



EXECUTIVE INSIGHTS

For Packaging Industry, Brand Owner Challenges Are a Path to Opportunity

Insights from L.E.K. Consulting's 2021 Brand Owner Packaging Study

The consumer packaged goods (CPG) industry faced several major challenges in 2021. The industry seems to be weathering the COVID-19 pandemic, and CPG companies' spend on packaging is no exception — with spending on packaging continuing to increase in line with long-term trends across a range of brand product categories. And expectations are that the trend will be sustained. Sixty-five percent of brand owners expect to increase their packaging spend over the next two years. And for Tier 1 brands, the number is even higher — 78% of Tier 1 brand owners plan to increase their packaging spending.

But as in other sectors, the pandemic has served to accelerate and intensify changes impacting packaging demand that were already underway, such as the resumption of stock keeping unit (SKU) proliferation after a temporary reversal in some segments and the accelerating penetration of ecommerce. In parallel, there is rapidly growing pressure for sustainable packaging solutions from consumers and regulators — pressure that brand owners are hard-pressed to meet.

The result is a set of significant and growing challenges for brand owners with packaging decision-maker power. Meeting those challenges represents opportunity for packaging manufacturers and suppliers as well as investors in the packaging space.

To better understand how brand owner packaging needs are evolving — and the implications for the industry and investors — L.E.K. Consulting conducted its fourth annual brand owner packaging study in summer 2021.

We asked about brand trends and their impact on packaging, as well as changes to packaging itself. Specifically, we wanted to know:

- **What do brand trends mean for demand and what are the implications for packaging?** How has the total number of sub-brands and SKUs evolved, and how did SKU count evolve during the pandemic? What impacts are these trends having on packaging run lengths? How has packaging changed over the past several years, and how will it continue to change?
- **What is the impact of sustainability trends on packaging?** How do brand owners define sustainable packaging? What percentage of brand owners have a medium-term (i.e., 2025) sustainability goal, and what progress are they making toward it? How do brand owners

2021 Brand Owner Packaging Study

To develop the study, we surveyed 425 brand managers and other packaging decision-makers at CPG companies (in packaging engineering, R&D, brand management, procurement, finance and executive/ownership roles). Our survey covered brands in consumer-facing markets: food, beverage, beauty and personal care, healthcare, pet food, consumer electronics, and cannabis.

All participants are either responsible for or directly involved in packaging decisions for one or more consumer brands. In addition, participants are responsible for brands that are sold at least in the U.S. but may also be sold in international markets.

Brands were categorized by "tiers" based on revenue and geographic coverage:

Tier 1: Branded international presence with more than \$1 billion revenue

Tier 2: Branded international presence with \$500 million to \$1 billion revenue, or national and regional presence with more than \$500 million revenue

Micro: Branded international, national or regional presence with less than \$500 million revenue

Private label: Store or "house" brands of any revenue size and geographic coverage

Eleven percent of respondents were responsible for Tier 1 brands; 42% were responsible for Tier 2 brands; 43% were responsible for micro brands; and 4% were responsible for private label.

expect their use of sustainable materials in packaging to develop over the next several years, and what do they expect will be their primary actions moving forward?

- **How is ecommerce evolving, and what does that mean for packaging?** How does ecommerce use vary by end market, and how is it expected to trend? What percentage of brand owners use ecommerce-specific packaging formats, and how does that spending compare to packaging designed for brick-and-mortar use? What new ecommerce-specific packaging features are brand owners introducing?

Here's what we learned.

Packaging spend continues to grow — with Tier 1 brands in the lead

Packaging spend on CPG brands has grown over the past two years. According to the self-reported numbers provided in the survey, overall growth over that period was 3.7% in 2019-20, approximately 200 basis points above the 1.6% rate of inflation as measured by the U.S. Consumer Price Index. Fifty-six percent of brand-owner respondents increased their spend on packaging during that period.

The biggest spending increases involved Tier 1 brands, where overall, 78% of those surveyed reported increased spending (and 36% increased it by 6%-10%). But private-label brands registered the most variability — 24% of those surveyed reported a spending increase of more than 10%, and 12% decreased it by more than 10%.

