

Food & Beverage in Spain

Consumer shifts will unlock further growth

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Executive summary

Changes are occurring in the food & beverage industry regarding consumers providing opportunities to unlock growth.

In Arthur D. Little, we summarize them in four key trends:

- **Demographic Variations.** The importance of the segment of the elderly, a segment in which much of the purchasing power is concentrated and the smaller size of the Spanish households
- **The economic recovery.** Recovering of the Spanish national GDP, growth of the business confidence and the rise of the consumption of the households
- **Changes in consumer habits.** Consumer hyper-sensitivity to price in those products in which there is no perceived differentiation among the category and an increase in the number of customer willing to pay extra for high quality products
- **Impact on distribution channels.** Purchase frequency in the food channel has been shorten to avoid big-ticket disbursement boosting sales in convenience and proximity channels. On the other hand, away from home channel is benefiting from the improvement of the country's economic situation

Consequently, companies could manage to outpace overall industry growth by focusing on core capabilities, anticipating channel shifts and nurturing future profit pools based on consumer insight. For this, companies will need to focus on three key areas: (i) steering their strategies, (ii) developing propositions aligned with the new consumer, and (iii) build go-to-market strategies that are able to maximize such value propositions

- **Defining the future company strategy and positioning** as the path to ensuring that players develop capabilities that will enable them to maintain perceived differentiation in a market that is rapidly changing
- **Developing competitive propositions** through consumer and market knowledge as the means to prepare for the emerging changes in occasions, habits and overall segment value
- **Defining go-to-market strategies** that maximize developed propositions, given the increasing professionalization of distribution and the expected value shifts among channels

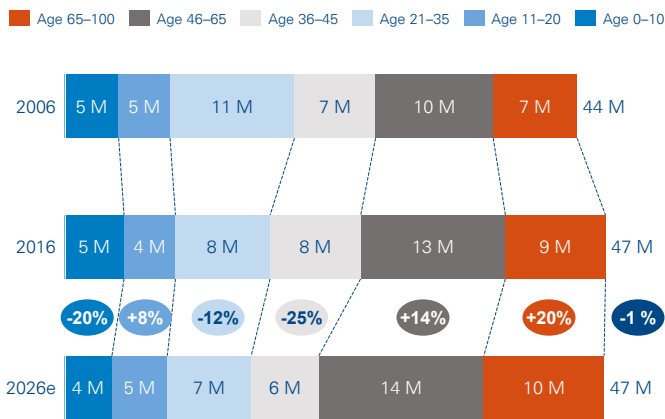
1. What has changed?

Key changes in the food & beverage industry regarding consumers will provide opportunities to unlock growth of 2–3 percent p.a. in an otherwise-vegetative market

There will be major segment value shifts in a moderate-growth environment, derived from demographic changes and the economic outlook.

Forecasts show a declining population base in Spain, paired with overall aging of the pyramid, given the deceleration of birth rates and lifespan gains. A 10-year comparison shows segments will vary as follows:

Figure 1: Population forecast by age



Source: Instituto Nacional de Estadística

As older population segments become increasingly important in the coming years, understanding these age groups will prove to be essential.

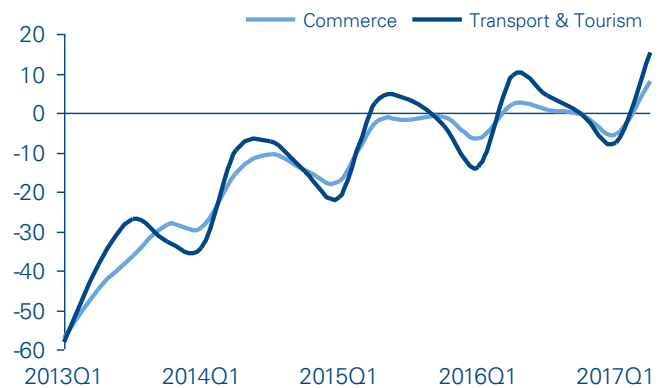
Furthermore, as the average household continues to shift towards smaller sizes in Spain (27 percent of households had one or two inhabitants in 1994, versus 56 percent in 2016), so will consumer needs, occasions and habits, which are very different from those of large young families.

Another key change in the coming years will be driven by the economic recovery in the country.

Although Spain has suffered from both a global crisis and country-specific economic difficulties, it is recovering at a faster pace than average EU countries, and its economic outlook is stable.

- The national GDP has been recovering since 2013, at a 2.4 percent CAGR with a 3.2 percent growth rate in the past two years.
- Business confidence in most industries has been steadily growing since 2013.

