McKinsey & Company

Consumer Packaged Goods Practice

'Power partnerships': Manufacturer–retailer collaborations that work

Our research shows that when consumer-goods manufacturers collaborate more closely with retailers, they outperform their competitors. We identified four principles for fruitful partnerships.

by Kari Alldredge, Brandon Brown, Lindsay Hirsch, and Travis Reaves

May 2019

Consumer-packaged-goods (CPG) manufacturers are feeling pressure from all sides. For one, consumers are becoming more value conscious and less brand loyal. They're also steadily shifting spending away from traditional brick-and-mortar stores toward channels with higher costs to serve, such as e-commerce. And, in part enabled by these new consumer preferences and channel trends, small brands are elbowing out bigger, established brands on retailers' physical and virtual shelves.[1]

It's perhaps to be expected that in this challenging environment, large CPG players have fought to protect their market share and margins—in part by taking a harder stance in negotiations with their retail partners. Retailers, facing headwinds themselves, have also tended to pull back from collaborating too closely with large CPG manufacturers. But does less manufacturer–retailer collaboration truly yield better business results?

Our latest research suggests the opposite. The CPG manufacturers that are clearly winning relative to their category are those that have deepened and broadened their collaboration with retail partners, forming "power partnerships" that yield meaningful growth in both revenue and profit.

That's one of the most intriguing findings from our latest Commercial Excellence Benchmarking (CEB) survey, developed in partnership with the Grocery Manufacturers Association and Nielsen (see sidebar "About the Commercial Excellence Benchmarking survey"). To supplement the survey insights, we also interviewed a dozen US-based CPG and retail executives. Our research sheds light on the industry's current challenges and, more importantly, brings into sharp focus four key principles of successful manufacturer–retailer collaboration that can help address those challenges.

Challenges and tensions

The past few years haven't been easy for large CPG manufacturers. Their median revenue-growth rate has slowed dramatically, from 9.7 percent at the end of 2011 to a mere 1.2 percent at the end of 2018. At the same time, the costs to serve their retail partners (as a percentage of net sales) have been rising by an average of 40 basis points since 2016.

Against this backdrop, it's no surprise that manufacturers tend to feel put upon every time retailers make a new request—whether it's a request to match or exceed historical levels of trade spending, to pony up for digital couponing or loyalty programs, or to help fund significant retail infrastructure investments such as front-of-store updates or click-and-collect capabilities. Manufacturers also feel additional pressure when

About the Commercial Excellence Benchmarking survey

This article draws on the results of the 2018 Commercial Excellence Benchmarking (CEB) survey, with an exclusive focus on the 110 North American companies that participated. The CEB survey, developed in partnership with the Grocery Manufacturers Association and Nielsen, asks about the practices and organizational decisions of CPG manufacturers, then correlates those practices with outperformance and underperformance relative to category and geography.

Formerly known as the Customer and Channel Management Survey, the CEB survey has been conducted at least every other year since 1978. More than 280 companies, representing combined revenues exceeding $2.2 trillion, are now in the global CEB database.

[1] For more on these trends, see Greg Kelly, Udo Kopka, Jörn Küpper, and Jessica Moulton, "The new model for consumer goods," April 2018, McKinsey.com.

The CPG manufacturers that are clearly winning relative to their category are those that have deepened and broadened their collaboration with retail partners.

retailers step up enforcement of steep fines for late or incomplete shipments, at a time when carrier shortages have caused on-time fill rates to drop.

To be sure, retailers are grappling with their own challenges as well (see sidebar "The retailer's perspective"). In fact, in the US market, the decline in profit over the past two years has been even steeper for retailers than for CPG manufacturers (Exhibit 1)—so it's also unsurprising that retailers would seek ways to protect their margins by negotiating more aggressively with manufacturers.

Yet, certain CPG manufacturers have broken this cycle. They've proactively entered into deep and broad collaborative efforts with retailers—and demonstrated above-average sales growth and profitability as a result.

Four principles for successful collaboration

What elements do power partnerships have in common? When it comes to retailer relationships, what do CPG "winners" do differently than "others"—winners being those CPG companies that outperform their categories in sales growth, while also managing costs effectively? Our CEB survey

Exhibit 1

Manufacturers and retailers alike have experienced significant profit declines in recent years.

Note: 2018 data represents latest 12 months ending October 2018.

[1] Consumer packaged goods.
[2] Operating profit (earnings before interest and taxes (EBIT)) for US and Canada business of top CPG manufacturers: ABI, Coca-Cola Company, Colgate-Palmolive Company, General Mills, Kimberly Clark, Mondelēz, PepsiCo, P&G, and Tyson.
[3] Operating profit (EBIT) for US business of top retailers: Ahold Delhaize, Albertsons–Safeway, Alimentation Couche-Tard (Circle K), Costco, CVS, Dollar General, Kroger, Target, Walgreens Boots Alliance, and Walmart.

