



EXECUTIVE INSIGHTS

For Packaging Industry, a Post-Pandemic Picture Begins To Emerge

A clearer picture is developing as the world and the packaging industry begin to emerge from the shadow of the COVID-19 pandemic.

After a sharp reduction in the number of new stock-keeping unit (SKU) introductions during the depths of the pandemic, a reversal of the trend seems to be in the offing as brand owners experiment with SKU expansion. But it is important not to misread or overinterpret this development — it does not necessarily indicate a full-scale return to pre-pandemic SKU proliferation. Instead, it reflects a willingness on the part of brand owners to experiment with an expansion trajectory as the economy rights itself, tempered by concerns about near-term macroeconomic trends.

On the other hand, the pandemic-era focus on private label shows signs of continuing — spelling opportunity for converters able to take advantage.

The state of supplier relationships is in flux, with some brand owners expanding their ranks of converters while others consolidate. Overall, there has been a modest net expansion of supplier relationships — a positive development.

In all, while signs are encouraging, the packaging industry finds itself in complex circumstances that do not easily translate into a simplistic “new normal.” What we can say with confidence is that brand owners are beginning to invest consistent with prior trends and that new pockets of opportunity are emerging. With longer-term trends not yet clear, and with a stressful, volatile macroeconomic environment continuing to impact sourcing strategies and production costs, brand owners and converters alike will have to keep close

watch on developments within their own business ecosystems and tailor their strategies to their specific circumstances and capabilities.

The state of the industry — and how best to shape near-term strategies — is the focus of L.E.K. Consulting's fifth annual brand owner packaging study. As in past years, the study reflects the responses of leaders in the brand owner community — including those engaged in marketing, brand management, procurement and package engineering. Its goal is to shed light on their packaging needs and capture their views on the most important trends that are driving demand.

This year's study provides insight into the ways in which brand owners are trying to solve for supply chain disruptions that have been omnipresent since the pandemic began — in contrast to last year's study, which examined how they were managing through the chaos. A year later, brand owners and converters alike have more ability to look back at what worked and what did not — a perspective reflected in the results — and to anticipate the industry's near-term direction.

About the study

The 2022 L.E.K. Consulting Brand Owner Packaging Study — our fifth annual proprietary exploration of packaging industry trends — is based on a survey of 421 brand managers and packaging stakeholders at brand owners.

As in past years, we looked specifically at brand trends and their impact on packaging demand, SKU trends, changes to packaging materials, implementation of sustainable packaging initiatives, and the implications of ecommerce on packaging.

But with an eye toward the extraordinary stresses of the past three years and the current challenging macroeconomic environment, we also looked at how perspectives may have shifted and how the macroeconomic environment has impacted companies' packaging sourcing strategies and costs.

The leaders we surveyed are:

- Responsible for or directly involved in making packaging decisions for consumer brands
- Responsible for a consumer brand that is sold in the U.S. but that may also be sold in international markets
- Responsible for a brand within the following end-market categories:
 - Food and beverage
 - Beauty and personal care
 - Healthcare

- Pet food
- Consumer electronics
- Cannabis

The survey was conducted during September and October 2022.

The big questions for 2022

As in past years, we set out to explore industry trends in five main dimensions:

- **The impact of brand performance and SKU dynamics on packaging.** How has the total number of sub-brands and SKUs evolved for brand owners, and how do they expect it to change over the next year? How many new SKUs have they introduced each year, and how many do they expect to introduce next year? What number of SKUs are brand owners refreshing or retiring? What percentage of a brand's primary volume sales is attributed to the top SKU?
- **Packaging trends and associated spend.** How important do brand owners think packaging is to the success of the primary brand? How has the spend on packaging changed over time? What materials are they using in their primary packaging, and how is that changing?
- **Megatrends' impact on packaging – in particular, sustainability and ecommerce.** How do brand owners define sustainable packaging? What percentage have a 2025 sustainability goal, and what progress have they made? How do they expect their usage of sustainable materials to trend over the next few years? How is their use of ecommerce trending? To what extent are they developing packaging formats and features specific to ecommerce?
- **Brand owner packaging sourcing strategies.** In the aftermath of the pandemic, have supply chain challenges persisted? Where are brands sourcing their packaging materials, and have sourcing strategies changed?
- **The impact of inflation.** How are inflationary pressures influencing spending? To what extent are decisions to increase the packaging spend a response to inflation rather than a sign of increased investment?

