How to balance the CPG, retail and consumer relationship

Building a better working world

Disruption and innovation have put pressure on the consumer packaged goods (CPG) and retail relationship, driving a focus on the consumer.

In brief

- Retailers and consumer packaged goods (CPG) companies have invested in new technology, channels, product development and consumer touchpoints to stay relevant.

- But their relationship has unsettled, with each taking on parts of the other's traditional role and innovating in different ways.

- Consumers ultimately hold the power – those companies who deliver to their needs and expectations will be in the strongest position to reset the relationship.

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Retailers, consumer packaged goods companies and consumer behavior have all changed significantly in the last five years – evolving, but not in lockstep. It's meant the relationship dynamics between the three have altered significantly, creating unsettling tension as the challenge and competition for attention and relevance become more acute. Is it time to reset the relationship?

These changing dynamics are in part a product of the disruptive times we're living through, but they also reflect the appetite to innovate and integrate new technology. As these companies pivot from tried-and-tested interventions, their actions haven't just had a significant impact on their own organization; they've influenced and reshaped their relationships with partners and customers.

But what does this mean for the future? Consumers ultimately hold the power, so are retail and CPG companies paying enough attention to changing consumer behavior, and would more collaboration between them, rather than separate approaches, help to reset the relationship?

Retailers have become more empowered

Retailers, especially in grocery, are enjoying a renewed sense of confidence. They've always tried to focus on what they do best and what customers need from them the most, but the COVID-19 pandemic created acute issues to hastily resolve, including staffing, access to stores, logistics and supply chain. Consequently, they accelerated technology plans, enabling contactless payments, self-service check-outs, click and collect, and delivery services, as well as revising their SKUs. The interventions they made then to stay in business now meet the demand for consumer convenience and drive cost efficiencies too. Retailers have not just returned to normal but moved forward in the same innovative vein. Buoyed by the positive consumer reaction and inspired by the success of discounters, retailers are now exerting much more control over what they sell and are focused on delivering value. They are continuing to extend their private label product range and improve the customer experience, driving convenience, efficiency and value.

In addition, many retailers have taken on a wider role as local community hubs – collecting for foodbanks and organizing recycling for example – building on the essential connection they have with their customers. In the last few years, some have also become a vocal "defender of the consumer," pushing back against excessive price increases from CPG companies and refusing to stock their branded goods.

CPG companies have become more accessible

In contrast, as engagement with consumers becomes more prized, CPG companies are using technology to reduce the distance and build a connection with consumers. Many have developed direct-to-consumer (D2C) business models — not only websites, but subscription models, social selling and pop-up stores — and continue to find new ways to influence prices, position their brands, manage the value chain and collect data.

Brands are not important in

48%

of purchase decisions, putting CPG companies at a disadvantage.

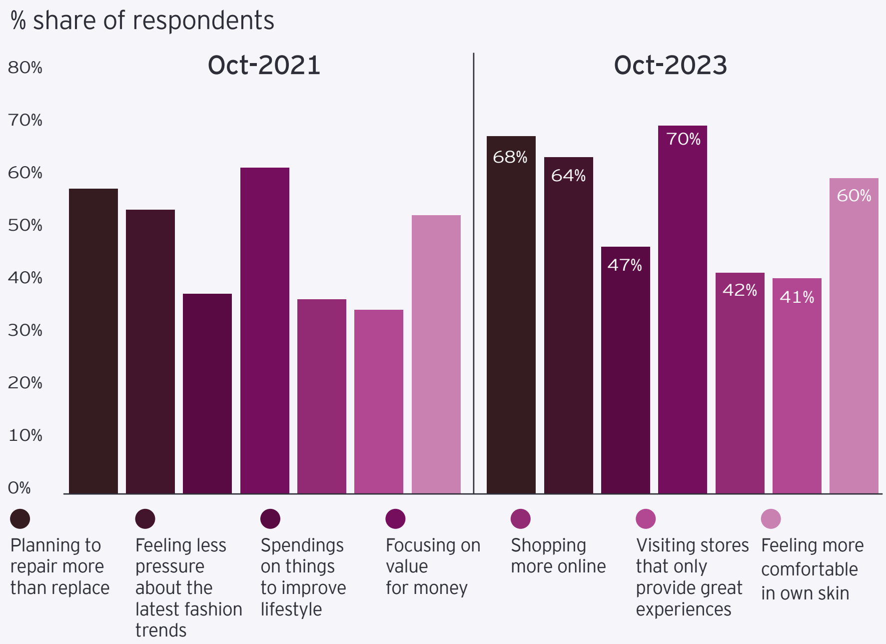
Source: EY Future Consumer Index, October 2023.