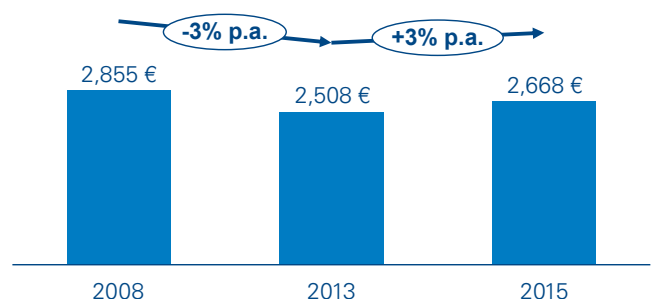
Figure 2: Business-confidence evolution



Source: Instituto Nacional de Estadística

Hence, purchasing power of households is now on the rise, and so are consumption levels.

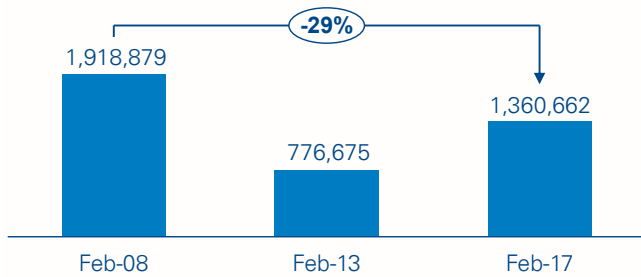
Figure 3: Food & beverage consumption per person



Source: Instituto Nacional de Estadística

In addition, it has further room to develop, as consumption of most goods in the country are still depressed when compared to pre-crisis levels.

Figure 4: New car registrations (YTD units)



Source: DGT

Summing up, moderate consumption growth for food & beverage of around 2–3 percent in the next years can be expected. This overall growth, however, will coexist with major segment shifts where growth opportunities rise, while some of the currently winning propositions will erode.

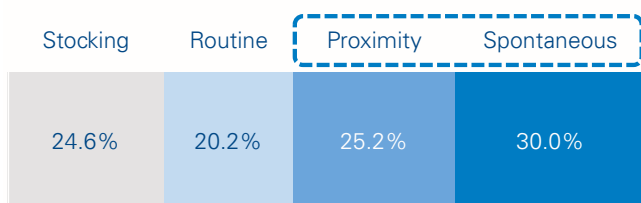
“Away from home” will recover in an increasingly competitive environment, while convenience will become an important sub-channel.

Recent consumer-driven changes are greatly affecting channel opportunities. Therefore, winning propositions by format are changing.

The current consumer is increasingly impatient and looks for immediate satisfaction. As technology has evolved and propositions for goods and services are delivered in ever-decreasing time, the consumer expects this purchasing relationship in more and more propositions.

Furthermore, purchase frequency in the food channel in the past years has also been shortened because of the post-crisis years, as it has been a measure to avoid big-ticket disbursements. From 2010 to 2014, average-ticket expenditure of Spanish households dropped 2–3 percent per annum, while the number of visits to the channel increased at 1.7 percent.

Figure 5: Declared expenditure by nature



Source: Kantar 2014

Planning for meals has also lost relevance in the past years, in a country where proximity and spontaneous decisions account for most consumer occasions in the food & beverage industry.

In this context, we expect convenience and proximity propositions to become clear winners, able to better cover the needs of the Spanish consumer, while the “away from home” channel will benefit both the economic recovery and new consumer habits.

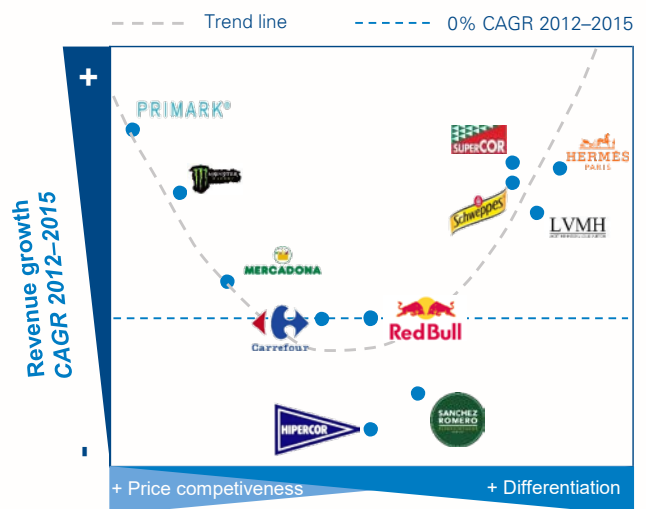
Consumers will intensify trading up, based on differentiation of the propositions versus substitutes in the consumption occasion

In a market where consumers widely accepted the low-cost products after the crisis, Spaniards show two differentiated attitudes towards their purchases:

- Hyper-sensitivity to price in which there is no perceived differentiation among the category; as an example, private label held a 41.5 percent value-market share in 2015 for FCMG, although it has been shrinking for the past two years.
- An increase in the number of customers that declare they are willing to pay extra for certain attributes such as high quality (31 percent), additional benefits (29 percent) and wellness (28 percent).