These questions point to our overarching considerations. Here is what we learned.

2022 in overview

2022 was clearly a post-pandemic year for the packaging industry.

That is not to suggest that the year produced dramatic changes or that there has been a return to a pre-pandemic normal. Rather, the gradual reappearance of certain pre-pandemic tendencies – most notably a willingness on the part of brand owners to begin expanding the

number of SKUs — suggests that brand owners believe they are operating in a more stable and predictable environment.

A return to stability and predictability, if it continues, does not necessarily imply that the industry will ever revert to its pre-pandemic state. Indeed, certain pandemic-era trends show signs of carrying over, for example, the increased market power of private label, which emerged during the pandemic and continued to exert influence this year.

Pandemic-era sourcing strategies also demonstrate staying power. The supply chain disruptions of 2020-2021 seem to have left a lasting impression. But brand owners are not aligned on how best to respond. While there is an overall shift to U.S.-sourced packaging, some brand owners are acting to diversify their suppliers while others are consolidating. Both approaches can translate into opportunity for converters, depending on their capabilities and their approach. The net trend is toward expansion and an increase in the number of supplier relationships.

Major trends and findings

SKU proliferation makes a comeback — or does it?

During the several years before the pandemic, SKU proliferation was a major focus for the industry as brand owners sought more shelf space and market share by expanding and extending product lines.

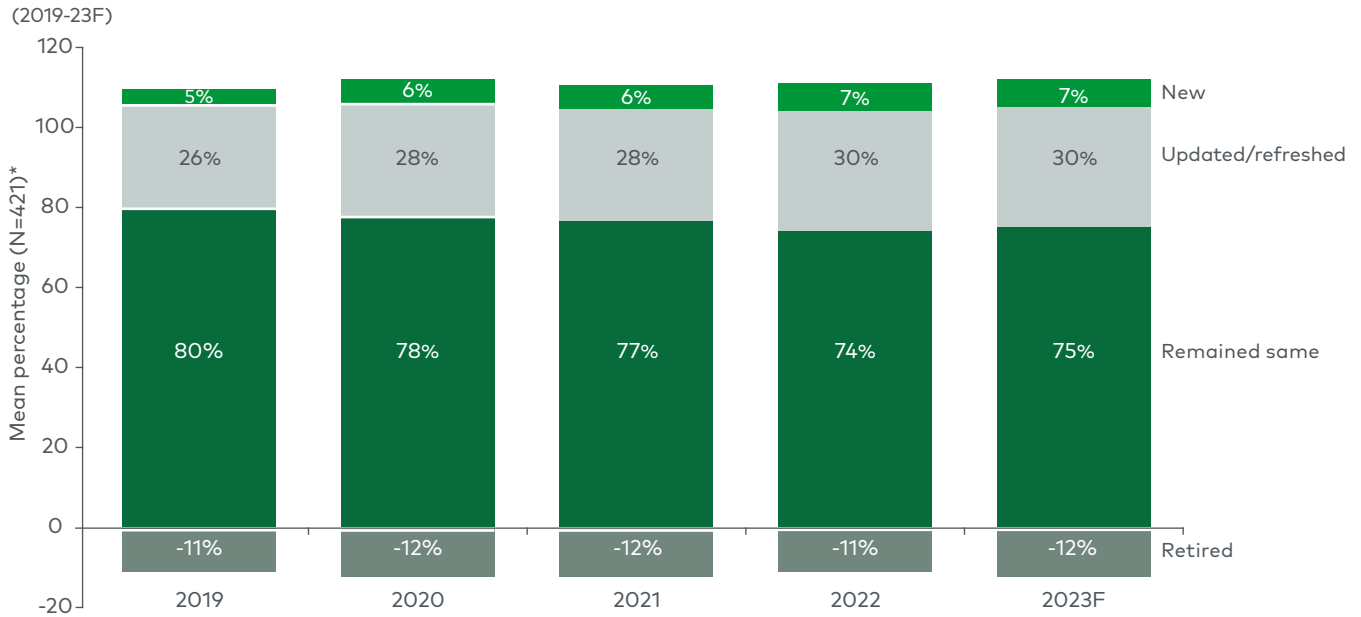
The pandemic, by effectively shutting down retail for an extended period and simultaneously disrupting grocery supply chains and consumer buying patterns, brought the SKU proliferation dynamic to a halt. Brand owners shifted focus to their highest-performing and most-profitable product lines. Facing the difficulty of getting product onto the shelves at all, brand owners prioritized the highest-volume and highest-margin SKUs while simultaneously investing less in new product introductions.