CPG companies have had to maintain production in the face of ongoing disruption, needing to cut costs and execute their growth strategies. They've focused on making supply chains more flexible and responsive, reviewing ingredients and recipes in an effort to reduce costs and be more sustainable, as well as reconsidering their pack sizes, product portfolios and packaging to expand margins. In search of maintaining sales volume, they continue to explore other physical channels beyond major grocery stores and supercenters, including convenience stores, value (discount/dollar stores) and members clubs, as well as trying to adapt to the growing power of larger retailers.

Consumers have become more demanding

At the same time, consumers are shopping very differently, with different goals and values in mind. They're much more price sensitive; they're buying less and thrifting more. Many are increasing their online shopping, organizing deliveries to home, and going in-store less. Increasingly, they're active across social channels for much of the day and more informed than ever about what they buy — whether that's what ingredients a company uses in its products, how it treats its employees or how big its carbon footprint is.

Consumer behaviors and values are changing significantly



Source: EY Future Consumer Index, October 2021 – October 2023.

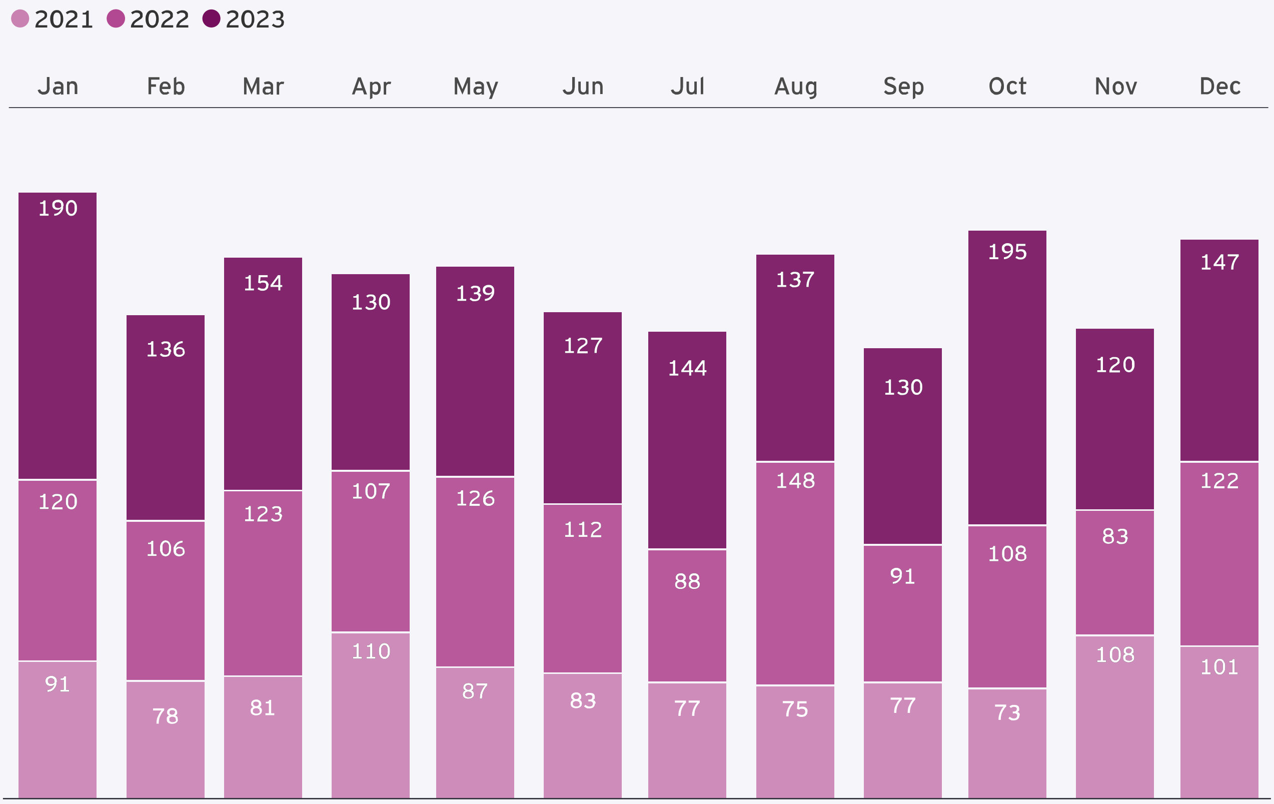
As retail and CPG change, pressure on their relationship is building

Shelf space is at a premium again

The EY Future Consumer Index shows that as their priorities and options change consumers are turning away from once-favored brands. Branded products now come in smaller pack sizes, say 74% of consumers (they've spotted shrinkflation). And 50% would switch to a new product if it offered better quality. They're more willing to try private label, with 41% having switched already. Brands are not important in 48% of purchase decisions, putting CPG companies at a disadvantage.