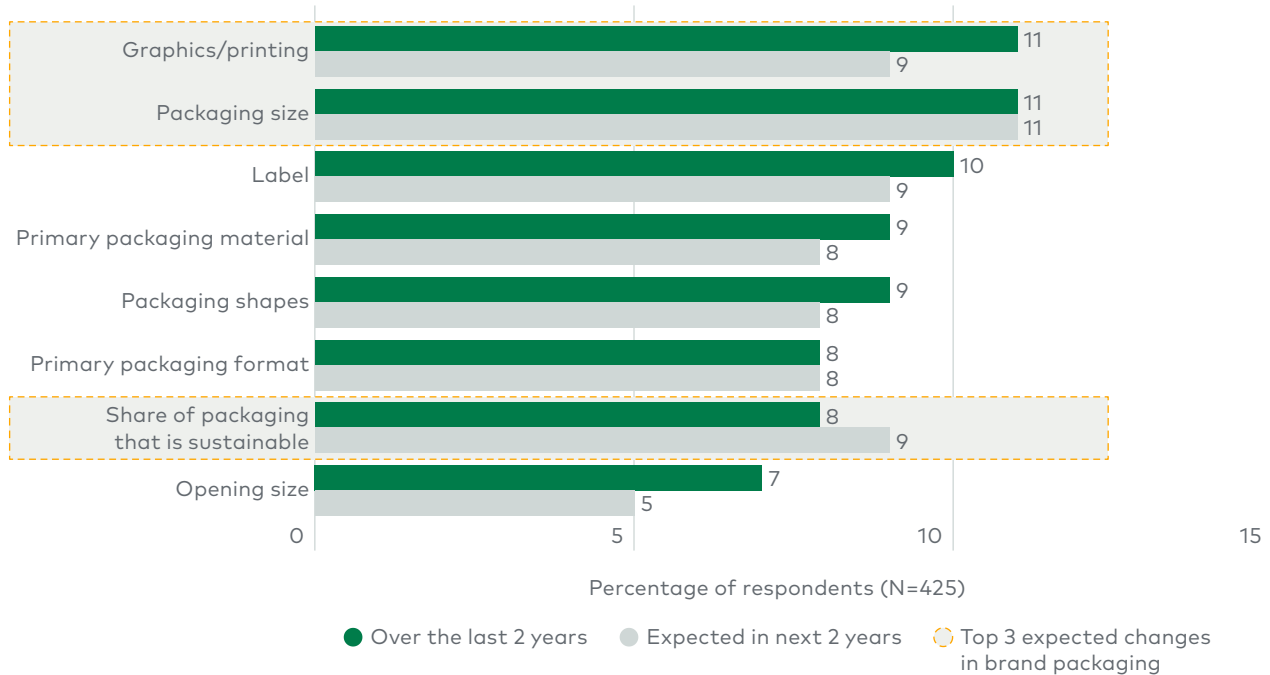
Going forward, respondents expect spend on packaging to increase further. Sixty-five percent of those surveyed said they anticipate growing their spending in 2022 and 2023, and nearly a third (31%) plan a 6%-10% increase. But most of the expected increase appears to be in Tier 1 brands — fully 78% of Tier 1 brand owners and decision-makers anticipate increasing their spend on packaging, with 18% forecasting a more-than-10% increase and another 18% looking at a 6%-10% increase. Only 4% of Tier 1 brand owners report they expect to spend less on packaging in the next two years.

Tier 2 and micro brand owners' packaging spend forecasts are roughly in line with the overall forecast, and a degree of variability is expected to continue in private label, with 11% planning an increase of 10% or more, and another 11% expecting a decrease of 10% or more.

What are brand owners spending on? In a nutshell: brand promotion and sustainable and ecommerce-friendly packaging. Changes in graphics and printing lead the pack, especially in household and pet products. Spending to reduce the size of packaging (for example, by downgauging) is almost equally high. Changes in primary packaging materials, changes in

packaging shape and format, and increasing use of sustainable materials are all the focus of spending increases. Change is in the air – only 3% of those surveyed report they expect to make no changes to their packaging in the next two years (see Figure 1).

Figure 1
Changes in brand packaging (2019-2023F)*



*Survey questions: Have you made any of the following changes to your primary brand packaging in the last two years? Do you expect to make any of these changes in the next two years?
Source: L.E.K. 2021 Packaging Survey

What’s driving the spend? It’s a response to four major trends that have impacted the industry over the past two years and continue to do so – increased competition on the shelf that leads to increased emphasis on packaging as a selling tool, continuing SKU proliferation, changes in packaging to meet sustainability goals and accelerating shifts in ecommerce.

Trend 1: Brand owners ‘buy’ the need for packaging

The biggest spending driver is that brand owners continue to overinvest in packaging. This isn’t surprising given intense competition on the retail shelf for consumer mindshare and share of wallet, not to mention the continuing proliferation of SKUs (see below). Brand owners regard packaging as a high ROI tool for awareness, promotion and sales, and look to it to drive differentiation and win over consumers.

