THE OC&C
GLOBAL 50 2009

RIDERS ON THE STORM

Annual review of the global top 50 FMCG giants

OC&C Strategy Consultants

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RIDERS ON THE STORM

Despite tempestuous economic conditions, the big suppliers delivered impressive growth. James Ball reports on the 2009 OC&C Global 50 rankings

Food and drink suppliers, even the globe-spanning giants, could be forgiven for a modest performance in 2008. Nigh-on unprecedented food price inflation was challenging enough, even without the tightest credit conditions in living memory.

Add the deepest global recession since the Great Depression and you have a perfect storm. Yet the top 50 grocery suppliers are weathering the conditions remarkably well. The Global 50 delivered a whopping 13.3% average sales growth, according to OC&C's report – four percentage points ahead of the record of 9.3%, set in 2007.

Return on capital employed – a measure tracking how effectively a company is using its investment – also increased, from an average of 21.1% in 2007 to 22% in 2008.

"This is pretty chunky growth for markets that are relatively mature," says Will Hayllar, associate partner at strategy consultancy OC&C.

"Headline sales figure growth is the highest it's ever been. There's a fair amount of price inflation there, but the figures show fmcg giants have been responding to changing times."

OC&C's estimate of underlying growth, ignoring the effects of M&A and changing exchange rates, is the still impressive but more modest figure of 6.7%.

Arguably the most significant battle of the past year, however, and one that's had a bruising effect on margins, has been inflation. Agricultural commodities rocketed 23.3% in 2008, and other costs such as property, electricity and wages rose as much as 55%. Yet the price consumers paid for the end product rose just 5.8%, according to the OECD consumer food price index.

Cost cutting and other tactics have helped to offset the increase in input prices, but the fmcg giants – and not the retailers – have still had to take a margin hit. Average gross margins in the top 50 fell 1.6 percentage points, according to OC&C, while retail margins fell just 0.1 of a point.

Two thirds of the top 50 saw their margins recede, a trend that accelerated in the first quarter of 2009.

"There is a pattern of gross margins being squeezed," says Hayllar. "This is a mixture of commodity costs coming through and, in particular, the rise in the number of promotions. The wave of restructuring and cost-cutting also incurs a one-off charge, and companies have also written down recent investments, which are now less valuable."

Fully 98% of the top 50 took a one-off hit from cost-cutting. Of the measures available, 86% rationalised their manufacturing sites, while 81% removed cost from their supply chains and 77% of the top 50 said they had also changed their purchasing policies to reduce cost.

Cost-cutting measures managed to compensate for about two-thirds of the commodity hit, before restructuring costs, OC&C estimates. And the good news is that next year they should continue to benefit from cost savings without another restructuring charge.

Yet while cost-cutting was almost universal, the competing challenges of the past year have divided the global giants markedly.

Some have battened down the hatches and are waiting out the storm, while others have gone full tilt for growth. Both tactics could have their rewards, but neither has proved an obvious winner yet.

For example, of businesses that published information on their research and development, 16% cut their spend in cash terms, while almost half increased their spend by less than food inflation. Others, like Danone, SAB Miller and Cadbury, increased their R&D spending by more than 15%.

Advertising cuts

Advertising spend also divided the giants. On average, spending was cut substantially – the giants spent 0.2 percentage points less of their sales on ads.

But this masked some very different tactics. Unilever was the biggest ad cutter, slashing spend by 0.7 percentage points. About a third of fmcg giants took the opposite approach, led by Pernod Ricard, which spent 0.8 extra points defending its premium positioning.

It's these spending differences that separate the pack. One group, led by Nestlé, Procter & Gamble and Campbell's, is aggressively chasing growth, even in the downturn. Many are reshaping their portfolios to include value offerings, and keeping research and development budgets 38 »

BRAVING THE ELEMENTS

Global supplier: Nestlé
Grocery sales: $94.8bn
Captain's log: Nestlé might be the biggest food and drink business in the world, but it's no lumbering out-of-touch behemoth. It has wasted no time shifting its efforts towards promoting the value end of its portfolio. Organic sales are up 9%, and margins are up a huge 7.2 percentage points.