This has resulted in polarization of growth, with products either winning by price competitiveness or winning traction thanks to a higher perceived added value, while the middle propositions erode.

Figure 6: Positioning versus performance matrix



Source: Company reports, Alimarket, Arthur D. Little analysis

As a result, we expect intensification of this pattern in the coming years, with customers choosing extremes based on perceived differentiation.

2. Where to unlock growth?

By focusing on core capabilities, anticipating channel shifts and nurturing future profit pools based on consumer insight, companies could manage to outpace overall industry growth.

Companies will need to focus operations on “key core capabilities,” while collaborating in complementary relationships.

Given the current capability of consumers to compare all market propositions, along with lowered price points in the past years, to stand out from the pack, winning players will need to have a clear sense of what makes them different and how to communicate it.

Furthermore, we have identified a trend in which different players generate collaborative ecosystems –one player can leverage the differential capabilities of its partners alongside its own. These structures can deliver truly excellent propositions for consumers based on what each partner knows best.

An example of such partnerships in Spain occurred in September 2016, when Amazon and the traditional market of La Paz in Madrid launched a joint venture to serve a food offering of excellent quality and tradition in the city, through the e-commerce channel and leveraging Amazon’s distribution capabilities.

The partnership had beneficial results from the first month of activity (with a 62 percent increase in afternoon sales for the market, and offering the possibility for Amazon to enter the fresh-product market).

Distribution has always been a key capability in the food & beverage sector, particularly in Spain, where there are more than 390,000 PoSs and 300,000 vending machines for the whole industry.

In the past years, efforts have been steered towards efficiency gains. Most common strategies have relied on manufacturer and distributor alliances or optimization of owned distribution infrastructures with other manufacturer products.

Moving forward, however, players will need to develop their current infrastructures to remain competitive in at least one of the following lines:

- Basic service level on PoS with a competitive pricing strategy.

- PoS value proposition that is differential and relevant to the segment served.

Companies will need to anticipate channel shifts and develop resources to better capture growth opportunities.

“Away from home” will remain the main growth driver, primarily derived from the economic turnaround in Spain, coupled with a relatively positive outlook perception.

This having been said, we believe the previously mentioned structural changes in demographics and new consumer habits will further favor this trend in the coming years.

However, there are different key dynamics within sub-channels that explain where and how the changes in demand are having the most effect.

Retail has been, and will continue to be, reshaped towards convenience and proximity stores, given the changes in the consumer.

- In the Spanish market, independent retailers that evolved their offerings to convenience/impulse with basic ranges and small formats firstly covered this need. As an example, one of the main specialized distributors for the central region of Spain saw a 36 percent p.a. growth rate in PoS from 2002 to 2012.
- In the coming years, however, we believe modern retailers will mostly capture the trend. Early starters in convenience Carrefour and El Corte Inglés, along with other followers such as Condis and Caprabo, which are seriously starting to invest in this concept, are professionalizing the format.

Moreover, the online-sales channel shows potential for the future, and investment is required to earn an early position in the trend. For instance, the retailer Mercadona currently represents approximately half of sales in the channel.

We believe, however, that the opportunity for food & beverage in this channel is still some years down the line, given the weight of traditional customers coupled with a country that has and will increase its convenience and proximity offerings even more.

- Online supermarket-sales penetration in Spain is 13 percent of households, while in the UK it reaches 49 percent.
- Consumer goods sold by the e-commerce channel amount to 0.8 percent in Spain, while in the UK they represent a 6.4 percent.

On the other hand, “away from home” channels are currently over-performing, given the readjustment after the crisis. However, within this recovery, HORECA chains and collective restauration are leading this growth:

- The current atomization of the sub-channel has attracted private-equity investment in recent years. Nazca, H.I.G., Oquendo and Springwater are some of the most recent examples.
- Their critical mass gives them a competitive advantage when it comes to investing in growth.

Thus, by the end of the process, this sub-channel will come out considerably reinforced, and food & beverage players that tailor their strategies to the sub-channel will benefit from this growth. Some of the key areas to cover will be:

- Account management based on long-term objectives.
- Strategic cooperation with clients based on win-win plans.
- Adapted and, very often, even exclusive portfolios.