A spending rate that steadily doubles relative to the rate of inflation reflects the high demand for promotional packaging and high expectations for performance.

Overall spending levels are a response to competitive demands, but they are also a sign that the industry is healthy and that opportunity abounds for converters and investors — at least for those that can rise to the occasion and meet the challenge.

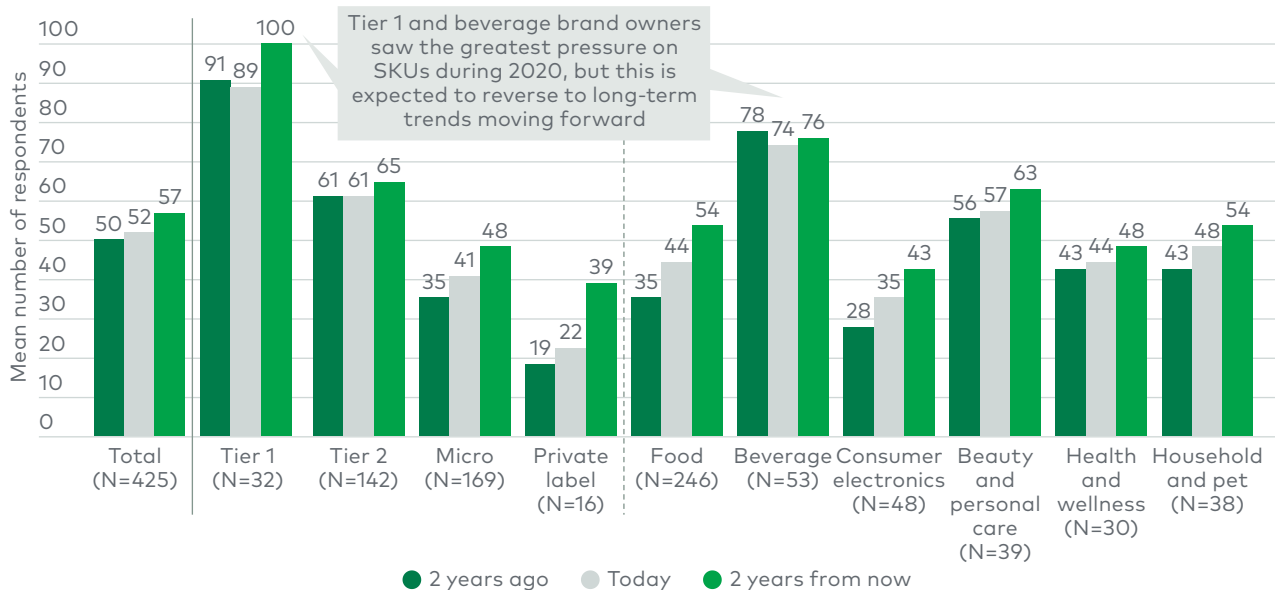
Trend 2: The SKU proliferation ‘wave’ continues

Despite COVID-19-related headwinds — especially among Tier 1 and beverage brands — SKU proliferation is expected to persist across consumer product segments over the next two years. Even factoring in the pandemic, the growth forecast is largely in line with long-term trends.

There was in fact some SKU rationalization at the height of the pandemic as supply chains became constrainers and brand owners responded by returning to their core SKUs. However, brand owners report that the SKU count is likely to increase in the future, rebounding and resuming pre-pandemic growth rates.

There has been SKU volatility, especially in the beverage category and for Tier 1 brands overall. Both saw the sharpest decreases of any category during the pandemic, which was a temporary divergence from the long-term SKU proliferation trend. Both are expected to reverse the trend and grow over the next two years (see Figure 2).

Figure 2
Average number of SKUs available for primary brand (2019, 2021E, 2023F)*



Tier 1 and beverage brand owners saw the greatest pressure on SKUs during 2020, but this is expected to reverse to long-term trends moving forward

*Survey questions: How has the number of different SKUs available from your primary brand evolved over the last two years? How do you expect it to evolve over the next two years?
Source: L.E.K. 2021 Packaging Survey

Proliferation is not the whole story, however. Brand owners also report that they expect sales volume of top SKUs to increase modestly over the next several years. Again, this varies by segment. Micro and private-label brands generate significantly more sales (~45% and ~60%, respectively, in 2021) from their top SKUs, compared to Tier 1 and Tier 2 (~33% and ~35%, respectively, in 2021). But overall, brand owners expect the sales volume for top SKUs as a percentage of overall sales to continue to grow (from 40% in 2021 to 42% in 2023) while other top SKUs and long-tail SKUs decline somewhat as a share of sales.

