Is Big Food in Trouble?

The industry’s major players are struggling as smaller companies gain a competitive edge. Staying on top will require shifting the focus toward consumers’ preference for “real” food.
Small Firms Taking a Bite Out of Market Share

Large food manufacturers are losing the growth game. The top 25 food manufacturers in the United States have ceded 300 basis points to small and medium-size competitors since 2012 and have grown revenue at 1.8 percent compared with 11 to 15 percent growth for the smaller companies. US consumers are voting with their wallets to leave the established large food companies. Changes in consumers’ core values—amplified by social media, celebrity chefs, and a myriad of food experts—are rewarding small and medium-size companies with above-average growth and slowing the growth of the top 25 food and beverage (F&B) companies.¹

The top 25 food manufacturers in the United States have grown revenue at 1.8 percent compared to 11–15 percent growth for the smaller companies.

After decades of making food safer, more accessible, and more affordable, some of these large companies might not survive in this new “real” food marketplace. Forward-thinking firms will change direction to recapture lost share and return to a profitable growth trajectory.

Consumers’ Growing Influence on Food

Today’s consumers are more passionate about the food they eat, and their appetites are creating dynamic shifts in the grocery aisle. Viewpoints and products that once were the domain of co-ops and local health food stores have gone mainstream. The market has shifted from previous decades’ focus on diet foods to a focus on real food as a way to maintain health. Most people now view food—particularly food with benefits—as the key to good health.² More foods are being launched that go beyond basic nutrition to support heart health, digestive health, and higher energy levels. Consumers are rewarding retailers that, by investing heavily in private-label lines, offer high-value products at lower prices than branded alternatives. They are embracing free-from segments (non-genetically modified, organic, and gluten-free), which collectively have a projected growth rate at a CAGR of 21 percent over the next five years. Fresh food departments and formats are growing in popularity at the expense of center store and processed foods. Locally sourced foods with a direct-to-consumer model are becoming more attractive; the demand for transparency in food sourcing, production, and labeling is gaining traction; and consumers are discovering novel, foreign ingredients such as quinoa. Figure 1 on page 2 highlights the trends that are roiling the branded marketplace.

A 2015 study by The Hartman Group indicates that for the first time, consumers believe their purchasing decisions have a much greater impact on society than their voting decisions or

¹ Food and beverage companies with annual revenue of more than $4 billion
² Shopping for Health study, Organic Life magazine, 2016
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Millennials and Gen Xers—significant consumers for future grocery sales—have especially strong feelings about the impact of their purchasing decisions.

As consumers—led by Millennials and Gen Xers—continue the shift from a traditional production-driven food culture to a more modern demand-driven food culture, they will continue to press companies and retailers for more information and accountability about how ingredients are sourced and processed, how “real” their food products are, and how responsive they are to consumers’ desire for choice and customization. This growing influence has major ramifications for the future of big food.


1 Ken Research
2 Statista
3 Food Dive, Specialty Food Association, Nutrition Business Journal, Food Navigator, Statista
4 Willard Bishop
5 A.T. Kearney
Source: A.T. Kearney analysis

their involvement in their local community (see figure 2 on page 3). Millennials and Gen Xers—significant consumers for future grocery sales—have especially strong feelings about the impact of their purchasing decisions.

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3 Transparency 2015, The Hartman Group
Big Food: Bigger Issues

As a result of these trends, the top 25 US food manufacturers’ share of US food and beverage retail sales has declined from 66 percent in 2012 to 63 percent in 2015. While the overall market has grown 3.4 percent, the top 25 have shown a CAGR of only 1.8 percent over the past three years. Meanwhile, medium and small companies have driven market growth with 11 to 15 percent CAGR from 2012 to 2015 and $14 billion of added revenue, catching up with the big food companies that grew their total revenue by $16 billion over the same period (see figure 3 on page 4).\(^4\)

Big food companies have been evaluating strategies, **improving their core businesses to accelerate growth.**

In addition to big food’s loss of market share to small and medium-size companies, big-food earnings growth slowed to 4.8 percent from 2012 to 2015. During this same period, market capitalization has grown by 8.1 percent—begging the question of whether current valuations are sustainable and implying that the large food manufacturers need to step up top-line and earnings growth from current trajectories (see figure 4 on page 5). For many larger food companies, the declines are coming from their core businesses. With the market betting on future growth, big food companies have been evaluating strategies to improve their core businesses along with other options to accelerate growth.