Global supplier: Procter & Gamble
Grocery sales: $83.5bn
Captain's log: Keeping up marketing and R&D share in a downturn is bold enough, but P&G has publicly stated its intention to keep investing during the recession to grow its share. And why not? As the second-biggest fmcg group in the world, it's starting from a position of strength.

Global supplier: Johnson & Johnson
Grocery sales: $16.1bn
Captain's log: Investing for the long term is tricky in any climate. So Johnson & Johnson's move into China with its acquisition of cosmetics business Beijing Dabao is bold. But it's got the figures – Johnson & Johnson posted organic growth of 4.3% and margin improvement of more than five points.

Global supplier: JBS
Grocery sales: $8.2bn
Captain's log: South American meat processor JBS has become the biggest in the world in recent years through aggressive M&A. In 2008 alone it spent more than $1bn buying up rivals in Australia and the US, generating economies of scale. The only question is whether, given the asset boom of recent years, it bought at too high a price.

Global supplier: Campbell's
Grocery sales: $8.0bn
Captain's log: Campbell's portfolio was in a good position to perform resiliently in 2008, and the soup brand has been quick to capitalise, launching a web-based "savings centre". It's also combined value and functional trends by launching cheaper 'healthy' ranges to pick up downtraders, fuelling its 8% sales growth and 2.2 percentage point margin boost.

THE GLOBAL 50

RANK	COMPANY	COUNTRY OF DOMICILE	GROCERY SALES 2008 ($M)	% OF SALES IN GROCERY	GROCERY SALES GROWTH 08–07	PROFIT MARGIN 2008	ROCE 2008
1	Nestlé AG	Switzerland	94,834	93%	2%	22%	31%
2	Procter & Gamble	US	83,503	100%	9%	21%	17%
3	Unilever	UK/Netherlands	59,623	100%	1%	18%	34%
4	PepsiCo	US	43,251	100%	10%	17%	36%
5	Kraft Foods	US	42,201	100%	17%	12%	11%
6	Coca-Cola Company	US	31,944	100%	11%	24%	25%
7	Archer Daniels Midland	US	28,614	41%	62%	4%	11%
8	L'Oréal	France	25,810	100%	3%	16%	17%
9	Philip Morris International	US	25,705	100%	13%	40%	53%
10	AB InBev	Belgium	23,692	100%	12%	23%	7%
11	British American Tobacco	UK	22,488	100%	21%	34%	21%
12	Groupe Danone	France	22,394	100%	19%	17%	12%
13	Japan Tobacco	Japan	22,094	97%	27%	15%	11%
14	Heineken Holding	Netherlands	21,068	100%	27%	8%	7%
15	SAB Miller	UK	17,057	100%	15%	22%	13%
16	Diageo	UK	16,208	100%	8%	30%	21%
17	Johnson & Johnson	US	16,054	25%	11%	27%	31%
18	Altria Group	US	15,741	99%	5%	45%	70%
19	Colgate-Palmolive	US	15,330	100%	11%	20%	54%
20	Kimberly-Clark	US	15,020	77%	7%	14%	24%
21	Kirin Breweries	Japan	14,719	79%	20%	9%	10%
22	General Mills	US	13,652	100%	10%	17%	17%
23	Asahi Breweries	Japan	13,499	95%	1%	6%	10%
24	Sara Lee Corporation	US	13,212	100%	10%	2%	3%
25	Kellogg Company	US	12,822	100%	9%	15%	28%
26	Tyson Foods	US	12,625	47%	4%	1%	5%
27	Dean Foods	US	12,455	100%	5%	5%	12%
28	Carlsberg	Denmark	11,829	100%	34%	11%	6%
29	Royal Friesland Campina	Netherlands	11,746	84%	4%	3%	8%
30	ConAgra	US	11,606	100%	10%	12%	15%
31	Reckitt Benckiser	UK	11,543	95%	23%	23%	31%
32	Avon	US	10,690	100%	8%	12%	41%
33	Henkel	Germany	10,576	51%	1%	13%	18%
34	Imperial Tobacco	UK	10,335	52%	60%	11%	6%
35	HJ Heinz	US	10,071	100%	12%	15%	22%
36	Bunge	Bermuda	10,026	19%	45%	3%	15%
37	Cadbury	UK	9,988	100%	15%	7%	7%
38	Pernod Ricard	France	9,690	100%	2%	21%	11%
39	Kao	Japan	9,604	83%	5%	9%	13%
40	Reynolds American	US	8,845	100%	-2%	26%	21%
41	LVMH	France	8,819	35%	1%	20%	18%
42	JBS	Brazil	8,212	50%	115%	2%	6%
43	Arla Foods	Denmark	8,132	83%	7%	3%	7%
44	Campbell	US	7,998	100%	8%	20%	40%
45	Estée Lauder	US	7,911	100%	12%	10%	28%
46	Beiersdorf	Germany	7,541	86%	10%	13%	30%
47	GlaxoSmithKline	UK	7,367	16%	12%	30%	29%
48	Yamazaki Baking	Japan	7,284	93%	5%	2%	11%
49	Ajinomoto	Japan	6,921	65%	6%	4%	7%
50	Associated British Foods	UK	6,421	40%	25%	7%	9%