All of that suggests that run lengths for long-tail SKUs will continue to decrease — and that there will be disproportionate benefit for industry participants that can support brand owners that require shorter run lengths and custom packaging and labeling — including design. And thanks to SKU proliferation, the overall profit pool is expected to expand at rates greater than market growth. But to meet the challenge, converters will require design support and they will need to maintain — or increase — their flexibility. At the same time, the likelihood that Tier 1 brands will continue to rely on long run lengths means that the ability to provide cost-effective production for long run lengths will still be a differentiator for industry participants seeking to win over Tier 1 accounts.

Trend 3: Brand owners deepen their commitment to sustainability — but not yet at the pace required to meet their midterm goals on time; the packaging industry can help

As in multiple industries, sustainability is a significant factor in packaging. In fact, when asked what the greatest change in packaging has been over the past two years, most respondents cited an increase in the share of sustainable packaging.

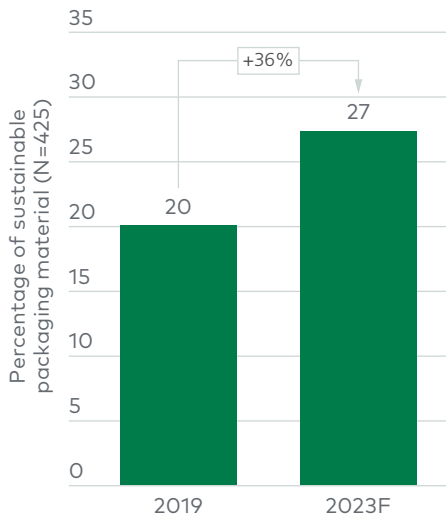
But when it comes to sustainability, brand owners find themselves running behind. Approximately 74% have set a sustainability goal for 2025. But the majority of brand owners report they are behind the pace required to meet their target. They report that to date, they have achieved only 40% of their 2025 goals, and expect to have met only 68% of their targets when 2025 rolls around.

To advance their packaging sustainability goals, most brand owners are focused on materials. Asked for their top three criteria for sustainability, 42% cited recycled content, 30% cited biodegradable materials, 28% cited compostable materials and 28% cited materials manufactured using renewable energy. Ranking at 27% or lower were manufacturing issues (carbon footprint to manufacture, minimal materials) and working with suppliers that support environmental issues.

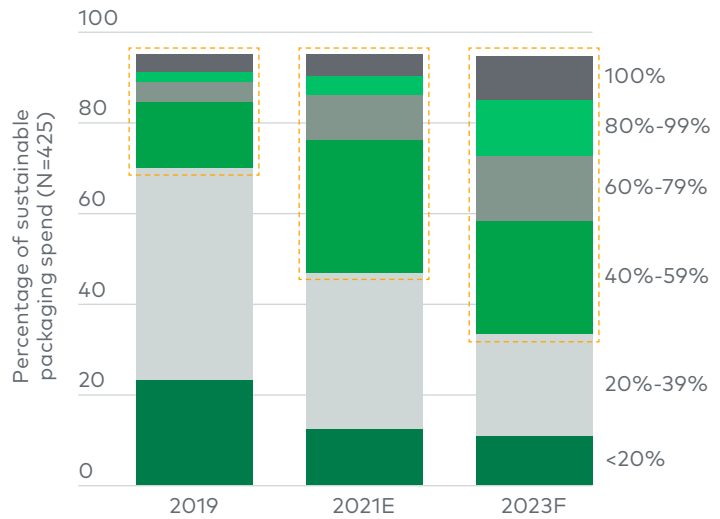
Perhaps under pressure to meet their targets, brand owners appear ready to pick up the pace. They reported they expect to increase the amount of sustainable material in their packaging by 36% from 2019 to 2023, and to spend dramatically more on sustainable packaging by that year (see Figure 3). Their main focus is on decreasing the number of material types used in packaging, designing packaging to be recyclable and switching to lightweight packaging (see Figure 4).