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\(^4\) Top 25 is based on revenue.

\(^5\) Medium-size companies have $1 billion to $4 billion in annual revenue; small companies have $0.5 to $1 billion.
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Figure 3
Small and midsize companies grew at 11–15 percent CAGR and added $14 billion in revenue over the past three years

Food manufacturer revenue ($ billion), ratio vs. big food by segment¹

<table>
<thead>
<tr>
<th>Year</th>
<th>Small companies US revenue ($ billion)</th>
<th>Midsize companies US revenue ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>8.9%</td>
<td>+11%</td>
</tr>
<tr>
<td>2013</td>
<td>9.9%</td>
<td>25.8</td>
</tr>
<tr>
<td>2014</td>
<td>11.0%</td>
<td>29.6</td>
</tr>
<tr>
<td>2015</td>
<td>11.6%</td>
<td>33.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Small companies US revenue ($ billion)</th>
<th>Midsize companies US revenue ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>3.0%</td>
<td>+15%</td>
</tr>
<tr>
<td>2013</td>
<td>3.1%</td>
<td>8.9</td>
</tr>
<tr>
<td>2014</td>
<td>3.6%</td>
<td>9.3</td>
</tr>
<tr>
<td>2015</td>
<td>4.3%</td>
<td>11.1</td>
</tr>
</tbody>
</table>

Sources: Company annual reports and SEC Filings, Foodprocessing.com, A.T. Kearney analysis

Campaign for Sustainable Growth

Based on industry projections, big food can tap into a $70 billion opportunity in overall F&B market growth over the next three years. Recognizing slow growth in their core businesses and mounting pressure to align their brands with consumer tastes, big food companies need a systematic campaign to rebuild loyalty and win back consumers. They need to rigorously evaluate their portfolios, create strategies to reduce costs and enable investment in growth activities, pursue expansion into trending categories, and participate in joint ventures to nurture potential acquisitions. Recapturing profitable growth will hinge on finding the right mix of three strategies.

Strategy 1: Take advantage of cost take-out and divestiture to enable investments in growth activities

In 2008, 3G Capital purchased Anheuser-Busch for $52 billion and used an aggressive approach to remove unnecessary costs. Some of the measures included slashing 1,400 jobs (75 percent of which were at the St. Louis headquarters), replacing existing management with external people,
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Figure 4
Market cap exceeded earnings growth for the top 25 producers, indicating overvaluation by investors

Food manufacturer EBITDA vs. market cap by segment

| Top 25 Q1 EBITDA ($ billion) segment | Top 25 Q1 market cap ($ billion) segment
|-------------------------------------|------------------------------------------|
| Modest EBITDA growth of Top 25 at 4.8% does not justify growth in value | The Top 25 producers saw a corresponding 8.1% annual growth in value
| 55.1 | 54.0 | 58.2 | 63.5 | 655.7 | 762.8 | 808.4 | 829.3 |

+4.8% | +8.1%

Does not include currently private companies (Mars, Bimbo Bakeries, Land O’ Lakes, HJ Heinz, Kraft, Smithfield Foods) included in Top 25 sample
Sources: Yahoo Finance, annual reports; A.T. Kearney analysis

Venture funds allow F&B companies to engage with entrepreneurs.

Selected divestitures have enabled big food to refocus capital on promising growth opportunities. ConAgra, for example, divested its private-label business because of stagnant sales, which helped consolidate 32 manufacturing facilities, and the company will focus more on higher-margin businesses. General Mills divested Green Giant, a frozen and canned vegetable producer out of step with accelerating trends toward fresh foods and produce, and J.M. Smucker divested canned milk because of stagnant sales.