««37 high to fuel this. They're also more likely to be keeping their advertising spend high to drive growth.

"This is a good time to gain market share and a good time to change your market positioning," says Hayllar.

"If you're strong and bold you can really make a big difference to your market positioning. People who are investing in their business, gaining market share and improving market position could prove real recession heroes. They just have to hold their nerve."

Hayllar adds that companies with broad portfolios, such as Nestlé (the world's biggest grocery supplier, with sales of £94.8bn), need only to change the emphasis of their advertising, promotions and launches to suit value products, and can do this without undermining more premium offerings. This leaves higher-end brands intact to recover share come the recovery.

Others have launched new formats and pack sizes into certain markets. Danone brought its eco-pack, an innovation for its emerging Eastern European markets, to its core French consumers, while Procter & Gamble introduced larger bulk value packs into supermarkets and other mainstream retailers. Heavy promotional discounts were another common tactic, used by 58% of top 50 companies.

Sticking tight

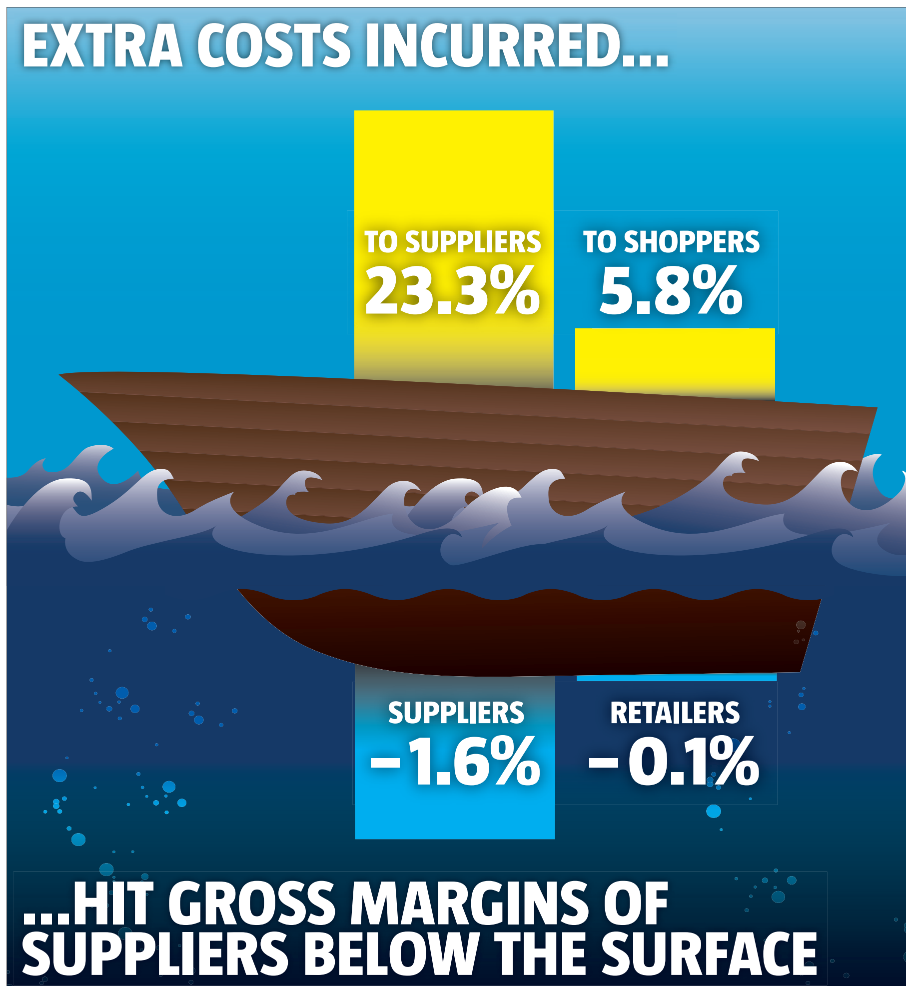
Not every corporation has bought into this line of reasoning. While some sally forth into the economic waters, other companies are sticking tight, closing the shutters, and weathering the storm – waiting to venture out again when conditions are more fair.

