strategy+business

ISSUE 74 SPRING 2014

Achieving Growth in a Lean Europe

With consumer spending down and investment drying up, what's an E.U. firm to do?

BY RICHARD RAWLINSON

REPRINT 00231

This article was originally published by Booz & Company.

Achieving Growth in a Lean Europe

With consumer spending down and investment drying up, what's an E.U. firm to do?

by Richard Rawlinson

Executives of consumer products and retail companies in Europe responded to the recent global economic crisis the best way they knew how. As demand shrank, they cut costs across the board. And initially, these measures worked: Between 2009 and 2012, even as revenues fell, many companies posted increased earnings and relatively strong stock market performance. But today this strategy has run out of steam. There's only so much excess to remove and overhead to reduce.

That's left these executives facing a significant challenge. They need to find ways to grow in Europe, but the market is working against them. The social safety net that supported European consumers early on has been worn thin by continuing economic pressures and rising taxes. Since 2011, disposable income in Europe has been contracting in real terms. This decline in consumer spending power makes it hard to argue for increased investment in the region. At the same time, other regions are attracting more investment away from Europe. In countries such as Brazil, Russia, India, and China, even though disposable income growth has leveled off at around 6 percent per year from a high of 10 percent in 2007, the middle class is large and growing, and has cash to spend on products that had long been out of reach. Meanwhile, North America's personal income growth rate has rebounded to about 2 percent per year, supporting reinvestment in the North American market.

It's a forbidding picture of Europe: consumers with less cash to spend in a market that most companies aren't eager to invest in. Fortunately, there is a way to grow even in today's lean times. Executives confronting these pressures will need to look within—at the markets and customers their companies already have—and find new ways to reach them by using the capabilities and strengths that make their companies distinctive.

Illustration by Chi Birmingham

A New Approach

For many companies, growth opportunities hide in plain sight—and finding and seizing them doesn't always require significant investment. Executives should look at the products in their current portfolio with fresh eyes, and determine whether consumers are using them in unintended ways. For example, Procter & Gamble learned that people were using its cold medicine NyQuil, which comes with a warning that it can cause drowsiness, as a sleep aid. In response, the company started marketing ZzzQuil, a product that uses the same active ingredient, but with a modified formulation—obviating the need for a major R&D effort. And P&G already had strong distribution and marketing networks in place. With minimal investment, it was able to create an entirely new growth segment.

Reckitt Benckiser (RB) has also had great success in developing product variants. The company starts by paying careful attention to consumer interests and gaps in consumer needs, closely connecting its R&D and consumer insight–gathering capabilities. RB realized that it could create versions of Nurofen, its popular pain relief medication, that were targeted to specific ailments such as migraines, muscle pain, and colds, among others. The basic ingredient—ibuprofen—remains the same. And like P&G, the company could leverage its superior distribution and marketing capabilities to sell each of the variants at a premium over regular Nurofen.

In rethinking their product portfolio, established consumer and retail companies can take a page from their upstart competitors. In early 2013, Booz & Company found that smaller companies—those with less than US$1 billion in sales—were prospering, growing their market share more rapidly than larger competitors in 18 of the top 25 food and beverage categories. Some recent market developments favor these smaller players. For one, "selectionist" consumers seek out brands that match their own needs and sense of differentiation, and often turn to products from local sources. And, with extensive outsourcing, smaller players can now offset scale disadvantages in administrative and support functions (*see "The Big Bite of Small Brands," by Elisabeth Hartley, Steffen Lauster, and J. Neely,* s+b, *Autumn 2013*).

What's driving this trend is the fact that smaller players know that coherence beats scale. In Scotland, Irn-Bru ("Iron Brew"), a carbonated soft drink owned by British manufacturer A.G. Barr, outsells all of its competitors—even Coca-Cola. A.G. Barr has achieved 9 percent CAGR for the past six years by focusing on the Scottish market and a narrow product lineup. It's a strategy that traditional retailers can adopt. Heineken, for example, markets dozens of beer brands by emulating its microbrewery competitors—but its brands all benefit from the company's proficiency and scale in innovation, marketing, and distribution.

Smaller players can also serve as testing grounds for innovation, and acquiring or partnering with them can bring those innovations to scale. Although such ventures obviously require investment, they are capitalized investments that would be more palatable and justifiable to company leaders than operating investments. Avis's acquisition of Zipcar in early 2013 followed this model. Zipcar had reframed urban car rental by allowing customers to subscribe to its service with hour-by-hour pricing. To make the integration work over the long term, Avis will need to take advantage of Zipcar's well-known brand and marketing prowess, but apply its economies of scale at the back end, in car purchasing, fleet management, and information technology. Johnson & Johnson has used a similar strategy to expand in both pharmaceuticals and consumer healthcare.

Double your investments in those growth areas that align with your strengths and take advantage of your existing assets.

If there is a common enabler for many of the strategies discussed thus far, it is digitization. Digital technologies hold immense promise for revitalizing the retail and consumer products industries. They bring consumers and retailers closer, reduce costs, and enable a variety of lucrative new services and marketing tools. But the rule of economy applies even to digitization: You have to manage investment and cost as you seek growth.

Recent developments in the U.K. grocery industry illustrate the risks of ignoring this rule. Every major supermarket has committed to developing a digitally enabled business. But in so doing, they have had to move away from the magic of the supermarket model, in which the customer does the work of coming to the store and picking out, checking out, and bringing home the merchandise. By adding online and delivery options, grocers have increased their activities, assets, and operating costs. Meanwhile, they have carried many existing pricing and assortment policies into their online operations.

More effective digital strategies often use more of a company's existing asset base and capabilities system, but less of the inherited pricing and assortment policies. Retailers that find new uses for their existing stores will benefit most. Burberry Group used social media to make its luxury brand feel accessible to people around the world with live feeds of its fashion shows, but it also uses its brick-and-mortar stores as high-tech experience centers. Burberry's flagship store in London began using RFID tags and mobile technology to enable customers to engage with products and salespeople on the floor. The effort, led by then CEO Angela Ahrendts, was so successful that in October 2013, Apple tapped Ahrendts to transform and streamline its physical and online retail stores.

Make Your Own Success

Success in today's Europe comes down to the overlap between market opportunities and a company's capabilities. The best advice: Seek out those opportunities that match the few things you do extremely well. Double your investments in those growth areas that align with your strengths and take advantage of your existing assets. Ruthlessly diminish or discard your investments in other areas. They are extraneous; you can't afford the baggage now.

Most consumer products and retail companies won't take these steps. They will continue to seek out new growth market opportunities anywhere they can find them. The trouble is, there just aren't many around in a time of declining consumer spending. And even if they do find those opportunities, companies can't necessarily exploit them, because they may not have the capabilities needed to do so or the investment needed to develop those capabilities. That's why executives in Europe need to start with what they have and what they're good at, and work from there. When the market itself isn't creating opportunities, this is how companies make their own. +

Reprint No. 00231

Richard Rawlinson
richard.rawlinson@booz.com
is a partner with Booz & Company's consumer and retail practice, and is based in London.

strategy+business magazine
is published by PwC Strategy& Inc.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

For more information about Strategy&,
visit www.strategyand.pwc.com

• strategy-business.com
• facebook.com/strategybusiness
• http://twitter.com/stratandbiz
101 Park Ave., 18th Floor, New York, NY 10178

pwc | strategy&
Formerly Booz & Company