Source: CapIQ; company websites and filings; US Bureau of Economic Analysis

The retailer's perspective

Retailers, too, have reasons to feel beleaguered. They're in fierce competition with discounters, online start-ups, and fast-growing ecosystems like Amazon. They're racing to keep up with consumers' ever-rising demands for niche brands and digital touchpoints. And they're striving to build up their capabilities in big data, advanced analytics, automation, and artificial intelligence.

In their increasingly difficult quest for growth, retailers are looking to partner with high-growth CPG brands. But the large, established CPG manufacturers—which were traditionally the primary source of new and unique products that drove traffic to retail stores—are no longer reliable innovation engines. In the words of one retail executive, "Innovation by traditional manufacturers is happening at a slower pace than consumers expect." And while retailers possess valuable shopper data that could inform new-product innovation, they're often hesitant to share the data because, as one retailer put it, "CPG manufacturers are increasingly in a position to build relationships directly with consumers and become our competitors rather than our partners."

Given this context, manufacturer–retailer trust levels have hit new lows. It doesn't help that many CPG companies have been undergoing organizational transformations and experimenting with their structure and decision rights, without communicating the changes to retailers. "We're constantly trying to figure out how decisions are made [at CPG companies]," said one retail executive. "It seems to change every month or quarter."

and executive interviews brought to light four principles, all of which are essential components of fruitful manufacturer–retailer collaboration.

1. Codevelop long-term strategies
In a partnership, both parties should understand each other's medium- to long-term goals. As one collaboration-focused CPG executive said, "Both sides must be willing to share three- to five-year strategic plans and build a joint long-term vision. Ideally, 60 percent of time together would be spent on strategic initiatives, and only 40 percent on delivering the annual plan." Conversations should primarily be about growth and long-term priorities rather than cost concessions and quarterly numbers.

Indeed, the CEB survey results indicate that winning CPG companies are more likely to plan and execute joint strategic initiatives with retailers. Winners are about 40 percent more likely to create tailored products and packaging for and with their retail partners, and twice as likely to codevelop shopper-marketing plans.

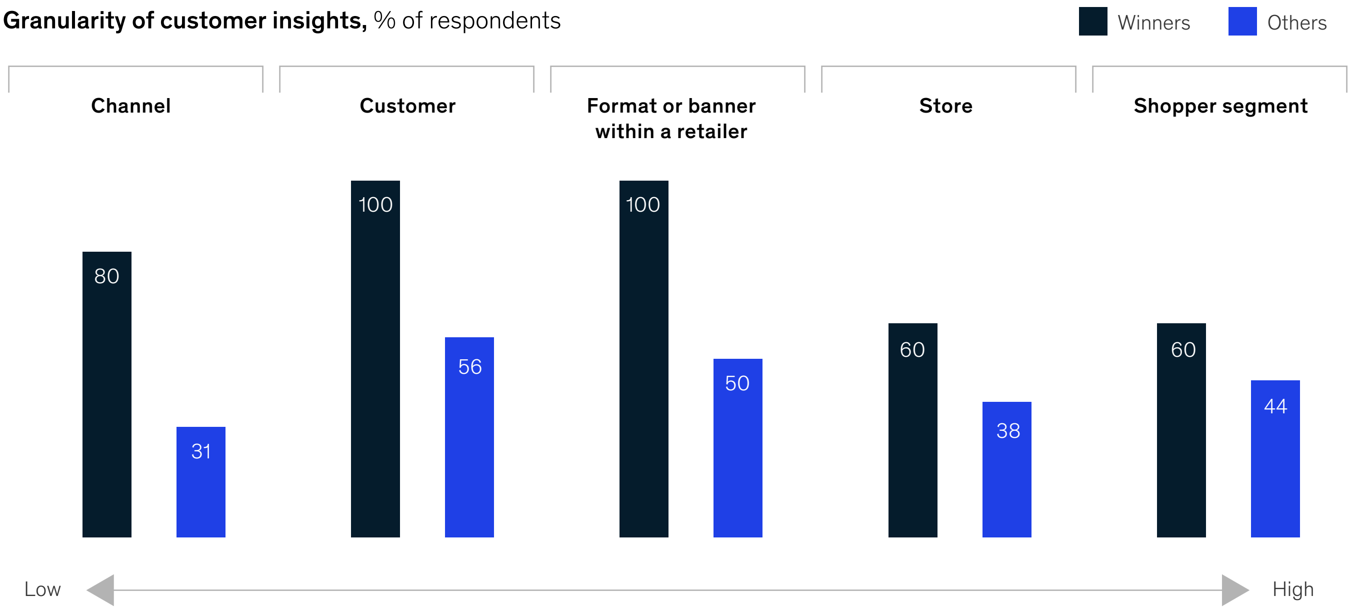
2. Conduct advanced analytics at a detailed level to jointly determine where and how to place bets
Shared goals are important building blocks of a successful collaboration, but they're not sufficient on their own to generate shared value. Winning CPG companies also use advanced analytics to generate fine-grained insights that deliver against those goals; they then share these insights with retailers. For example, 60 percent of winners—versus only 38 percent of others—generate nuanced, store-specific (not just retailer- or format-specific) insights. A majority of winners also drill down to the shopper-segment level, compared with only 44 percent of others (Exhibit 2).

