

## Challenges ahead for the European Consumer Goods and Retail Industry

### **The paradox between retail power and supplier ability to pass on increased cost of goods**

In the Consumer Markets space, whilst the key issue remains the ongoing power battle between retailers and food & drink manufacturers, the novelty is the booming food price hike and its consequences on many players across the food value chain.

Manufacturers traditionally faced hard times negotiating price increases to retailers. 2007-2008 saw a major change in that suppliers were largely able to pass on increases in raw materials and fuel prices. In a context of continued tension due to the classical power game between retailers and manufacturers, we have seen retailers increase to further heights the market share of their own private label offerings, which are going premium full steam ahead, just like many of the branded food and beverage products. The gap between the premium end of own label and the mainstream brands is narrowing dangerously. Dangerously because what is at stake today more than ever before, is the capability to survive the rising innovation pressure for brands which are not number 1 or 2 in their core markets.

Aside from the challenging and potentially costly quest in keeping an edge over premium private label food offering and therefore brand differentiation, manufacturers will probably look to strip off costs even further and forcing them to make tough calls on any remaining non-core assets they hold.

### **The link between retail power, multi format retailing and innovation**

The main result of private labels gaining further market share is that there is less and less shelf space for branded products of established food & drink manufacturers. This shelf space conflict is exacerbated even further in retail markets where the hypermarket format is less developed, but also in mature markets due to the emergence of innovative store concepts like *Tesco Express*, *Kesko Extra*, *Delhaize "Shop'n go"* or *"Albert Heijn to go"* who are making the fight for shelf space even more intense. Lots of collateral damage ahead? Yes, but there is hope, as the two European hard discounting superpowers, *Lidl* and *Aldi*, are shifting their strategies to take up market leading brands in their assortments. Will this help the large majority of brands which do not enjoy a number 1 or 2 position in their category? Clearly, the future for those brands will be a challenging one. Their survival kit will need much more than traditional innovation and differentiation efforts. Those brand owners have the choice between redefining their future core business (i.e. migrating to a private label specialist manufacturer or moving up the positioning of their brand proposition) or hoping to benefit from a consolidation in their category and selling out.

### **The impact of premiumisation on food giants' R&D and Innovation strategies**

At the current pace, many food & drink manufacturers can be expected to continue to migrate from mainstream food into highly differentiated value-added areas, mainly into products combining one or more of the premium, organic, sustainable, fair-trade, health & wellness, functional, and nutritional attributes.

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Taken together, the overall premium food market is expected to reach by 2015 a similar market value as the well-established discount retail sector.

This creates an enviable prospect for niche players (like *Innocent*, *Gu*, *Newtree* and a myriad of others) becoming attractive take-over targets for either private equities or food giants.

What is new is the trend of food giants acquiring ultra innovative niche players to use them as incremental R&D platforms. A recent example is *Nestlé*, entering the capital of the Belgian super premium *Marcolini* chocolates early 2008 in a quest to boost its upscale confectionery capabilities.

## New York, the city that never sleeps

Looking at the category level, the frozen food market is a perfect example of an entire category that lost track of what New York stands for, and got asleep a decade ago. Driven by the overwhelming dynamism of the chilled foods category, it is now undergoing a massive transformation across Europe, largely re-inventing itself and battling hard to gain market share back from the chilled foods segment. *Bonduelle*, the French based worldwide frozen food player is an example of a company that is shifting from being a lower end commodity vegetable provider into a more sophisticated frozen foods category leader.

Frozen foods are in a come back, as shown by recent category reports in France as well as by frozen food industry campaigns promoting the freshness and nutritional value of frozen food as being at least as good as fresh and chilled offerings. Time will tell whether Unilever's decision to dispose of its frozen food arm was adequate...

## How much more Health & Wellness can we take?

Consumer interest in health & wellness is gaining massive traction and dominates the food & drink innovation space. H&W is not just about more healthy ingredients or recipes. The latest rage comes, unsurprisingly, from the UK market. Next to the "Enriched with" functional foods like bread, milk and eggs with Omega 3 or flavanols and plant sterols, the new kid on the block is now the "Free from" food assortment flourishing across the food aisles. "Free from" is not just free from GMOs, it expands to bad cholesterol, animal testing, trans-fatty acids, gluten and more.

Next to the "bad for your healthy diet" trend, there is the "good for you" trend. Building further on the functional food and beverage trend, the latest most talked about hype is "super-foods" like mangosteen or garbanzo beans and super-fruits like the acai berry which are seen as "must have" ingredients for the beverage and ice cream industries. Super-fruits are hype for their incredible antioxidant properties. Surfing on the same wave is the largely promoted "eat 5 portions of fruit a day" campaigns in several European countries. Chocolate makers too are leveraging the healthy properties of their dark gold. *Barry Callebaut*, world leader in industrial chocolate, is promote the numerous health benefits of dark chocolate intake, playing its *Acticoa* card.

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## And beyond Health & Wellness?

H&W is still largely a “developed” markets thing. In the awaiting of the explosion of this megatrend in the emerging BRIC markets, the food & beverage industry needs to prepare for other megatrends too.

Ethical consumer considerations, which encompass fair trade and sustainable food production, are growing faster amongst the new generations of shoppers. Manufacturers should anticipate this impact on their sourcing and innovation strategies, as this market could well overtake the organic food category by 2016 in value terms.

Another interesting trend to watch is “*cosmetofood*”, (combination of food and cosmetic attributes) of which Danone’s *Essensis* yogurt is a pioneering example claiming an impact on your beauty from within. All these megatrends are likely to significantly influence consumer choices.

## Green living, Global sourcing and food value chain sustainability

While global sourcing and sustainability have clearly moved up the ladder of CEO’s agenda, the consumer agenda is getting filled with green considerations. Less pesticides, antibiotics, carbon emissions are up on their agenda.

With strong domestic Chinese and Indian food manufacturers preparing for expansion beyond Asia, European food and retail companies need to engage with and/or prepare to compete more intensively with suppliers from emerging markets, while managing their carbon footprint and their overall Corporate Social Responsibility image.

Global procurement of raw materials by manufacturers and global sourcing of semi to finished products by retailers are forcing both to redesign the organisation charts, to enhance their business processes and to review their food safety standards. As a result, we expect increased regulation from the European Food Safety Authority to provide the industry with a clear framework for food safety and reliable track and trace solutions.

## Major technology breakthroughs ahead

We expect technology to continue to impact the food value chain, essentially through nanotechnology and RFID.

Nanotechnology, even in its infancy, should be considered seriously by all food manufacturers, as its impact on the cost base may be significant. Small and medium sized food companies should consider pooling resources in order to bridge their lack of scale, potentially keeping them to watch the nanotechnology revolution from the sidelines.

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Rolling out the RFID technology down to the consumer item level in the food and beverage industry remains still largely uneconomical. In the meantime, self scanning in store and also self check outs in supermarkets see a widespread proliferation, slowly but surely preparing consumers for the “Store of the Future” era, where the *EPCglobal* revolution will remove queues at check outs and take further costs out of the value chain. Whether we as consumers will pay less for our groceries with more efficient supply chains remains to be seen...



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