Heinz is the most explicit member of the camp, having publicly announced its intentions to sit out the recession.

"Chasing volume in this category right now is chasing the customer walking out the door for a short period of time," CEO Bill Johnson told analysts in February. "They will come back. They have in the past three recessions. We expect to see that again."

Pernod Ricard is taking a similar approach, absorbing a hit now to maintain its premium position later, rather than risk devaluing its brand. Despite OC&C analysis suggesting worldwide organic sales have fallen 12%, Pernod Ricard has maintained advertising spend and pricing.

"Spirits are resilient in a downturn; people are very loyal to the brand," CEO Pierre Pringuet told investors. "[However,] organic growth was adversely impacted by



our clients' willingness to decrease their inventories due to credit tightening."

Looking at Nestlé's storming performance – and seven point margin growth – next to the falling volumes of some of its cautious rivals, it might seem obvious which tactic is working best for the top 50. But the picture may not be so clear cut.

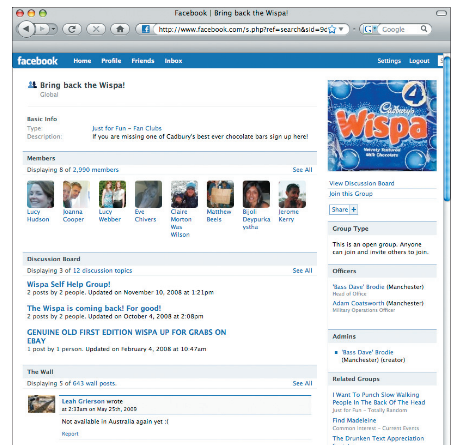
"History tends to suggest brands that maintain their presence and commitment perform better as the economy recovers," says brand consultant Giles Lury.

"Similarly, it can be a good time to bury bad brands. But companies that have taken a lot of steps to adapt to recession face several challenges. The first, quite simply, is timing the end right. The economy might start growing again, but that doesn't necessarily mean all will be rosy again with consumers. There has also been an explosion in value products that consumers have been encouraged to trade into, most of whom have probably been pleasantly surprised. Regaining the appeal of premium brands might not be straightforward.

"For brands that have really played into promotional and discount tactics to reinforce their position, this will be especially tough. Consumers may have come to expect a 'real' price far below the nominal ticket value."

In Lury's view, whether a brand has cut marketing spend is not necessarily the key factor. Rather, he says, it's about how they've set about it. If a brand has cut its marketing budget, but switched to cost-effective innovative advertising, it may not have cut its impact. High-profile tactics like the notorious You've Been Tango'd campaign often deliver solid value for money," he says. "The crucial thing is maintaining brand impact. It's more important to out-think your rivals in this climate 40 »

> "It's more important to out-think your rivals in this climate than it is to outspend them"



THE CYBER-MARKETING ERA

The Global 50 might be cutting back on their marketing spend. But it's not a case of slash and burn – many of the fmcg giants have been embracing new media to work their tightened budgets that much harder.

More than half – 29 out of 50 – of the Global 50 mention using alternative media in their annual reports, while 10 (up from five last year) mention making use of social media sites such as Facebook or Bebo.

Cadbury attracted 270,000 Facebook fans to a campaign to resurrect the Wispa bar, while Coca-Cola gained widespread credo for endorsing a fan page rather than shutting it down.

It now co-runs the site with its founders and has 2.5 million fans – the second-largest fan page on Facebook.

