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**S**mall consumer packaged goods (CPG) companies in the U.S. are steadily gaining market share these days, often at the expense of larger competitors. Booz & Company recently analyzed the food and beverage industry and found that small players (those with sales of less than US\$1 billion) are outperforming the competition in 18 of the top 25 categories, including the largest and most consolidated ones, such as bakery, dairy, snacks, and ready meals (*see Exhibit, page 2*). From 2009 to 2012 in packaged foods and from 2008 to 2011 in beverages, small players grew revenue about three times faster than the overall category. Specifically, in packaged foods, small players experienced a three-year compound annual growth rate (CAGR) of 6.2 percent, and gained 1.7 percent of market share. Meanwhile, large players increased sales by just 1.6 percent CAGR and saw their market share decline 0.7 percent.

Along with market share gains, small players enjoyed price premiums in many categories. A survey of

in-store pricing found that Godiva chocolate cost 138 percent more than the Hershey's product of comparable size and flavor, and Amy's Kitchen soups cost 58 percent more than Campbell's. Small players also showed pricing strength over private-label manufacturers. From 2011 to 2012, the price premium for small players over private labels jumped 5 percent for butter, olive oil, and packaged/industrial bread.

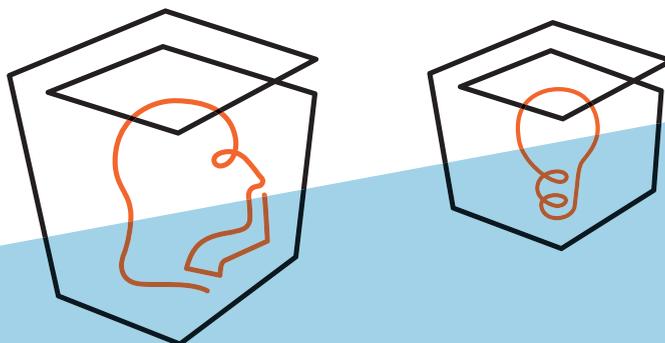
Several broad forces, most of them peculiar to our times, are combining to create advantageous conditions for small companies. A market segment known as "selectionists," who constitute 30 percent of consumers, are seeking greater variety and new tastes in the food and drinks they buy—and sometimes care deeply about factors such as the origins of a product and how far it has been shipped. Some traditional supermarkets are catering to this trend as a way to differentiate themselves from Walmart and big price clubs. The fragmentation of media and the generally lower cost of digital platforms are giving small players new outlets to reach customers in more targeted, cost-efficient ways. But what should most concern large players is how technology is eroding their scale-driven advantages. Small players are increasingly able to outsource invoicing, HR systems, and logistics, as well as other

back-office SG&A functions. Retail consolidation is further chipping away at scale advantage. The preference among bigger retailers is to work with a broad range of manufacturers—both large and small—to keep large consumer packaged goods companies from gaining too much leverage.

How do the most successful large CPG players respond to these changes and the serious threats they contain? The leaders of these companies begin by developing a better understanding of the strategies that upstart competitors are employing to grab market share. Next, they look at the capabilities underpinning those strategies and consider how they might take advantage of these capabilities themselves.

## Capabilities That Differentiate

Small players don't have a single or consistent approach across all categories to account for their success. They are using a variety of strategies that incorporate brand positioning, pricing, market entry, innovation, route to market, and in-store marketing and merchandising. Within these categories, each carves out distinct positions depending on the product and competitive environment. The overall effect is a patchwork of bespoke strategies. That means one needs to look harder for the lessons—but they are there.



Successful small players appear to have one important similarity: They possess a coherent system of capabilities that allows them to focus on a few critical areas where they can most effectively exploit the weaknesses of less-nimble large players. This coherence gives its owner the means to differentiate itself.

Take the Cabot Creamery, a cooperative dairy enterprise based in the northeastern U.S., which plays against the corporate stereotype of rivals by highlighting its business model and connection to the Vermont dairy farmer. In the same vein, Cabot uses its online presence (Facebook, Twitter, Pinterest, Instagram) to promote community involvement. The company has developed the capabilities to roll out new flavors and specialty aged cheeses that appeal to consumers' desire for variety and homespun creativity: Horseradish Cheddar, Hot Habanero Cheddar, and Tomato Basil Cheddar, to name a few. These specialty cheeses have allowed Cabot to expand its presence in stores to the deli case (with other artisanal cheeses), thus gaining shelf space in a more "premium" section of the store.

Utz Quality Foods is a family-founded potato chip brand in the United States that creates a direct relationship with consumers by offering products online and delivering directly to homes. It also appeals to health-conscious consumers with wheat-free and gluten-free Rice Crisps, non-fried light potato chips, and organic tortilla chips and pretzels. This capability to create healthy innovations is a powerful differentiator for snacks that are often labeled as junk food.