Figure 3
Spend on sustainable packaging

Respondent-reported past and projected share of packaging that is sustainable (2019, 2023F)*



Respondent-reported past, current and expected share of packaging spend on sustainable packaging (2019, 2021E, 2023F)*

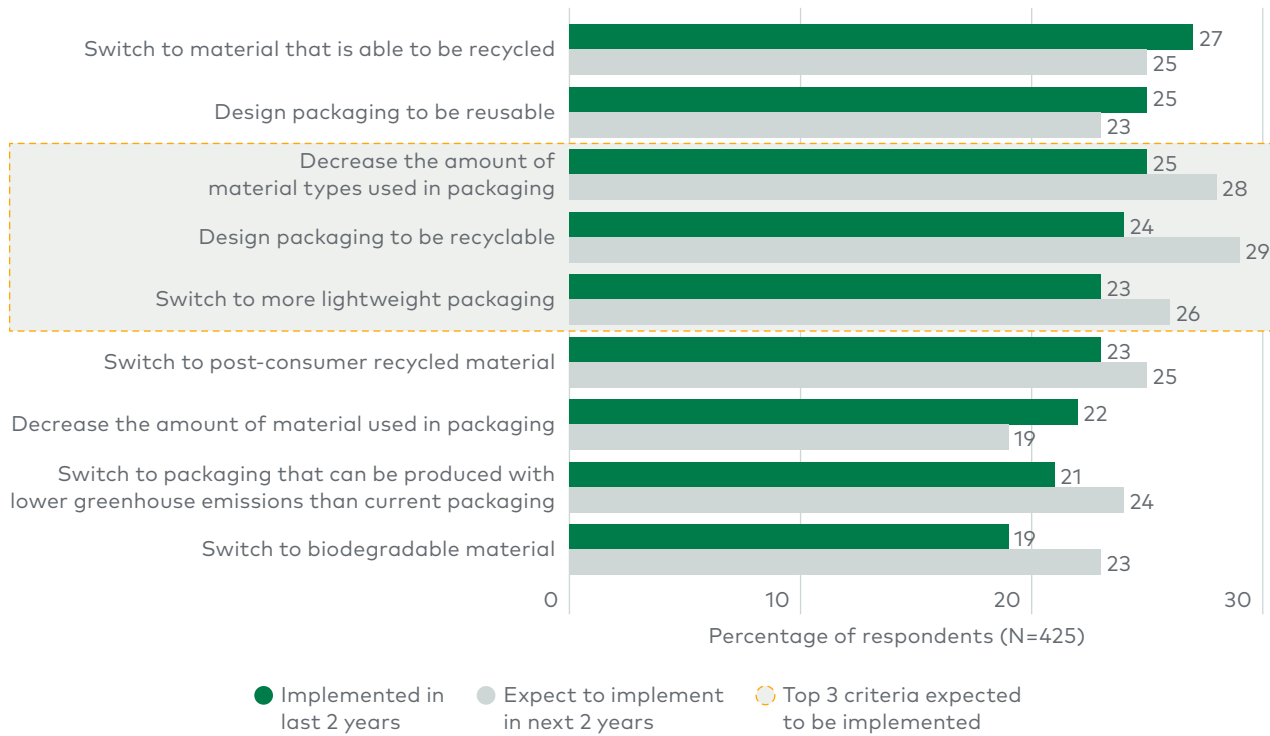


*Survey questions: Has your organization changed or is it planning to change the share of packaging material that is sustainable?
What percentage of total packaging spend is sustainable?
Source: L.E.K. 2021 Packaging Survey; L.E.K. research and analysis

But access to materials is a significant limiting factor. While ~75% of brand owners reported they have some access to sustainable packaging materials today, the capacity of material recycling facilities (MRFs) is insufficient to meet the demand. That suggests there will be future imbalances for supply. And a shortage of recyclable materials adds to supply-side pressures, especially for plastics, where only 9% of the material in use is currently recycled.

The struggle to keep pace on sustainability targets and the materials shortfall represent major opportunities for industry participants and investors. Any converter able to partner with brands to decrease packaging weight and to design recyclable packaging will achieve a critical level of differentiation. Also critical for differentiation is the ability to ensure sufficient supply of sustainable packaging materials. There have been examples of converters purchasing or developing supply relationships with MRFs in order to reduce supply risk.

Figure 4
 Actions taken on primary brand regarding sustainable packaging (2019-2023F)*



*Survey questions: What actions have you taken in the past two years regarding environmentally friendly/sustainable packaging for your primary brand? What actions do you expect to take in the next two years? Is your current packaging supplier for your primary brand able to meet your expected packaging needs in the next two years in regard to sustainable packaging?
 Source: L.E.K. 2021 Packaging Survey

Trend 4: Ecommerce continues to take share – and presents performance challenges for brands and converters

Ecommerce growth continues apace – with the pandemic accelerating well-established trends. Brand owners expect pandemic ecommerce gains to hold and brick-and-mortar share to fall ~10% from an indexed 2019 baseline between 2019 and 2023.

