific Limited
Diageo plc (ADR)
Diamond Foods, Inc.
Diedrich Coffee, Inc.
Dole Food Company, Inc.
Dr Pepper Snapple Group Inc.

DSG International Limited
Ecolab Inc.
Elizabeth Arden, Inc.
Energizer Holdings, Inc.
Exide Technologies
Farmer Brothers Co.
Flowers Foods, Inc.
Fomento Económico Mexicano S.A.B. de C.V. (ADR)
Foster's Group Limited
General Mills, Incorporated
Gold Kist Inc.
Golden Enterprises, Inc.
Greatbatch Inc.
Green Mountain Coffee Roasters Inc.
Groupe Danone SA (ADR)
Gruma, S.A.B. de C.V. (ADR)
H.J. Heinz Company
Hansen Natural Corporation
Heineken N.V. (ADR)
Hormel Foods Corporation
Imperial Sugar Company
Inter Parfums, Inc.
Interstate Bakeries Corp.
Inventure Group, Inc.
J&J Snack Foods Corp.
Jamba, Inc.
Jarden Corporation
John B. Sanfilippo & Son, Inc.
Johnson & Johnson
Kellogg Company
Kerry Group plc
Kimberly-Clark Corporation
Kirin Holdings Company, Limited (ADR)
Kraft Foods Inc.
Lancaster Colony Corp.
Lance, Inc.
Land O'Lakes, Inc.
Lifeway Foods, Inc.
L'Oréal
Marine Harvest ASA
McCormick & Company, Inc.
Mead Johnson Nutrition Co.
Medifast, Inc.
Merisant Company
MGP Ingredients, Inc.
Molson Coors Brewing Company
Monterey Gourmet Foods, Inc.
National Beverage Corp.
Nestlé SA

Novartis AG (ADR)
Overhill Farms, Inc.
Owens-Illinois, Inc.
Parlux Fragrances, Inc.
Peet's Coffee & Tea, Inc.
PepsiAmericas, Inc.
PepsiCo, Inc.
Physicians Formula Holdings, Inc.
Pilgrim's Pride Corporation
Pinnacle Foods Finance LLC
Playtex Products Inc.
Premium Standard Farms, Inc.
Ralcorp Holdings, Inc.
Reckitt Benckiser Group plc
Reddy Ice Holdings, Inc.
Revlon, Inc.
SABMiller plc
Sanderson Farms, Inc.
Sara Lee Corporation
Seaboard Corporation
Seneca Foods Corporation
Shiseido Co. Ltd. (ADR)
Smart Balance, Inc.
Smithfield Foods, Inc.
Solo Cup Company
SunOpta, Inc. (USA)
Synutra International, Inc.
Tasty Baking Company
Tate & Lyle PLC (ADR)
The Boston Beer Company, Inc.
The Clorox Company
The Coca-Cola Company
The Estée Lauder Companies Inc.
The Hain Celestial Group, Inc.
The Hershey Company
The J.M. Smucker Company
The Pepsi Bottling Group, Inc.
The Procter & Gamble Company
The Topps Company, Inc.
Tootsie Roll Industries, Inc.
TreeHouse Foods Inc.
Tyson Foods, Inc.
Ultralife Corporation
Unilever PLC (ADR)
Vermont Pure Holdings, Ltd.
Vina Concha y Toro S.A. (ADR)
Wm. Wrigley Jr. Company
Wyeth
Zep Inc.

Appendix C: Retailer company list

99¢ Only Stores
Alimentation Couche-Tard Inc.
Alimentation Couche-Tard Inc. (USA)
Alliance Boots Plc (ADR)
Alon Brands, Inc.
Amazon.com, Inc.
Arden Group, Inc.
Big Lots, Inc.
BJ's Wholesale Club, Inc.
Cargills (Ceylon) PLC
Casey's General Stores, Inc.
CCS Medical Holdings, Inc.
Chem Rx Corporation
Controladora Comercial Mexicana SA (ADR)
Cost Plus, Inc.
Costco Wholesale Corporation
Cost-U-Less, Inc.
CVS Caremark Corporation
Dairy Farm International Holdings Limited
Delhaize America, Inc.
Delhaize Group (ADR)
Distribucion y Servicio D&S S.A. (ADR)
Dollar General Corp.
Dollar Tree, Inc.
drugstore.com, inc.
Duane Reade Holdings, Inc.
Duckwall-ALCO Stores, Inc
Empire Company Limited
Family Dollar Stores, Inc.
Fred's, Inc.
GraceKennedy Limited
Harry & David Holdings, Inc.
Ingles Markets, Incorporated
J Sainsbury plc (ADR)
Koninklijke Ahold N.V. (ADR)
Loblaw Companies Limited
Longs Drug Stores Corp.
Magnit OAO
Marsh Supermarkets, Inc.
Medco Health Solutions Inc.
Metro, Inc.
Nash-Finch Company
Omnicare, Inc.
Pathmark Stores, Inc.
Perfumania Holdings, Inc.
Pet Valu Inc.
Petro Stopping Centers Holdings, L.P.
PetSmart, Inc.
PharMerica Corporation
PriceSmart, Inc.
Publix Super Markets Inc.
Rev Holdings LLC
Rite Aid Corporation
Ruddick Corporation
Safeway Inc.
Sally Beauty Holdings, Inc.
Sears Holdings Corporation
Shoppers Drug Mart Corporation
Spartan Stores, Inc.
Stater Bros. Holdings Inc.
SUPERVALU INC.
Susser Holdings Corporation
Target Corporation
Tesco PLC (ADR)
The Great Atlantic & Pacific Tea Company
The Jean Coutu Group (PJC) Inc.
The Kroger Co.
The Pantry, Inc.
The Penn Traffic Company
Titan Global Holdings Inc.
TravelCenters of America LLC
Ultra Salon, Cosmetics & Fragrance, Inc.
Village Super Market, Inc.
Vitacost.com, Inc.
VS Holdings Inc.
Walgreen Company
Wal-Mart de Mexico, S.A.B. de C.V. (ADR)
Wal-Mart Stores, Inc.
Weis Markets, Inc.
Whole Foods Market, Inc.
Winn-Dixie Stores, Inc.