In 2022, SKU expansion got underway again, but not in the same way or at the same pace as before.

According to the study, brand owner sentiment implies an increase in the number of SKUs. The proportion of SKUs that brand owners intend to introduce, update and refresh is expected to gradually rise through 2023 (see Figure 1).

The average total SKU count will rise as well, continuing a trend (see Figure 2).

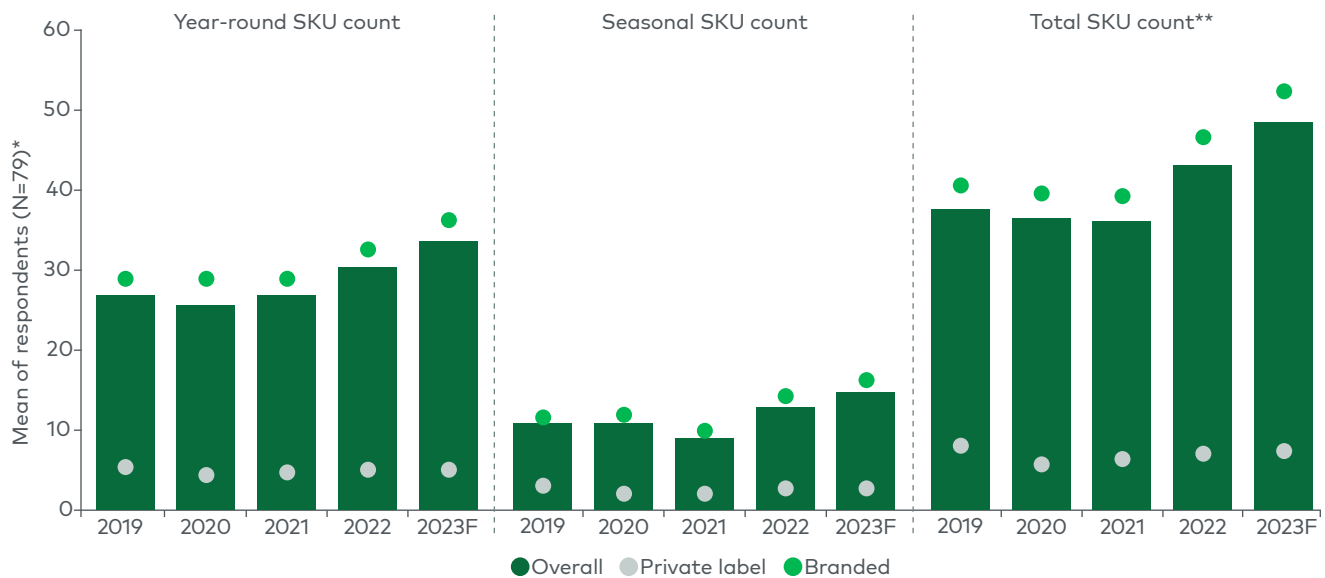
Figure 1
Average split of brand SKUs by new, updated/refreshed and retired



*Survey questions: The number of SKUs available for your primary brand you provided are listed below. In each prior year, please enter the number (#) of SKUs that you refreshed and retired. What are the SKUs being refreshed or retired this year (2022)? What do you expect this number to be next year (2023)? How many SKUs will your primary brand introduce by the end of this year (2022)? In prior years (2019-21)? How many new SKUs do you expect to introduce during 2023?

Note: Median used for new SKUs
Source: L.E.K. 2022 Packaging Survey

Figure 2
Average number of year-round SKUs, seasonal SKUs and total SKUs



*Survey questions: Please enter the number (#) of different SKUs available from your primary brand by the end of this year (2022). What was this number at the end of prior years (2019-21)? What do you expect this number to be by the end of next year (2023)?

**Includes year-round and seasonal/promotional SKUs
Source: L.E.K. 2022 Packaging Survey

But the study indicates that brand owners' focus will be on premium brands and short runs. In other words, this is not a full-scale return to SKU proliferation but rather a return to the marketplace with seasonal and special products, likely backed by a concentrated marketing spend.