Strategy 2: Use controlled acquisitions of smaller, established players and external venture capital development to add trending categories to a portfolio

Controlled acquisitions could include one or two small public competitors with about $550 million in 2015 revenue and 7 percent CAGR until 2019, or two to three companies each with $250 million to $350 million in 2015 revenue and 13 percent CAGR until 2019. Examples include Kraft, Hillshire Brands, MOM Brands, Krave Jerky, and Applegate. Alternatively, companies can launch four

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EBITDA is earnings before interest, tax, depreciation, and amortization.
or five high-growth products (equivalent to $100 million valued start-up) with potential for 100 percent CAGR until 2019. Examples include Soylent, Quinn Popcorn, and WikiFoods.

Early this year, General Mills acquired EPIC Provisions, a two-year-old maker of bars and other snacks with meat in them. Prior to that, General Mills acquired Annie’s for $820 million to expand its US natural and organic food category. In addition, the company has a new business development and venturing unit called 301 INC to provide capital, knowledge, and expertise to entrepreneurs and early-stage food companies. Investments have been focused on natural and organic foods. As a result, General Mills achieved 4.3 percent CAGR from 2011 to 2015, which is significantly above the big-food average. Today, the company has seven organic or natural brands with net sales that exceeded $570 million in fiscal 2015.

**Strategy 3: Create venture funds to invest, seed, and grow nascent brands, products, and technologies that could position companies to take advantage of consumer trends with a lower entry cost**

By creating a venture fund, F&B companies can engage with entrepreneurs whose ideas may be too risky for acquisition or who are uninterested in giving up complete control of their business. This also allows F&B companies to invest in promising start-ups early on rather than paying a hefty acquisition cost later. One good example is General Mill’s acquisition of Annie’s at a multiple of 27 times EBITDA where the industry norm is between eight and 10 times. Figure 5 shows the key start-up investments by large F&B companies’ venture funds.

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**Figure 5**

In efforts to create small-company growth prospects, many companies are looking to invest in new business models

- Multiple food and beverage companies have created “venture funds” to invest, seed, and grow nascent brands, products, and technologies that could take advantage of trends
- Venture funds provide the opportunity to engage with an entrepreneur whose idea may be too risky for acquisition, or who is uninterested in giving up complete control of his or her business

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<table>
<thead>
<tr>
<th>General Mills</th>
<th>Unilever</th>
<th>Coca-Cola</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>301 Inc.</strong></td>
<td><strong>Unilever ventures</strong></td>
<td><strong>Venture and emerging brands</strong></td>
</tr>
<tr>
<td><strong>Investments</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Rhythm Superfoods: Nutrient-dense, real-food snacks (for example, Beet Chips, Broccoli Bites)</td>
<td>• Froosh: Leading premium smoothie brand in the Nordics</td>
<td>• Honest Tea: Organic tea, lemonade, and sparkling soda</td>
</tr>
<tr>
<td>• Good Culture: Organic cottage cheese</td>
<td>• Snog: Premium frozen yogurt brand in UK</td>
<td>• Zico: Coconut water</td>
</tr>
<tr>
<td>• Beyond Meat: Plant-based protein snacks</td>
<td>• HangYo (Indirect): Regional ice cream and dairy in India</td>
<td>• Core Power: High-protein milkshake with real filtered milk</td>
</tr>
<tr>
<td>• Tio Gazpacho: Low-calorie, convenient cold soups</td>
<td>• SoBe V Water (Indirect): UK’s first natural vitamin water</td>
<td>• Suja: Organic, non-GMO pressed juices</td>
</tr>
</tbody>
</table>

**Non-exhaustive Investments**

Sources: General Mills, Unilever, Coca-Cola; A.T. Kearney analysis
Winning with Big Food

Over the past decade, acquisitions have been the primary means by which many F&B companies have attracted and retained consumers and quickly created value for shareholders (see figure 6).