Appendix D: Definitions

Beverage manufacturers

Manufacturers of beverage products, including breweries, distilleries, and wine producers.

Book capital

The sum of total debt and the book value of equity.

Cash conversion cycle

Sum of days sales outstanding and days inventory outstanding minus days payable outstanding for the same fiscal year.

Cost of goods sold

The total cost of the inputs to producing products, including excise tax payments.

CPG manufacturers (referred to in this report as “manufacturers”)

Companies that manufacture food, beverage, and household and personal care products.

CPG retailers (referred to in this report as “retailers”)

Companies that sell manufactured food, beverage, and household and personal care products.

Current ratio

Current assets for a reported fiscal year divided by the current liabilities for that same year.

Days sales outstanding

The average of the previous fiscal year’s and reported fiscal year’s accounts receivable divided by the reported fiscal year’s average daily net sales.

Debt-to-equity ratio

Total debt for a reported fiscal year divided by the total book equity for that same year.

EBIT

Earnings from continuing operations, before interest and taxes.

EBITDA

Earnings before interest, taxes, depreciation, and amortization.

Economic profit

Economic profit spread is calculated by taking return on invested capital (ROIC) and subtracting the weighted average cost of capital (WACC).

Effective tax rate

Income tax divided by earnings before tax for the same fiscal year.

Food manufacturers

Manufacturers of food products, including dry coffee and tea producers; frozen fruit, juice, and vegetable producers; and dry, condensed, and evaporated dairy product manufacturers.

Free cash flow as a percentage of sales

One-year, three-year, or five-year cumulative cash from operating activities, less capital expenditures plus cash interest paid as a percent of cumulative net sales, for the same time period.

Gross margin

Ratio of net sales minus cost of goods sold to net sales, for the same fiscal year.

Household products manufacturers

Manufacturers of household and personal care products, including primary battery producers and dog and cat food producers.

Interest coverage ratio

EBIT for a reported fiscal year divided by interest expense on debt for that same year.

Inventory turnover

Cost of goods sold for a reported fiscal year divided by the average of the previous fiscal year's and reported fiscal year's total inventory.

IRR

Internal rate of return, used in capital budgeting to measure the profitability of investments.

Large companies

Companies with greater than \$4 billion in net sales in their last reported fiscal year.

Market capital

Sum of total debt and total market value of equity.

Medium companies

Companies with greater than \$500 million and less than or equal to \$4 billion in net sales in their last reported fiscal year.

Net sales

Net revenue as reported by a company.

Operating cash flow ratio

Cash flow from operations divided by current liabilities.

Return on average assets

EBIT for a reported fiscal year divided by the average of the previous fiscal year's and reported fiscal year's total assets.

Return on invested capital

Net operating profit after taxes for a reported fiscal year divided by the average of the previous fiscal year's and reported fiscal year's book capital.

Return on market capital

EBITDA for a reported fiscal year, divided by the average of the previous fiscal year's and reported fiscal year's market capital.

Return on sales

EBIT for a reported fiscal year divided by net sales for that same year.

Sales per employee

Net sales for a given year divided by the average of the previous year's and reported fiscal year's total number of employees.

Selling, general, and administrative (SG&A) expense as a percentage of sales

Ratio of selling, general, and administrative expense to net sales, for the same fiscal year.

Shareholder return

Annualized percentage return from stock prices and reinvested dividends for a fiscal year-end.

Short-term to long-term debt ratio

Short-term debt for a reported fiscal year divided by long-term debt for that same year.

Small companies

Companies with greater than \$50 million and less than or equal to \$500 million in net sales in their last reported fiscal year.

Total debt

Total debt outstanding, including notes payable/short-term debt, current portion of long-term debt/capital leases, and total long-term debt.