For converters, this may be good news, since lower-volume runs tend to be higher-margin opportunities. But converters geared toward the longer-run segment of the market may find it challenging to win this type of business. Building or augmenting short-run production capabilities should be a priority.

Packaging continues to be a brand owner focus

The further good news for converters is that brand owners remain strongly committed to packaging and see it as critical to brand success.

Eighty-four percent of brand owners report that they consider packaging to be "highly important" to the success of the brand. They continue to view packaging as a high-ROI expenditure that drives competitive differentiation.

Spending on packaging is up. Brand owners increased their packaging spend by 3% from 2020 to 2022, but they expect to spend still more — they forecast a spending increase of 5.4% from 2022 through 2024.

Private label leads the way on spending

The biggest spending increase by far is in private label. The study indicates that private-label packaging spending is likely to see the largest increase of any brand owner category — a 7.1% rise by 2024 is expected.

The strength of private label is a pandemic-era dynamic that shows every sign of continuing. Private label rose to prominence in 2020-2021 as pandemic-challenged consumers sought value. But in the current macroeconomic environment — marked as it is by inflation, and by food inflation in particular — the private-label category is likely to continue near-term growth ahead of the industry's overall growth rate.

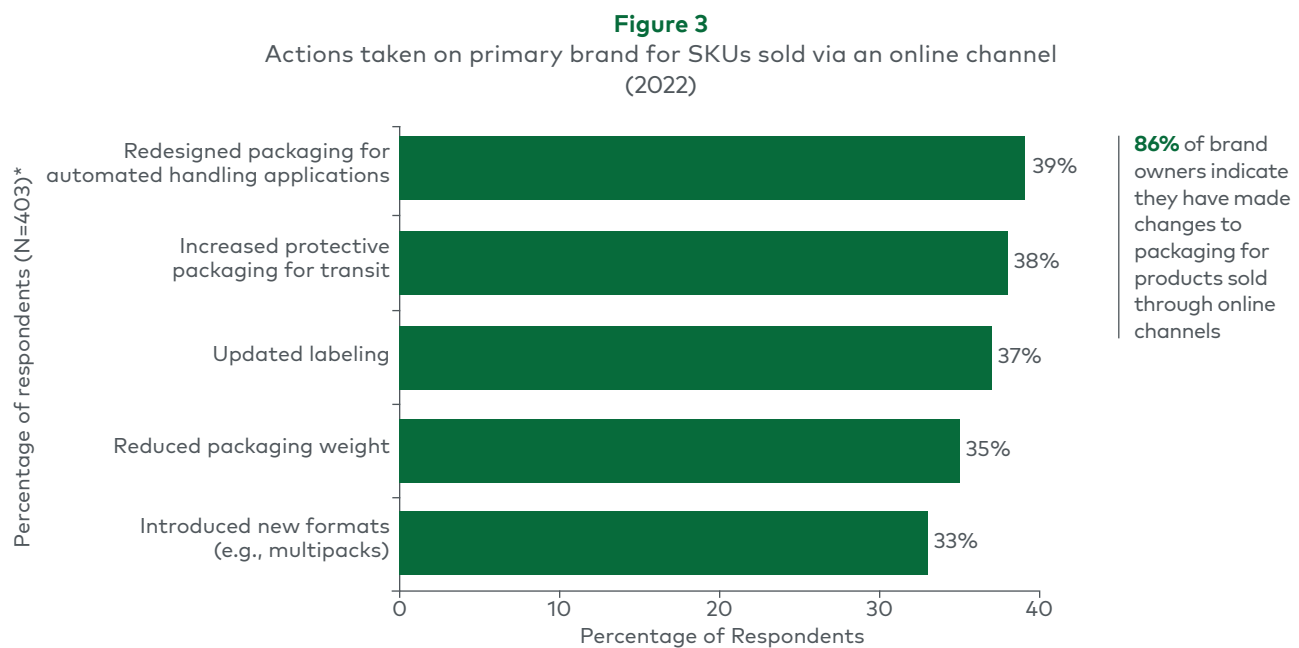
On the face of it, private label would seem to be an area of opportunity for converters, but there are challenges. Private-label customers invest more to compete with branded products, but they are nevertheless typically more price conscious than major brands and thus can be more difficult to serve. These engagements are not margin neutral. And capabilities that support engagements with brand owners — high-value, complex graphic design, for example — may not be meaningful to private-label clients. In other words, opportunities exist but they

impose a different set of criteria. Before targeting the private-label segment, converters should take a thoughtful look at the conditions of engagement and the strategy needed to engage. Strategies should focus on protecting profitability.