Although many of these acquisitions have driven some top-line growth, they expanded large food manufacturers’ scale in stagnant categories, not emerging ones. This relentless search for sustainable market-share growth will have winners and losers. Ultimately, the landscape of big food will change as there will not be enough large acquisition opportunities to keep investors happy. To succeed, larger F&B manufacturers need a focused acquisition strategy to expand into growth categories paired with a more robust internal innovation model.

With a focused strategy, big food can convince consumers to stay.

Along with M&A-driven growth, larger companies need to build their internal competencies in two ways. A culture of innovation enables a willingness to take risks and enter new categories or pursue novel ideas at leadership levels as well as throughout the organization.

Figure 6
Benchmarking accretive impact of acquisitions on earnings per share (EPS)

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Target</th>
<th>Date</th>
<th>Expected EPS increase</th>
<th>Expected EPS accretive date</th>
<th>Acquisition type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hormel</td>
<td>Applegate</td>
<td>July 2015</td>
<td>2015: Neutral 2016: +$0.07-0.08</td>
<td>FY 2016 (Year 2)</td>
<td>Scope expansion</td>
</tr>
<tr>
<td>Hershey’s</td>
<td>Krave Jerky</td>
<td>January 2015</td>
<td>Likely short-term dilutive1</td>
<td>–</td>
<td>Scope expansion</td>
</tr>
<tr>
<td>Post</td>
<td>MOM Brands</td>
<td>January 2015</td>
<td>–</td>
<td>Immediate</td>
<td>Scale expansion</td>
</tr>
<tr>
<td>General Mills</td>
<td>Annie’s</td>
<td>September 2014</td>
<td>2014: Neutral 2015: +$0.01</td>
<td>FY 2015 (Year 1)</td>
<td>Scope expansion</td>
</tr>
<tr>
<td>Tyson</td>
<td>Hillshire Brands</td>
<td>August 2014</td>
<td>2014: Neutral 2015: +$0.17</td>
<td>FY 2015 (Year 1)</td>
<td>Scale expansion</td>
</tr>
<tr>
<td>ConAgra Foods</td>
<td>Bertolli</td>
<td>July 2012</td>
<td>2012: Neutral 2013: Neutral 2014: +$0.05-0.07</td>
<td>FY 2014 (Year 2)</td>
<td>Scale expansion</td>
</tr>
</tbody>
</table>

1 Estimated impact of acquisitions (Krave, Allan, Golden Monkey) is ~-$0.03-0.05
2 EPS estimated to increase from 3.32 (FY 16) to 3.60 (FY 17) with accretive value being generated due to the merger

Sources: Broker reports, press releases, A.T. Kearney analysis
Financial forward-thinking helps build budgets based on future needs versus historical ones in order to cut unnecessary costs and drive growth along with willingness to sacrifice short-term high margins and return on investment to maintain share.

To win in this space, the large established food manufacturers will need to give consumers real reasons to remain loyal. This includes providing innovative products that meet consumers’ needs, delivered when and where they shop and with transparency in sourcing, production, and marketing. With a focused strategy that balances strategic acquisitions and forward-thinking investments, big food can convince consumers to stay.

Authors

Dave Donnan, partner, Chicago
dave.donnan@atkearney.com

Randy Burt, partner, Chicago
randy.burt@atkearney.com

Laurie Demeritt, CEO of
The Hartman Group
laurie@hartman-group.com

David Hokens, consultant, San Francisco
david.hokens@atkearney.com
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About The Hartman Group

For over 25 years, The Hartman Group has been a recognized thought leader on demand-side trends in the food industry. Our expertise ranges from how the smallest nuances of product design affect your product’s ability to grow to devising portfolio strategies that maximize sustainable, demand-led growth. We have advised some of the world’s largest food and beverage companies on issues of portfolio management, brand renovation, consumer insights and innovation. Our approach is always highly customized to each client’s strategic interests and corporate culture. For more information, visit www.hartman-group.com.

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