The granularity of insights is crucial, but winners demonstrate a greater frequency of insight generation as well. For example, one-third of winners analyze event-level promotional effectiveness in real time (using automated outputs from trade-promotion systems); all winners conduct this type of analysis at least quarterly. By contrast, roughly half of other CPG companies do it semiannually, annually, or not at all.

Exhibit 2

Winning consumer-packaged-goods companies develop a more detailed understanding of their retail partners.

Granularity of customer insights, % of respondents



Source: 2018 North America Commercial Excellence Benchmarking Survey (question: "Which of the following is your most granular level of channel/retailer shopper insights?")

Of course, handling this level of analytical complexity wouldn't be possible without investments in the right tools and technologies. The CEB survey sheds light on this point: it shows that winners are more than twice as likely to employ a predictive assortment-optimization tool that takes into account both manufacturer and retailer interests and generates recommendations accordingly. Winners are also twice as likely to have a robust consumer-data platform that integrates data from multiple sources (including retailer data, behavioral insights, and syndicated data).

3. Set up an agile operating model

The manufacturer–retailer operating model must evolve to support nimble execution. The best partnerships have adopted agile principles—for instance, they're reviewing and prioritizing collaboration topics and dynamically allocating resources, including bringing in topic-specific experts, during collaborative "sprints."[2] This evolution toward an agile model has three components: structure, cadence, and incentives.

— **Structure.** It's hard to be truly agile if the manufacturer's functional experts aren't in tune with and closely connected to the retail partner. Tellingly, winners are 40 percent more likely to create account-dedicated (rather than brand- or category-wide) functional roles, particularly for capabilities such as category management, e-commerce, and supply chain. Winners are also significantly more likely to involve their

[2] Jan Henrich, Ed Little, Anne Martinez, Kandarp Shah, and Bernardo Sichel, "Agility@Scale: Solving the growth challenge in consumer packaged goods," July 2018, McKinsey.com.

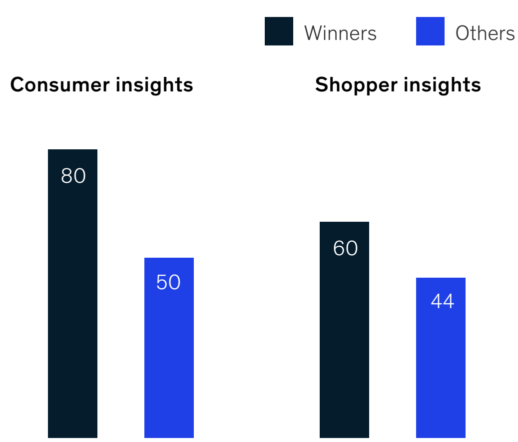
consumer-insights teams in discussions with retailers (Exhibit 3).

— **Cadence.** As several interviewees emphasized, quarterly meetings for joint business planning just don't cut it anymore. Real-time collaboration is critical. Agile operating models enable much more frequent, as-needed interaction and result in value-creating actions: for example, winners adjust trade-spend levels approximately 70 percent more frequently, and pricing or promotion plans about 20 percent more frequently, than others. What's more, winners' price changes are 12 percent more likely to stick compared with other manufacturers'.

Exhibit 3

Winning companies are more likely to involve their consumer- and shopper-insights teams in discussions with retailers.

Stakeholders involved in retailer conversation, % of respondents



Source: 2018 North America Commercial Excellence Benchmarking Survey (question: "Which stakeholders/teams put together the insights used in a typical selling story?")

— **Incentives.** Winning CPG companies ensure that their incentives are aligned with those of their retail partners. They're developing joint scorecards, with well-defined key performance indicators and targets that reflect benefits to both parties. For example, winners are 40 percent more likely to focus on category metrics instead of brand-specific metrics in joint performance management. In addition, they use pay-for-performance trade architectures: at winning companies, the trade-rate gap from customer to customer is 20 percent higher than at other companies. Done right, pay for performance allows CPG companies to focus their investment dollars where they'll have the most impact.