Ecommerce continues to dominate

The continued growth of ecommerce supports the argument that the pandemic did not introduce new trends — instead it accelerated trends already in place. Ecommerce was a major factor pre-pandemic, but the massive shift to online buying in 2020-2021 cemented consumer buying habits and catapulted the category into the future. Online sales materially increased during the pandemic, and the online channel is expected to continue to take share over the long term.

As a result, we expect to see continued high demand for ecommerce-specific packaging (see Figure 3).



*Survey question: For SKUs sold via ecommerce, what, if any, changes did you make to the packaging of your primary brand for products sold through this channel only?

Note: Excludes respondents who do not sell via ecommerce

Source: L.E.K. 2022 Packaging Survey

That added protection comes at a premium — one that brand owners are willing to invest in (see Figure 4).

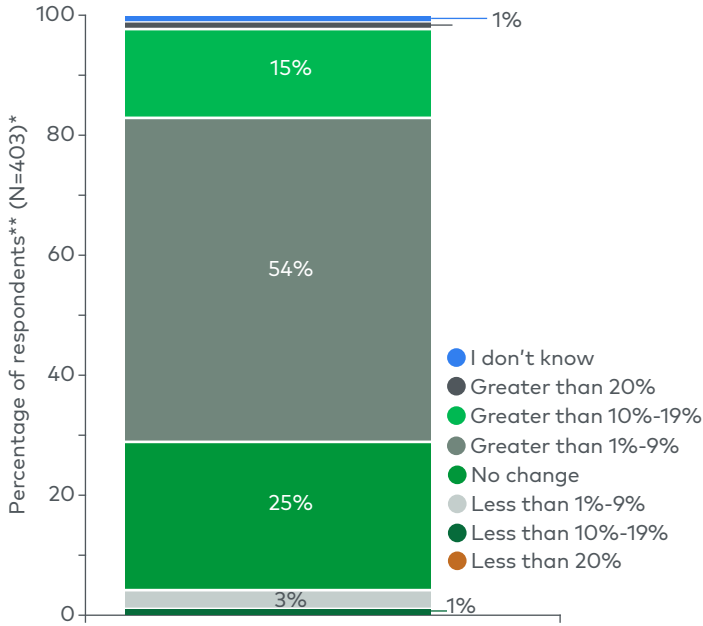
Sustainability continues to drive change

Completely apart from post-pandemic dynamics, the drive toward sustainability and carbon neutrality continues to gather major momentum in the business world in general. Packaging —

Figure 4

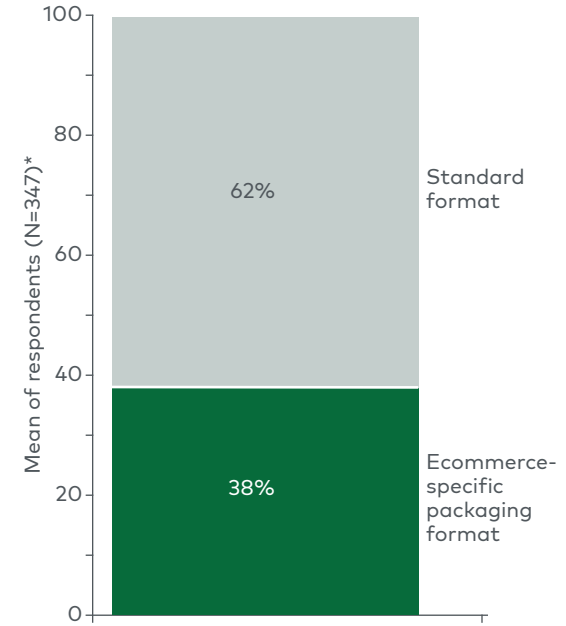
Brand owner spending on ecommerce-specific packaging

Relative spend (as a percentage of unit cost) for ecommerce[^] packaging vs. standard packaging (2022)



On average, brand owners indicate they spend ~4.7% more on packaging for online sales relative to other channels

Online sales fulfilled by ecommerce-specific[^] packaging formats (2022)



Nearly half of brand owner's online sales utilize packaging specifically made for online channels

*Survey questions: For SKUs sold via ecommerce, how, if at all, does your spending on packaging as a percentage of total unit price vary relative to all other channels? Over the past 12 months, what percentage of your ecommerce sales were fulfilled by ecommerce-specific formats?

