L.E.K.

EXECUTIVE INSIGHTS

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Hunger Games: Battling for Food Industry Supremacy in the Hourglass Economy

In Suzanne Collin's novel "The Hunger Games," representatives from districts are pitted against each other in a fight for survival in a fictional arena with an ever-changing landscape. In real life, food and beverage industry executives are battling to win share during a time when many companies are struggling to grow because they don't recognize that the economic playing field has changed dramatically.

L.E.K. Consulting maps the new set of rules for the food industry and spotlights new models for success in this terrain. Importantly, we also outline strategies for food & beverage manufacturers, grocers/retailers and foodservice companies to better position themselves for victory in this changing market.

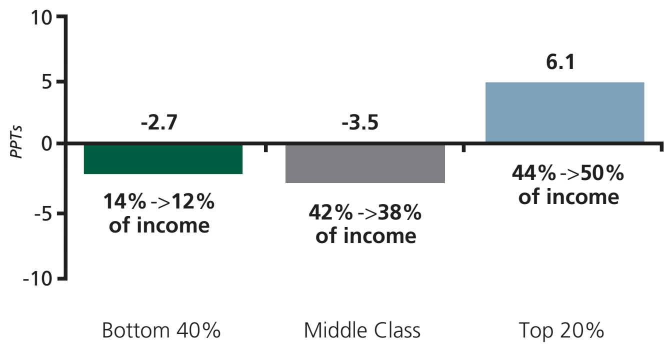
The Hourglass Economy: Squeezed in the Middle

The American middle class traditionally powered consumer spending. But unyielding economic pressures have continued to shift purchasing power away from the middle, creating an hourglass economy that features growing markets for affluent consumers at the top and lower-income consumers at the bottom of this model. And the once strong middle class now represents the shrinking middle in the hourglass analogy.

Since 1980, the share of U.S. income from the top 5% of households has increased by 10 percentage points (see Figure 1).

Figure 1

Percentage Change of U.S. Household Income Share (1980-10)



Source: U.S. Bureau of Labor Statistics, USDA Economic Research Service, U.S. Census, IRS, Berkeley Center for Equitable Growth, Food Research Action Center, Interbrand, Population Health Management, MSNBC, *Washington Post*, Capital IQ, L.E.K. research and analysis

And today, more than 34% of the nation's income is derived from households that earn more than $150,000 per year.

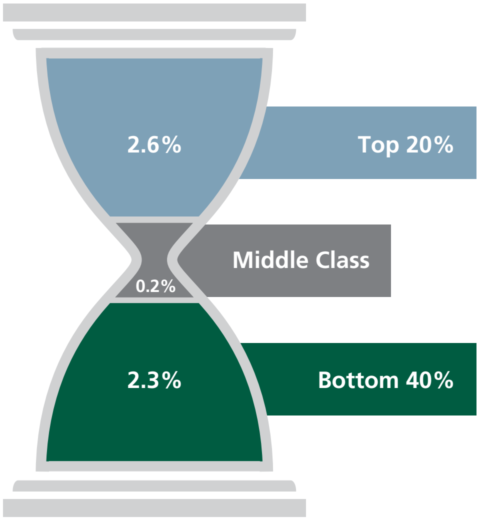
There is very good reason to believe that this trend isn't likely to reverse itself anytime soon. Globalization and fewer middle-class job opportunities, to name a few, should continue to place pressure on the middle class.

The middle class is being squeezed, and as a result, is not growing their spend on food (see Figure 2). If you want to succeed in the hourglass economy, companies need to tailor their product offerings and value proposition to the top and bottom of the hourglass.

Hunger Games: Battling for Food Industry Supremacy in the Hourglass Economy was written by **Manny Picciola** and **Jon Weber**, Vice Presidents of L.E.K. Consulting. Please contact us at consumerproducts@lek.com for additional information.

Figure 2

Growth in U.S. Food at Home Spend by Household Income (2007-10) CAGR



Source: U.S. Bureau of Labor Statistics, USDA Economic Research Service, U.S. Census, IRS, Berkeley Center for Equitable Growth, Food Research Action Center, Interbrand, Population Health Management, MSNBC, *Washington Post*, Capital IQ, L.E.K. research and analysis

Winners and Losers: Expand your Footing and Hedge your Bets

Food & Beverage Brands

A number of food & beverage manufacturers have created new brands, extended brands or developed premium and value-based offerings for buyers at both ends of the hourglass economy. For example, Frito-Lay makes some of the most well-known snack foods on store shelves, including Doritos, Cheetos and Lay's. The company is extending its portfolio of mid-priced products by also feeding the high and lower ends of the market. To gain share with value shoppers, the company is introducing products such as Taqueros, a low-priced tortilla chip that will be sold in discount stores, and repositioning established products like Cracker Jack to reach this demographic.

Anheuser-Busch InBev is also finding success using this model. Although sales of its flagship Budweiser and Bud Light brands slipped last year, consumer thirst for less expensive options boosted sales for its value-priced Natural Light beer by more than 9% last year. At the high end of its product portfolio, Shock Top beer sales grew 142%.

ConAgra Foods is similarly feeding the high and lower ends of the market. At the higher end, the company offers premium-priced products Hebrew National hot dogs and Healthy Choice meals. And its brands such as Slim Jim, Hunt's and Wesson cater to value-conscious consumers.