New power dynamics are certainly emerging. CPG companies and retailers now have a different kind of relationship with the consumer, and with each other. There used to be a simple linear chain: CPG companies manufactured brands; retailers sold them in their stores; consumers bought them. That's how it worked for decades. But with consumers focusing more on value and price, they're showing less interest in brands – apart from luxury goods – and more interest in what retailers themselves have to offer.

Total number of forum conversations mentioning preference for private label



Sources: Quid, Forums, Business Insights.

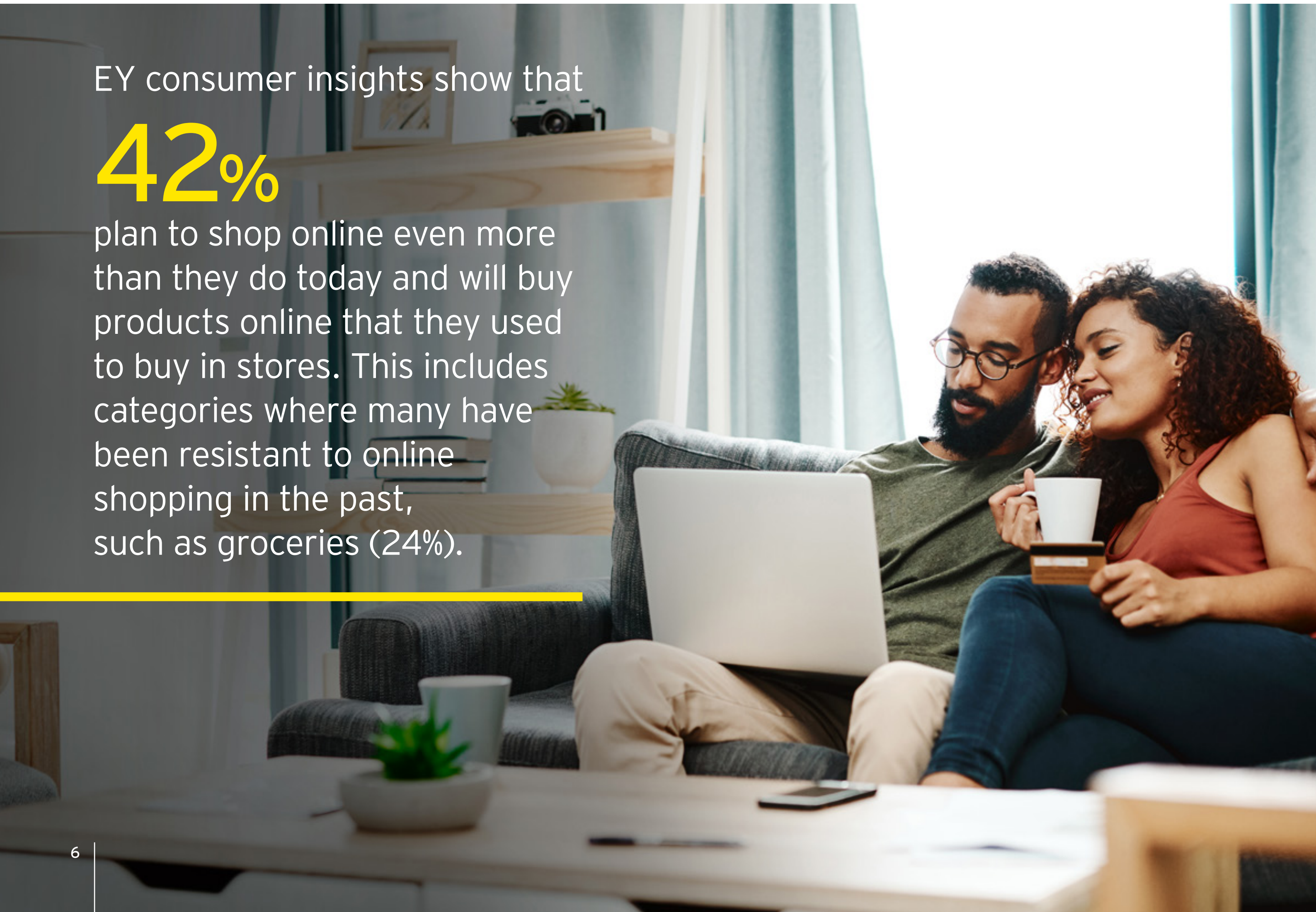
Shopping is fragmenting, making value elusive

While the power dynamic appears to be tilting toward the retailer in some aspects of the CPG relationship, they shouldn't celebrate too soon. In a world where marketplace and peer-to-peer platforms, subscription models, and social media are re-landscaping the shopping environment, consumers aren't just turning away from brands they used to trust; they're also losing interest in traditional shopping experiences.