4. Collaborate across the full value chain

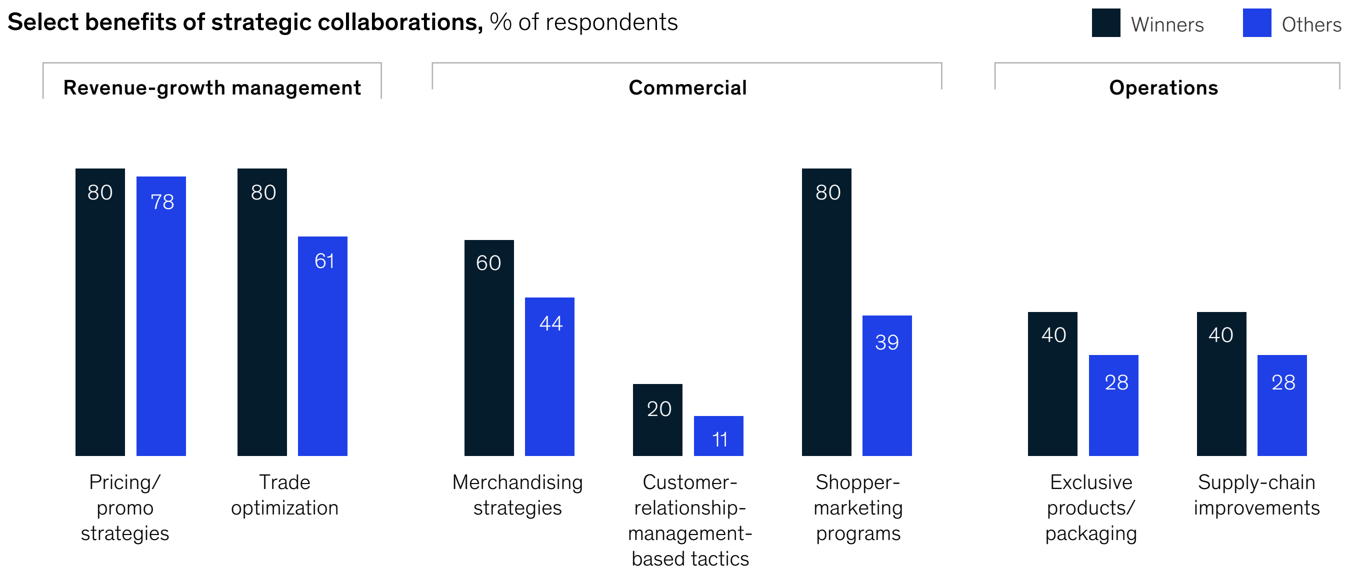
Finally, the highest-performing power partnerships cover the full range of commercial and operational topics. Winners are more likely than others to reap benefits from collaborations across a range of cross-functional topics, from trade optimization to merchandising to supply-chain improvements (Exhibit 4). As an illustration of the latter, winners are almost three times more likely to apply their advanced-analytics capabilities to predict and manage out-of-stocks at the store level.

Some manufacturers and retailers are taking their partnerships a step further by coinvesting in new ventures such as last-mile delivery. Companies that broaden the scope of collaboration have captured a range of benefits, including an increase in promotional effectiveness, product assortments that better align with consumer needs, lower transportation and inventory costs, and additional funds to reinvest in demand-driving in-store activities or innovation.

As the saying goes, transparency breeds trust. CPG companies that have chosen to be transparent

Exhibit 4

Winners are more likely to work with retailers on cross-functional topics—and to capture benefits from these collaborations.



Source: 2018 North America Commercial Excellence Benchmarking Survey (question: "Please rank the Top 5 benefits from strategic collaborations.")

in their retailer partnerships—being open about their long-term strategies, sharing insights and opportunities, aligning on metrics, and seeking collaboration beyond the traditional commercial areas—have gained the trust of retailers and, consequently, have outperformed their peers.

Of course, it's all much easier said than done; the four principles discussed above are straightforward concepts, but they're tricky to execute. The payoff, though, is worth it: power partnerships that boost revenue and profit growth and confer sustained competitive advantage.

Kari Alldredge is a partner in McKinsey's Minneapolis office, **Brandon Brown** is a partner in the Dallas office, **Lindsay Hirsch** is an associate partner in the Houston office, and **Travis Reaves** is an associate partner in the Atlanta office.

The authors wish to thank Jen Henry, Julie Lowrie, Megan Lesko Pacchia, Katharine Markley, and the Grocery Manufacturers Association Sales Committee for their contributions to this article.

Designed by Global Editorial Services