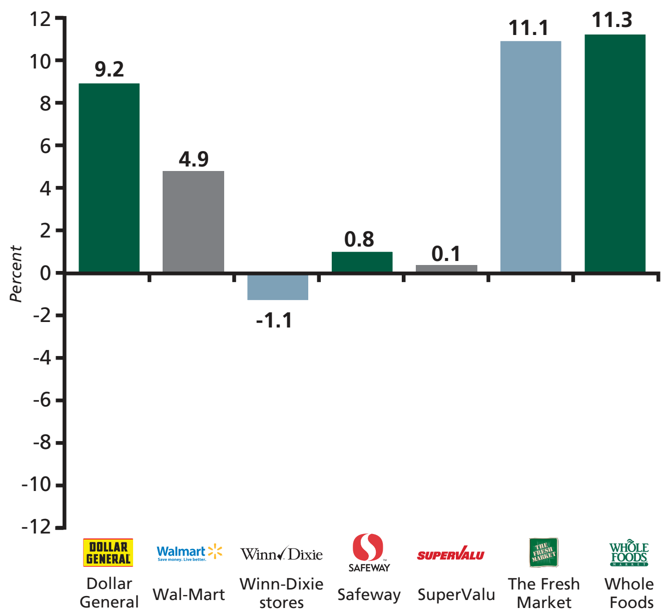
Grocers and Retailers

Several retailers and foodservice operators have positioned themselves to capitalize on this dynamic while others are feeling the squeeze. The checkout lines at many traditional supermarkets are getting shorter because many consumers are shopping elsewhere for their groceries. Many upper-middle-class and wealthy consumers readily pay a premium for food. In fact, households earning more than $150,000 annually have increased their spending for food consumed at home nearly 20% between 2005-2010, which is nearly two times higher than the nominal spending increases seen in lower-income households.

To find these higher-end items, affluent consumers have been crowding the aisles of specialty and premium grocers such as Whole Foods Market, which has established a dominant market

Figure 3

Select Retailer Annual Sales Growth (2007-11)

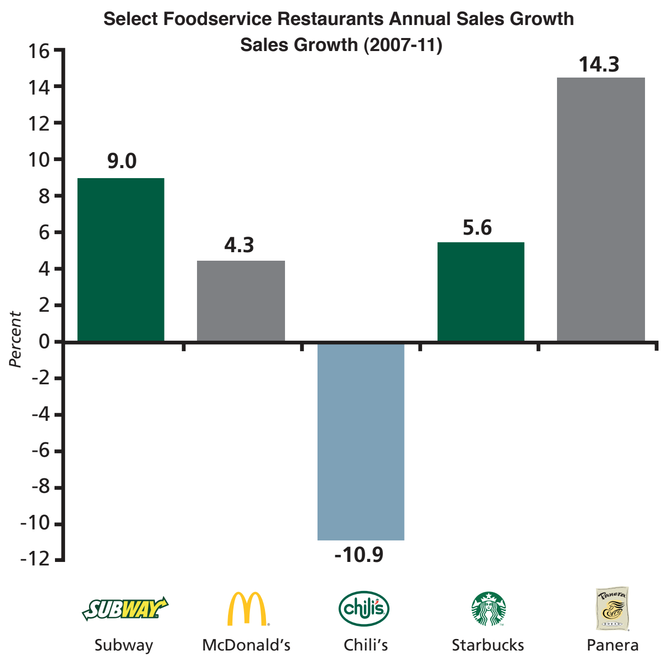


Source: Capital IQ, L.E.K. research and analysis position for premium natural and organic foods. And value-conscious food shoppers are filling up their carts at Wal-Mart and Dollar General (see Figure 3).

Restaurants

The allure of value pricing is also drawing consumers to lower-ticket restaurant chains. QSRs such as McDonald's and fast casual chains like Panera and Chipotle have enjoyed strong growth, while casual dining chains like Chili's have been fighting to find their footing in this environment (see Figure 4).

Figure 4



Source: Capital IQ, L.E.K. research and analysis

Strategies for the Hourglass Economy Hunger Games

Senior executives need to reevaluate their market position in light of the hourglass realities and identify how they can take advantage of market pockets that can deliver growth. For some companies, this may mean challenging decades-old edicts about the true power of their brands. For others, it may mean the need to bolster exposure to faster growing segments through new product introductions or acquisitions.

In trying to capture growth at the lower end, discounting existing brands and products alone will pressure margins and can put products in square competition with a new tier of brands or private labels that already own the segment, not to mention the risk of eroding the company's brand proposition. At the other end of the scale, it's harder for a brand to extend itself up the price spectrum, so it is important to first understand whether the brand(s) have the right attributes to play at higher tiers.

Successful execution may require subtle tweaks to your existing product portfolio and go-to-market strategy. Knowing the limits of your current capabilities is at the heart of your ability to execute. And this requires an unvarnished analysis of fundamental questions such as: How far can your brands' credibly extend? Do you have the right products that will garner consumer appeal? Can you hit price points and still make suitable margins? Will your retail partners play ball? Companies that can answer these questions have the ingredients to succeed and grow share in the future.

Game Planning for the Hourglass Economy

Changing spending priorities among significantly different consumer segments is something that food industry executives will need to continue to monitor closely in order to adapt to the ever-evolving hourglass model. Key issues to evaluate include:

- Understand the consumer segments that are driving your brand sales and how your brands are positioned to benefit or suffer from the forces of the hourglass economy
- Calibrate your brand portfolio to take advantage of growth at the top and bottom, and avoid getting squeezed in the middle by augmenting existing brands and knowing when new ones are required
- Realign your marketing strategy to target emerging and established opportunities in the hourglass economy
- At the upper end, ensure you have value-added products that are truly differentiated in premium markets
- At the bottom, find ways to convey value (e.g., package size, ingredients) – it doesn't always have to be just about price

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded nearly 30 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

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