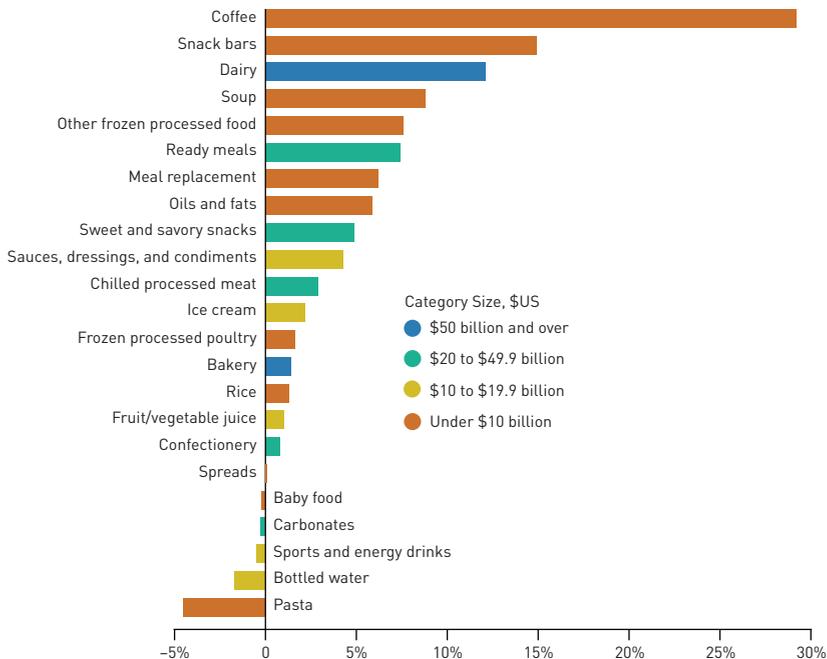
**The Large Player Response**

The success of small players and the

**Exhibit: Small Players Outperform**

In most of the biggest food and beverage categories, small CPG firms are increasing their market share.

Three-Year Growth of Small Players Relative to Category



**Notes:** Ready-to-drink tea and frozen processed vegetables are not shown because those categories have no small players. Packaged food categories show 2012 data; beverage categories show 2011 data.

**Source:** Euromonitor, Booz & Company analysis

conditions that have arisen to make them more competitive raise some critical issues for large players about their organic and inorganic growth strategies. Large players need to think carefully about how to access the capabilities that small players are using to such advantage.

But at what point should the large incumbent company respond to a small player's inroads? Should the response be to build or to buy? In either case, what new capabilities does the company need to succeed, and how can they be incorporated into existing systems?

Addressing these issues is a tall order, but several large companies are countering the incursion of small players effectively and consistently. Some, such as Coca-Cola, have acquired a long list of successful small businesses, capturing their contin-

ued high growth for themselves. Others, such as Frito-Lay, win by mimicking the small players' approach to innovation and then using their scale and brand leverage to compete and drive growth.

**Coca-Cola: The Acquirer**

Coca-Cola routinely expands its beverage portfolio to leverage its impressive and differentiating distribution capabilities. More recent acquisitions include Glaceau, an enhanced water; Fuze, a vitamin-enriched beverage; and a handful of other specialty drinks including Odwalla, Honest Tea, Innocent, and Zico.

- *Brand positioning:* To keep each new brand distinct and attractive to its established and sometimes devoted customer base, Coca-Cola does not affiliate the acquired brand directly with the Coca-Cola brand.

- *Pricing:* Acquired brands are often positioned as premium brands and are priced higher than the competition.

- *Market entry:* Coca-Cola chooses brands that have an established market presence in their niche and that have reached a certain multimillion-dollar revenue threshold.

- *Innovation:* Coca-Cola uses different governance models to oversee acquisitions, but the common priority is to keep the company flexible and innovative.

- *Route to market:* Coca-Cola continues to distribute the acquired brand to specialty retailers, but it also leverages its extensive distribution network to reach more consumers.

- *In-store marketing and merchandising:* Coca-Cola takes advantage of its reach and distribution to merchandise new products. For example, Vitamin Water is now available in numerous convenience stores and kiosks with coordinated displays and in-store support.

### Frito-Lay: The Builder

Instead of making acquisitions, Frito-Lay leverages its well-honed capability to mimic market innovations. Consider kettle chips (potato chips cooked in small batches, rather than in the more common continuous-flow machines), a category dominated by two small players: Cape Cod and Kettle Chips. Frito-Lay took careful notice, and created Lay's Kettle Cooked.

- *Brand positioning:* Frito-Lay positions its Kettle Cooked brand as a value brand in comparison to Kettle and Cape Cod products, and promotes the healthy aspects of the chip (e.g., "40 percent less fat than regular potato chips").

- *Pricing:* In keeping with its value brand position, Lay's Kettle

Cooked is priced below other kettle competitors. A canvass of supermarkets in January 2013 found that a \$3.29, 8-ounce bag of Lay's Kettle Cooked was as much as 7 percent less expensive than the small player alternatives.

- *Market entry:* Frito-Lay rolls out different flavors of Kettle Cooked chips over time, instead of all at once, while consistently pushing them as a healthier way to enjoy Lay's potato chips, which have a long-established brand following.

- *Innovation:* Frito-Lay has developed the ability to rapidly replicate new flavors introduced by Kettle and Cape Cod that it would not have considered offering in the past (for example, jalapeño and sun-dried tomato and Parmesan).

- *Route to market:* Frito-Lay sells primarily through grocery and supermarkets rather than restaurants and boutique markets. Lay's Kettle Cooked leverages Frito-Lay's extensive direct-store-delivery network to penetrate key channels.

- *In-store marketing and merchandising:* Lay's "category captain" position in traditional flat potato chips gives Frito-Lay the power to influence, if not set, category shelf plans. That sway over product placement is a key advantage.

### An Opportunity for Growth

Large companies should view small players not simply as a threat or nuisance, but as valuable working examples of how they might recharge their own growth. Whether a large company decides to acquire small players or to compete with them head on, it needs the right capabilities system. An acquirer must have the people, processes, and tools in place to leverage its scale and strength without snuffing out the

new brand's innovative spirit and upstart image. And a builder needs these elements in place to innovate quickly in response to small players and to reinforce the new brand through in-store marketing and merchandising.

Careful attention to building or buying the right capabilities will allow large companies to leverage the winning strategies of small players for their own growth ambitions. +

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