Others have taken different routes: Arla Foods and Campbell's both promote recipes on their popular websites. Arla attracts more than 16 million visits each year from Denmark and Sweden alone.

Kraft has taken the idea a step further by launching an iPhone application listing 7,000 recipes, plus directions to the nearest store stocking the ingredients.

"Now's a great time to think of more cost-effective ways of marketing," says brand consultant Giles Lury.

"And the ability to do things online gives companies more time and space coupled with less costly production. Plus there's no reason television can't be used to supplement it. Switching to 10-second adverts promoting a website saves a lot on traditional 30-second spots.

"But better yet is tapping into some viral phenomenon. The Carlsberg beer application is one of the best examples of that yet. A simple, interactive gimmick managed to attract millions of users – and keep the brand in their minds."

UNILEVER BACK ON FORM WITH SKIPPER POLMAN

It's not hard to see why Unilever and Procter & Gamble are so regularly compared and contrasted. As well as being international conglomerates with multiple billionaire brands, many go directly head to head: Unilever's Surf takes on P&G's Ariel, just as Dove tackles Olay.

Until recently, there's been no doubt who's had the upper hand. Five years ago, Unilever's organic growth lagged at 0.4% versus P&G's 8%. The same held true every year through to 2007, when finally Unilever grew slightly faster than its larger rival.

This year, new chief executive Paul Polman has been able to celebrate Unilever extending its lead, with organic growth of 8% to P&G's 5%. OC&C believes the change is largely down to the One Unilever programme, which has helped the company up its pace.

"Part of the One Unilever programme is about taking out cost, but trying to do it in a way that enables them to be more responsive to market conditions and more integrated in their thinking," says associate partner Will Hayllar. "This means they're producing fewer innovations, but faster and on a bigger scale. They've also sold off and cleared some clutter that wasn't doing so well."

Unilever's sell-off of its non-core brands, which included major brands such as Bertolli, has left it with a hefty cash pile for choice purchases now prices are lower. It's already taken advantage this year with its first purchase, haircare brand TIGI from hairdressing chain Toni & Guy, which it bought for $412m in January.

Yet it's not time to write off Procter & Gamble. The giant is still more skewed towards personal care than Unilever, and lower inflation in this area has made its growth look subdued compared with many rivals.

"Unilever has upped its game and is now in the same league as P&G," says Hayllar. "It's certainly not the case that anything at P&G has gone badly wrong."

39 than it is to out-spend them."

Mergers and acquisitions activity was a similarly divisive area. The effect of a few huge deals made 2008 a record breaking year for the top 50, despite the early effects of the credit crunch already beginning to take hold. There were 37 acquisitions involving companies from the top 50, with a record-breaking $233bn value, a 61.8% increase on 2007's total of $144bn.

"Everyone still has the mindset that deal-making has pretty much ground to a halt," says Hayllar. "But whereas some of the smaller guys are struggling to raise the debt at the moment, these Global 50 guys still have the strong balance sheets to go out and do that. Most of these deals have been about consolidating the core business and strengthening market positions, taking out a slightly weaker competitor."

Consolidation

The question for some is whether this M&A activity, which included the huge $58.5bn AB InBev acquisition, represents the first consolidation of the recession or the final stages of the credit boom.

"No-one would disagree that where the price is right the trade giants should try to consolidate their position if they're strong enough to do so," says one M&A broker.

"But for some deals in recent years, the price hasn't been right and the deal has gone through anyway. That's left some companies publicly struggling to deal with the debt and restructuring costs of their actions, not to mention writedowns."

Mergers, acquisitions and divestments were the main driver of big movements in the table, including most of the six new entrants and departures this year.

However, given the scale of the deals that propelled some of the new players into the charts, their tenure at the top will be brief if the price wasn't right.

The topline sales performance of the Global 50 in 2008 was phenomenal, even if, behind the headline performance, the strain shows: in tightening margins, cost-cutting, restructuring and dealmaking.

But it's only this year that recession has really started to bite. The shrinkage of margins, even among the top 50, has accelerated, and unemployment rates are on the rise. Still, the 50 have now staked their bets on which approach will take them to the top next year; all that remains is for 2009 to show who's on the money. ■

The Global 50 2009 Report was produced by strategy consultancy OC&C. To obtain a copy, contact OC&C on 0207 010 8000.

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