**Relative spend excludes respondents that do not sell via online channels

[^]Includes sales through ecommerce marketplaces, online retailers and direct-to-consumer online channels stores

Source: L.E.K. 2022 Packaging Survey

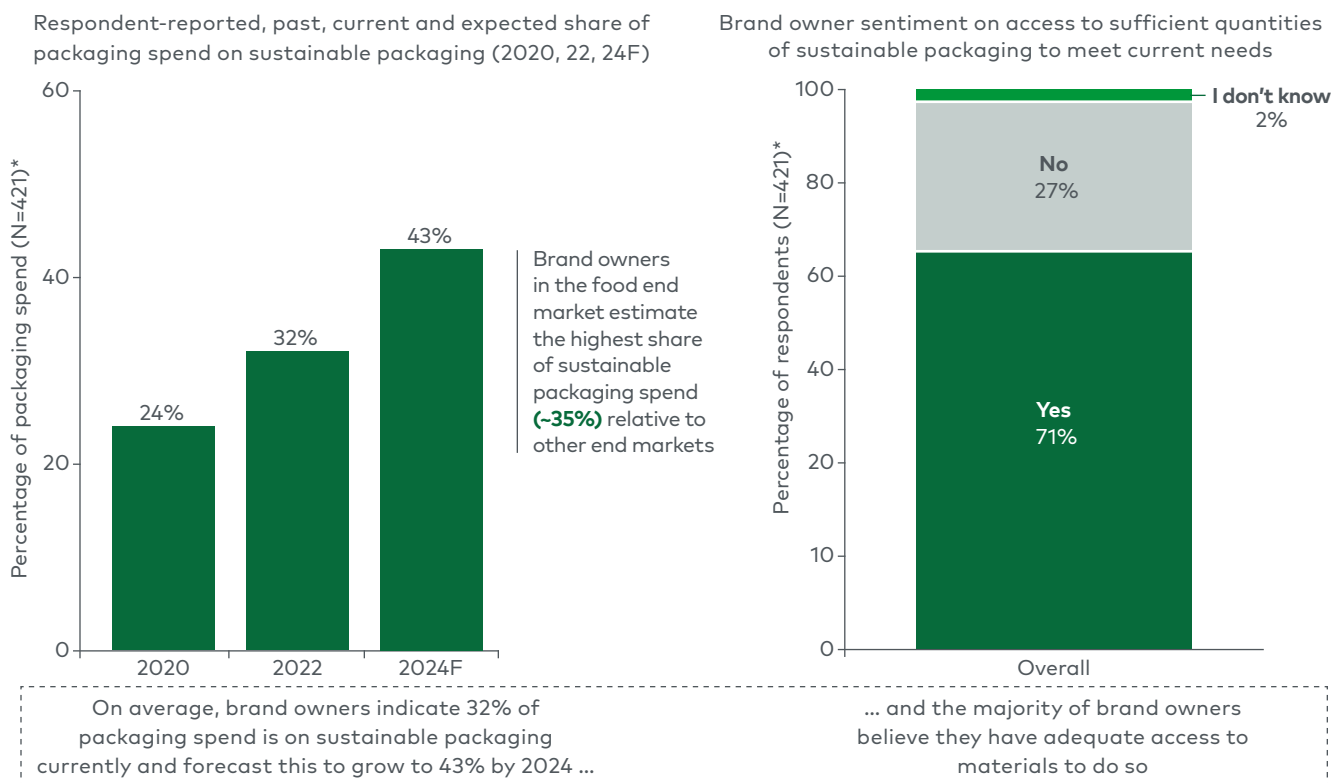
a carbon-intensive activity given materials consumption and the impact of transportation — is unsurprisingly at the forefront of sustainability initiatives. In 2022 as in past years, sustainability drove major changes in packaging.