But online shopping behaviors are fragmenting and becoming more complex too, with 29% of consumers now buying items direct from social media ads, which lessens the need for a physical presence. However, 38% buy items online then collect them in-store, which makes that presence critical.

While some retailers are enjoying a new sense of power, this acceleration of online shopping will challenge their margins and bring more complexity into their business model.

As the shopping experience expands across multiple channels, the challenge – or opportunity – for both CPG companies and retailers is to give consumers an experience they value, without the incremental cost of delivering that experience making it unprofitable. At the same time, they need to think beyond their traditional approach to metrics and KPIs – identifying ways to create value for the business that might generate no immediate revenue in the short term but is necessary for longer-term success, such as capturing first-party data and building consumer trust.



EY consumer insights show that

42%

plan to shop online even more than they do today and will buy products online that they used to buy in stores. This includes categories where many have been resistant to online shopping in the past, such as groceries (24%).

Controlling the product narrative is increasingly complex

In the past, CPG companies told us the good things about their products through TV advertising, in magazines, on billboards and so on, and we went out and bought them. There was little transparency on ingredients, carbon footprint or supply chain, and only a few ways to hear about it (all controlled by the company). Now selling products operates in a very different landscape – the breadth of information available, the plethora of influencers, reviews and forums, the opportunity to share delight and frustration; it all means consumers are a click away from accessing product messaging (good or bad) and making product choices. On hearing about a brand's inappropriate behavior, the EY Future Consumer Index reports, 32% of consumers decided not to buy its product and 26% told their friends and family not to use it.

There's a new level of complexity to be mindful of, understand, monitor and manage. CPG companies have had to adapt and invest to bring authenticity, purpose and transparency to their products in order to compete and stay relevant. They've needed to broaden their channels to market to maintain visibility and control of their brand message. In responding to changing customer expectations, they've had to invest in far more than product and mainstream advertising.

Now, there's much more to say about products but even less opportunity at the point of sale to share it. And margins are under pressure, reflecting the increased costs associated. Retailers find themselves suffering the same challenges with their own private label products but are better placed to connect with their customers at the point of sale.

Five opportunities for CPG companies and retailers to reset the relationship

In addressing their challenges, retailers and CPG companies have in many ways taken on parts of each other's traditional role with varying degrees of success. The change in relationship is unsettling, but the core goal of CPG companies and retailers remains true – to develop and sustain profitable relationships with consumers.

Ultimately, maintaining an understanding of the consumer remains critical. When actions benefit the consumer, the whole ecosystem reaps the rewards. And in such a mutually reliant ecosystem, success hinges on nurturing flexible, cooperative and innovative methods of thinking and operating – maximizing each other's talents and innovations to face the future. Here are five opportunities for better consumer-centricity and collaboration:

1 Working together to deliver multichannel experiences

With the many challenges that both CPG companies and retailers have to address, they must prioritize operating without friction across multiple channels and creating the distribution and logistics systems. They need to be able to make compelling offers to consumers wherever they are, in the moments that matter. And they also need to make their offers compelling to an algorithm, so the consumer is made aware of them.

This will take sustained investment in marketing and innovation from both parties. Retailers are rethinking the location, size, purpose and design of their stores, so they can maintain footfall while supporting e-commerce effectively. CPG companies are trying to carve out their share of online shopping by experimenting with direct to consumer (D2C) platforms. If they leverage one another's core strengths and take a combined strategic approach to these common challenges, addressing the investment needed together, it could pay dividends for them both.

2 Addressing value versus volume

In response to consumers becoming more price-sensitive, retailers have focused heavily on delivering value. However, this drive for value in retail appears to contradict a desire to drive volume in CPG. The EY Future Consumer Index shows that as price sensitivity is growing, consumers are buying less and trading down in search of value. With 55% only buying brands that are on promotion. This leads to the question of whether CPG companies are focused on the right metrics and measures of success if they are still pursuing volume. Both CPG companies and retailers have a shared interest in striking the balance between value and volume.