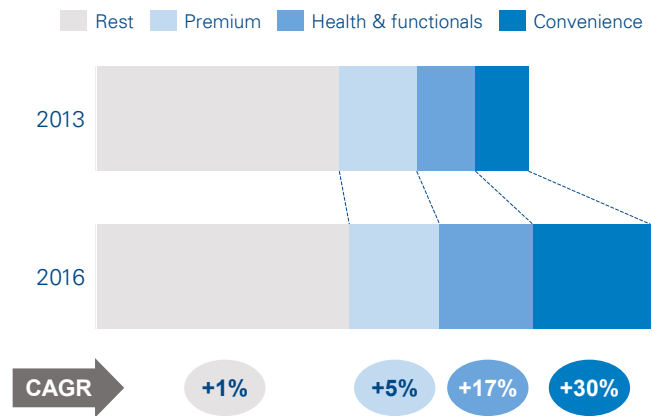
Companies will need to nurture potential profit pools by preparing for the volume shifts of each consumer segment in the coming years and developing credible trading-up options.

The main changes in demand will have a high impact on future products. While past years have been about private-label growth through an offering that had price at the center of the proposition, these strategies seem to be increasingly unproductive for further growth.

Adding to the trend that the new consumer is increasingly willing to upgrade and needs convenience and immediate solutions, future growth levers with the best potential will move around perceivable differentiation in the category, coupled with adequate sizes and formats.

Moreover, it is in the field of innovation that we can see the first battles in a rising war for medium-term growth through convenience, health and functional, as well as premium products.

Figure 7: Number of product launches by type



Source: Alimarket 2016

Launches, however, are the first step on a long road to victory, as consumers need to repeat purchases several times before incorporating new products into their regular baskets.

This implies developing a holistic strategy around the value propositions. The strategy must start with product innovation, but permeate the whole business and be backed by an adequate marketing investment that escorts the distribution footprint well beyond the launch year.

Portfolio strategies for companies operating in the Spanish market will also need to prepare for the shifts that will follow concerning population segments.

As older consumers grow in numbers, it is key to understand that they will be very different in some aspects from the current elders. For instance:

- Disposable income by age group will drastically change due to a public pension system that extends retirement ages while reducing pension schemes.
- Attitudes towards consumption will also vary, as new older segments will have a growing predisposition toward spending versus saving for the family, a new attitude towards staying active and healthy, a higher education level, etc.

Looking forward, outperformers will need to be able to identify and incorporate value into their portfolios, based on solid consumer insight, backed by an aligned company strategy, and focused on the current and future value of their consumer segments.

3. Key focus areas

Companies will need to focus on steering their strategies, developing propositions aligned with the new consumer, and build go-to-market strategies that are able to maximize such value propositions.

Defining the future company strategy and positioning as the path to ensuring that players develop capabilities that will enable them to maintain perceived differentiation in a market that is rapidly changing.

Drawing on the company's ambition rather than its current position, there are four main areas that enable redefinition of the business model:

- Constructing a vision of the industry in 10 years' time, according to most plausible scenarios and what part the company is going to play.
- Developing a map of all market opportunities, the potential value and the capabilities that need to be developed to capture each one.
- Selecting the strategy that best suits the defined ambition, with all pursued opportunities, as well as the capabilities that will need to be developed or partnerships that must be established in order to do so.
- Building a comprehensive roadmap of all activities to undertake in order to acquire capabilities that will allow the company to pursue each opportunity.

Developing competitive propositions through consumer and market knowledge as the means to prepare for the emerging changes in occasions, habits and overall segment value.

Once the vision is established, it is key to defining propositions based on both core capabilities and deep market understanding. The process is broken down as follows:

- Understanding the market's most likely future from three different perspectives in order to get a clear vision of

opportunities the company can capture from each: channels, clients and consumer shifts.

- Defining differential value propositions based on market and company knowledge: differential portfolio selection/ innovation needs, consumer price points and promotional strategies, needed activation and visibility definition.
- Establishing commercial terms and conditions with clients that enable the company's products to be where, when and how it needs them to be, in order to convey its customer propositions.
- Developing a marketing plan that backs the defined strategy, targeting the right customers in the adequate channels or platforms and moments.

Defining go-to-market strategies that maximize developed propositions, given the increasing professionalization of distribution and the expected value shifts among channels.

To exploit the full potential of developed competitive advantages in the market, companies should focus on the following four areas:

- Micro-segmentation of the market PoS and characterization of the specific needs of each segment to become a differential partner.
- Developing direct or indirect service models that cover the needs of each client while maximizing profitability.
- Defining a commercial model that optimizes visits, and is coherent with the defined strategy and backed by a variable scheme that ensures its implementation.
- Defining the optimum organizational structure and investment needed to attend each channel according to its current value and potential.

Arthur D. Little has broad experience in these fields, and is currently working hand in hand with its clients to solve these challenges in the food & beverage industry.

Notes



Notes

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Consumer Shifts

Corporations have pursued diversification strategies for decades as a means by which to create long-term value and achieve sustained growth.

Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

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