Very large companies

Companies with greater than \$10 billion in net sales in their last reported fiscal year.

Endnotes

Unless noted otherwise, quotes from the following business leaders were sourced from interviews conducted by PwC on the following dates:

- Dan Heinrich, CFO, The Clorox Company (March 31, 2011)
- Dennis Hickey, CFO, the Colgate-Palmolive Company (April 18, 2011)
- Jon Moeller, CFO, The Procter & Gamble Company (May 4, 2011)
- Don Mulligan, CFO, General Mills, Inc. (March 29, 2011)
- Bill Schumacher, CFO, Sunny Delight Beverages Company (April 6, 2011)
- Gordon Stetz, CFO, McCormick & Company (April 11, 2011)
- Duane Still, CFO, The Coca-Cola Company's CCR Operating Unit (March 24, 2011)

1. Yvonne Krishnan, "Libraries and the Mobile Revolution," *Computers in Libraries* (April 1, 2011).
2. Max Jarman, "Holiday Shoppers' Key Tool: Cellphone," *The Arizona Republic* (November 21, 2010).
3. PwC, *2011 Global State of Information Security Survey* (2010).
4. National Bureau of Economic Research.
5. International Trade Administration, TradeStats Express.
6. Ibid.
7. Average weekly overtime hours (not seasonally adjusted) from the US Bureau of Labor Statistics, Current Employment Statistics (May 6, 2011), and PwC calculations.
8. Producer Price Indexes for Crude Foodstuffs and Finished Consumer Foods (processed) and Consumer Price Index for Urban Consumers, Food at Home. US Bureau of Labor Statistics, Producer Price Indexes (April 5, 2011) and Consumer Price Indexes (April 5, 2011).
9. As measured by the increase in the consumer price index for urban consumers for motor fuels. US Bureau of Labor Statistics, Consumer Price Indexes (May 6, 2011).
10. Federal Reserve Board, G.5 Foreign Exchange Rates (monthly).
11. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2011 to 2021* (January 2011).
12. PwC analysis.
13. Ibid.
14. Ibid.
15. Emily Glazer, "Commodities Prices Are Hitting Your Wallet," *The Wall Street Journal* (January 23, 2011).
16. Ojas Rege, VP of Products and Marketing, MobileIron, quoted in P. J. Connolly, "iPad, iPhone Challenge Management Orthodoxy," eWeek.com (March 1, 2011).
17. eMarketer, "The Future of Smart Mobile Devices" (February 10, 2011).
18. Ibid.
19. Gustav Sandstrom, "Android Leads Handset-Sales Surge," *The Wall Street Journal* (February 11, 2011).
20. Ian Sherr and Don Clark, "Entrants Flood Race to Rival iPad," *The Wall Street Journal* (December 29, 2010).
21. "More Cell Phone Owners Use an App for That," States News Service (July 7, 2010).
22. Ibid.
23. "Not Just Talk: Clever Services on Cheap Mobile Phones Make a Powerful Combination—Especially in Poor Countries," *The Economist* (January 27, 2011).
24. "Augmented Business: Smart Systems Will Disrupt Lots of Industries and Perhaps the Entire Economy," *The Economist* (November 4, 2010).
25. Ibid.
26. P. J. Connolly, "iPad, iPhone Challenge Management Orthodoxy," eWeek.com (March 1, 2011).
27. Jessica Twentyman, "One Cloud Fits All," *The Wall Street Journal* (February 14, 2011).
28. Sucharita Malpuru, Peter Halt, et al, *US Online Retail Forecast, 2009 to 2014*, Forrester (November 24, 2010); see also eMarketer, *US Retail Ecommerce Forecast: Growth Opportunities in a Maturing Channel* (April 2011).
29. Interactive Advertising Bureau (IAB) and PwC, *IAB Internet Advertising Revenue Report* (April 2011).
30. Forrester Research, *Web Influenced Retail Sales Forecast, 12/09 (US)* (December 2009).

31. Stephanie Clifford, "Nordstrom Links Online Inventory to Real World," *The New York Times* (August 23, 2010).
32. Martec International, *Multichannel Retailing 2010: Summary of Research Findings* (2010).
33. Stephanie Clifford, "Nordstrom Links Online Inventory to Real World," *The New York Times* (August 23, 2010).
34. "More Cell Phone Owners Use an App for That," States News Service (July 7, 2010).
35. John Jannarone, "The Worst is Yet to Come for Best Buy," *The Wall Street Journal* (March 4, 2011).
36. "eBay Mobile Spending Grows 165% Globally on Mobile Sunday," *Telecompaper Americas* (December 14, 2010).
37. Michael Garry, "The High-Tech Divide," *SupermarketNews.com* (March 11, 2011).
38. PwC, *GDS Performance Study* (November 2010).
39. Prith Banerjee, "Retail's Brave New World," *TheDailyBeast.com* (December 9, 2010).
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Thriving in a Connected World



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