In an effort to achieve this there's scope to use AI-led solutions, such as revenue growth management, to customize and fine-tune portfolio, pricing, promotions and price/pack architecture right down to the store level.

3 Data innovation and insight sharing

Retailers have vast amounts of first-party data about what, where, when and how consumers make different purchase choices, which often determines a brand's future shelf space. But they have a limited view of the future consumer, where they are headed and what that looks like for their stores. In contrast, CPG companies tend to focus their insights on future product innovation or new product design, but these consumer insights tend to be very category-siloed, meaning product decision-makers don't have a view of how their products and categories are interacting with other categories and consumer buying behavior more broadly.

Working together and sharing their deep consumer insights, CPG and retail could deliver a much stronger understanding of consumer purchasing behaviors, enabling, for example, more effective analysis of trade promotions and create better-targeted consumer campaigns. Working together, they could create and execute more profitable business and promotion strategies, discover tactical opportunities through the year, and maximize return on investment.

4 Turning points of friction into drivers of value

There are many points of friction in the shopping experience; for example, in apparel, consumers have switched the changing room for their bedroom. They expect to return unwanted goods at no cost to themselves, and often engage in bracketing – buying items in multiple sizes, so they can send back what doesn't fit. For both retail and brands, returns have become a key point of friction, and in response to the associated costs, some sellers are experimenting with differentiated returns policies to reward and build customer loyalty. Some are accepting bracketing within defined limits and offering faster or free returns to regular customers who meet a minimum actual spend or who join their loyalty programs.

Others are innovating using artificial intelligence (AI) to help consumers make better buying choices from the start and deliver a better buying experience. The Index shows 59% of consumers trust AI-generated imagery to show them what a product would look like on them, 50% trust AI to take size measurements via their phone camera, and 56% are happy for AI to answer their questions about an item.

5 The AI opportunity

There are endless ways sellers can use AI to turn current points of friction into value drivers. The strategic use of AI is an increasingly important driver of growth and margin improvement. AI can help to anticipate future consumer needs before they arise, and it can help to constantly reassess and fine-tune the relationships with the other parties that are critical to success.

EY research[1] shows senior CPG executives are much more likely than their retail peers to see AI investment as an opportunity for front-end business transformation, for example around developing consumer touchpoints; retailers are more focused on AI as an optimization tool for their back-end operations to drive cost savings and efficiencies. CPG leaders are also more likely than their retail peers to believe AI will have a significant impact on revenue growth now and within the next two years.

What describes your organization's AI maturity?	CP leaders	Retailers
Transforming	47%	32%
Optimizing	30%	43%

But we expect these differing attitudes about the AI opportunity to come into alignment as AI becomes an essential part of a profitable and sustainable CPG and retail relationship. This will be increasingly critical as retailers and CPG companies anticipate additional costs in 2024 (63% of CP leaders and 58% of retailer leaders expect costs of inputs and cost of doing business to increase in 2024) and intend to pass these costs onto the consumer.

[1] CEO Outlook, January 2024.

Creating a collaborative mindset with the consumer in mind

The relationships between CPG, retail and consumers have changed primarily in response to the ongoing disruption of the past few years, but also because needs, expectations and values have changed too. The linear model we mentioned earlier is not a straight line anymore. CPG companies make products, but they also deliver and sell them to consumers; retailers sell and deliver products to consumers, but they also make them; consumers buy products, but they often personalize and co-create them with CPG companies.

In addition, the ecosystem has expanded, as shopping fragments across different places and platforms and consumers have more input into the products they buy – all of which creates challenges for CPG companies and retailers. This means it's more important than ever for retailers and CPG companies to stay close to their consumers. We see CPG companies still chasing volume, but when consumers aren't buying as much, are they focused on the right measures of success? The retailers who have survived the past few years have innovated and kept a laser focus on customer needs; those who didn't are no longer around.

In an ecosystem as interdependent as this one, success now is about fostering open, collaborative and agile ways of thinking and working – leveraging one another's strengths and innovations to approach the future in a position of strength. Ultimately, it's crucial to continue to understand the consumer. If you do the right thing for the consumer, the entire ecosystem wins.

Summary

Disruption and innovation have forced CPG and retail companies to rethink their businesses, while at the same time, consumers have been re-evaluating how they shop and what they really need.

The changes in the way CPG and retail work together could present the opportunity for a more radical rethink, not just of how they go to market, but how they measure success in a continually changing world.

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