So it’s not surprising that brand owners report making increasing use of ecommerce-specific formats. Approximately 50% of brand owners report using them, and 56% have increased their spend on ecommerce packaging relative to regular formats.

But with increased ecommerce emphasis come concerns – in particular about packaging performance. In fact, brand owners value function (such as lightweighting and performance through the fulfillment process) more than sustainability. They seem to be following the advice of legendary auto racing engineer Colin Chapman: “Simplify, then add lightness.” Thirty-six percent report acting to reduce packaging weight, 32% report introducing new formats, 31%

report reducing packaging size, 29% report they have redesigned their packaging for automated environments and 28% report increasing protective packaging to avoid damage in transit. En route damage is especially concerning for the consumer electronics industry, which needs cost-effective ways to ship fragile products.

Given the enormous and sometimes contradictory-seeming challenges involved in ecommerce packaging — protecting the product, reducing weight, promoting the brand — brand owners are likely to value solutions that the packaging industry can provide. Participants that serve brands that are winning in ecommerce can generate above-market growth. But to gain traction, it will be necessary to take a consultative approach, add value by helping brand owners overcome challenges and create shipping-friendly — as opposed to generic — packaging formats.

Interestingly, some of the value-add capabilities required for ecommerce performance — such as reducing packaging weight — are also central to creating sustainable packaging. There's a strong business case for adding capabilities that allow converters to produce lightweight packaging that targets both sustainability and ecommerce needs.

Opportunities abound — for those that can solve problems and add value

Given the complex and sometimes contradictory dynamics of the CPG industry — marked by external challenges, increasing overall spend and shifting priorities — where do the opportunities lie?

The major opportunity for converters and investors alike is to partner with brand decision-makers, understand what they are up against and deliver value-added solutions.

In practical terms, delivering those solutions can take many forms. Some providers will be able to draw on existing capabilities. Others will need to build or acquire them.

One of the most significant sets of challenges — cutting across both sustainability and ecommerce — concerns materials. The ability to, for example, work with sustainable materials without sacrificing performance, or to design packages that reduce weight while providing robust product protection for ecommerce, will be a main source of competitive advantage.

For industry participants, enhancing or adding such capabilities should be a strategic priority. For investors, identifying companies that offer these capabilities, or facilitating strategic acquisitions that add such capabilities to the offering, has the potential to be a pathway to competitive returns.

The good news is that while the industry is changing, its trajectory seems clear. Act now to be ready for a world of continued SKU proliferation, intensifying sustainability demands and a continued shift to ecommerce — and to help brand owners rise to the challenge.

If you would like to learn more or request access to the full **2021 Brand Owner Packaging Study**, please contact us at industrials@lek.com.

About the Authors



Thilo Henkes

Thilo Henkes is a Managing Director in L.E.K. Consulting's Boston office and leads the firm's global Paper & Packaging practice. Thilo is also active in the firm's Building & Construction, Industrial Equipment and Private Equity practices. He joined L.E.K. in 2000 and has more than 20 years of consulting experience specializing in transaction support and developing post-acquisition, value-enhancing strategies for portfolio companies. Consulting magazine named Thilo as a 2021 Global Leader in Consulting.



Jeff Cloetingh

Jeff Cloetingh is a Managing Director and Partner in L.E.K. Consulting's Boston office. As a leader in the firm's Paper & Packaging practice and broader Industrials team, Jeff has worked with corporate and financial sponsor clients globally on the development of growth strategy, go-to-market commercial strategy, investment thesis development, value creation plans and M&A transaction support. He has worked in consulting since 2006 and with L.E.K. for the past decade.



Amanda Davis Winters

Amanda Davis Winters is a Managing Director in L.E.K. Consulting's New York office. A member of the Industrials sector, Amanda has a particular focus on packaging, chemicals and environmental services. She has deep expertise in market entry strategy, market segment prioritization, go-to-market and commercial planning, inorganic growth strategy, and both buy- and sell-side diligence.



Jon Moss

Jon Moss is a Principal in L.E.K. Consulting's Chicago office. Jon is a member of the firm's Industrials sector, with a focus on the Paper & Packaging and Building & Construction practices. He has worked on growth strategy engagements focused on both U.S. and international opportunities and has supported corporate and private equity clients on buy- and sell-side transactions.

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