Thirty-six percent of brand owners said that a move to sustainable packaging is a top driver for changing packaging materials. Thirty-five percent plan to increase their share of sustainable packaging over the next two years. Nearly half (47%) have changed packaging materials over the past two years in order to use more sustainable materials.

But brand owners — like senior leaders in many corporate roles — are finding that it is not easy to deliver on sustainability commitments. Seventy percent of brand owners report they have a 2025 packaging sustainability goal. But they report having achieved only approximately 30% of their goals to date, and the majority indicate there are significant gaps in their ability to achieve sustainability goals beyond 2025.

Other studies and surveys shed light on the many barriers that stand between organizations and their sustainability targets — barriers that include a lack of internal alignment on goals and how to achieve them, and compensation systems that do not incentivize sustainability improvements. For the packaging industry, an emerging barrier is a limited supply of sustainable materials. This is not currently a major limiting factor but may become one. Today, 71% of brand owners report that they have access to sustainable materials. But given the current capacity of recycling facilities, access to sustainable materials may be constrained going forward, particularly given large forecast increases in future spend on sustainable packaging (see Figure 5).

Figure 5
Brand owner spending expectations on sustainable packaging to 2024



*Survey questions: What percentage of your total packaging spend in dollars for your primary brand is composed of sustainable (i.e., biodegradable, recyclable, recycled content or compostable) materials today (2022)? What was this percentage 2 years ago (2020)? What do you expect this percentage to be in 2 years (2024)? Do you have access to sufficient quantities of sustainable packaging to meet your current needs for environmentally friendly/sustainable packaging?
Source: L.E.K. 2022 Packaging Survey

Converters face their own challenges while working to ensure a sufficient supply of sustainable materials; however, sustainability presents converters with a significant opportunity to differentiate by offering products that help brands reach their goals. To this end, partnership is key. Converters able to take a consultative approach and to overcome sustainability-related packaging hurdles — protecting product while reducing package weight or providing for food preservation with sustainable material — will enjoy a significant competitive advantage.

Brand owners turn to U.S. suppliers for sourcing; they split on whether to consolidate or expand their supplier rosters

Supply chain disruptions hit the packaging industry just as they hit businesses in all sectors. And the disruptions have continued to cycle through.

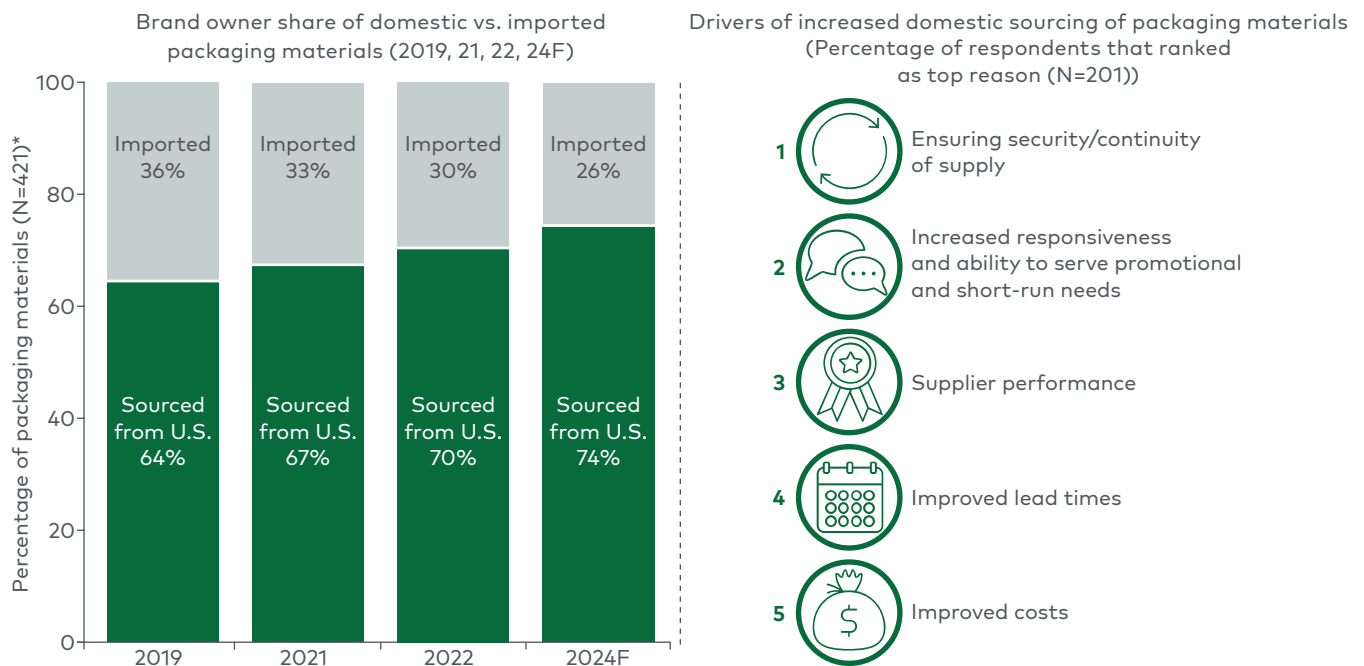
In response, brand owners have adjusted their sourcing strategies — but in different ways.

Some broadened their base of suppliers in order to add redundancy. Others did the opposite — they consolidated, seeking to fulfill unmet demand from their current supplier base or to achieve the security of a smaller supplier base that they consider more reliable. According to the study, 28% of brand owners increased the number of packaging materials suppliers, 32% decreased it and 38% made no change — an almost even split.

In another shift — also aimed at ensuring the security and continuity of their supply — brand owners have steadily increased the share of packaging sourced from the U.S. (see Figure 6).

Figure 6

Brand owner expectations on packaging sourcing to 2024



*Survey questions: What percentage of your primary brand's packaging materials were sourced from the U.S. vs. imported 3 years ago prior to COVID-19, in 2021 and this year (2022)? What share of your primary brand's packaging materials do you expect to source from the U.S. vs. import 2 years from now? You indicated you expect to increase/decrease the proportion of packaging materials you import from overseas in the next 2 years. Which of the following contributes to your decision to increase overseas sourcing?
 Source: L.E.K. 2022 Packaging Survey

The shift to U.S.-sourced packaging and moves by some brand owners to broaden supply represent upside opportunities for converters with U.S. production bases — they can look to capture more business from existing customers and sell to new ones.

Implications and recommendations

What do the study findings mean for the packaging industry?

With the future shape of the industry still unclear, the most critical consideration for brand owners and converters alike is to identify and capitalize on areas of opportunity — those most likely to outperform.

In the case of SKU proliferation — or more accurately, a careful, selective expansion of SKUs — the greatest benefits will be realized by brand owners that carefully manage their portfolios and stay focused on select SKUs and short runs rather than committing to the full range and duration of SKUs that were in evidence before 2020. Similarly, the most successful converters will be those best able to focus on short-run opportunities and to produce short runs profitably.

Pricing is another critical consideration for brand owners and converters alike. In an inflationary environment, tight management of prices will be a priority, especially when raw materials represent a large proportion of the total cost of the good. This dynamic is the driver behind the strength of private label — which seeks to meet consumer demand for an optimal price-value mix. Converters will need to approach pricing and profitability in a relatively narrow band — and to carefully manage the price/value equation for private-label customers.

Mention of private label underscores another price/value challenge — that of relative price positioning in a cycle. In certain segments, premium pricing is viable. But this is not universal, and, in many cases, a cautious approach to pricing — for both brand owners and converters — is advisable. Brand owners may consider it more effective to focus on value brands or sub-brands. Converters will need to consider the limits of the prices they can command and consider whether there are limits on their ability to pass along raw materials price fluctuations. They may want to think carefully about adding more private-label customers to the mix, with attention to the challenge of working with price-conscious private-label customers, and to shifting resources in order to make it possible to meet private-label demand.

In past studies, we have discussed the importance of strategic partnership, and this year is no exception. The most successful converters will be those best able to meet brand owners' strategic challenges, in particular for sustainable packaging (where converters can work to source hard-to-find materials) and ecommerce (where they can focus on the most effective approaches to product protection and package design). The packaging industry has the opportunity to help brand owners meet their ambitious (and severely challenging) sustainability goals and to support continued growth in the ecommerce channel.

As always, we are glad to share these insights with you and hope you find them helpful and actionable.

For more information or access to the full 2022 Brand Owner Packaging Study, please contact industrials@lek.com.

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