PORTFOLIO OPTIMISATION

CRITICAL SUCCESS FACTORS

Case Studies The Coca-Cola Company Mondelēz International

SIMPLIFICATION INSTITUTE

FOREWORD

The pandemic has exposed the challenges associated with SKU proliferation and complex international supply chains. "Simplification and eradication of low volume SKUs is becoming a trend where FMCG companies are increasingly active. Reducing complexity declutters shelves, drives velocities, keeps retailers happy and boosts manufacturer margins." said Warren Ackerman, MD and Head of European Consumer Staples Research at Barclays Investment Bank in August [1].

SKU rationalisation has been elevated on the CEO's priority list. Effectively tackling complexity and simplifying ranges makes supply chains more efficient and improves product availability and customer service. At the same time delivering cost savings and margin improvements. Research shows that about 25-35% of cost in consumer goods companies is driven by complexity[2].

We believe that the key to successful simplification initiatives is in the execution and therefore we decided to share a deep dive in the approach of two industry-leading players and their approach to simplification in 2020. We take confidentiality of our clients very seriously, all information in this white paper is based on publicly available material and sources are referenced.

Jo De Pauw
Managing Director Simplification Institute

(1) Ackerman Warren. How FMCG companies are beating the low investor expectations of the Covid era. The Grocer. (2) Jagersma, Pieter. The hidden cost of doing business. Business Strategy Series. 9. Nyenrode University, The Netherlands.

CASE STUDY 1

The Coca-Cola Company

“We are shifting to prioritizing fewer but bigger and stronger brands across various consumer needs to aid the supply chain.”

James Quincey Chairman and CEO of The Coca-Cola Company

DISAPPOINTING RESULTS ANNOUNCED IN Q2 2020

As a global beverage leader, The Coca-Cola Company markets over 500 brands and 4,300 products in more than 200 countries. In addition to global leading brands such as Coca-Cola or Fanta, the portfolio includes smaller and often local brands such as AdeS, Ayataka, Costa, Dasani, Innocent, Minute Maid, Powerade, Vitaminwater and Zico.

Q2 2020 performance was a mixture of good news and not so good news with revenues down 28% to $7.15 billion for the quarter ending June 26.

Even though grocery sales were good and some leading brands were growing, the company was impacted by fountain sales which have very high margins and shutdowns around the world have knocked this business segment. About half of Coca-Cola's revenue is generated from away-from-home venues that were shut around the world during the second quarter because of the pandemic.

Rival PepsiCo Inc. posted flat revenue for the quarter ending June 13, as increased demand for its snacks and packaged foods largely offset a decline in beverage sales.

BRAND PORTFOLIO STRATEGY

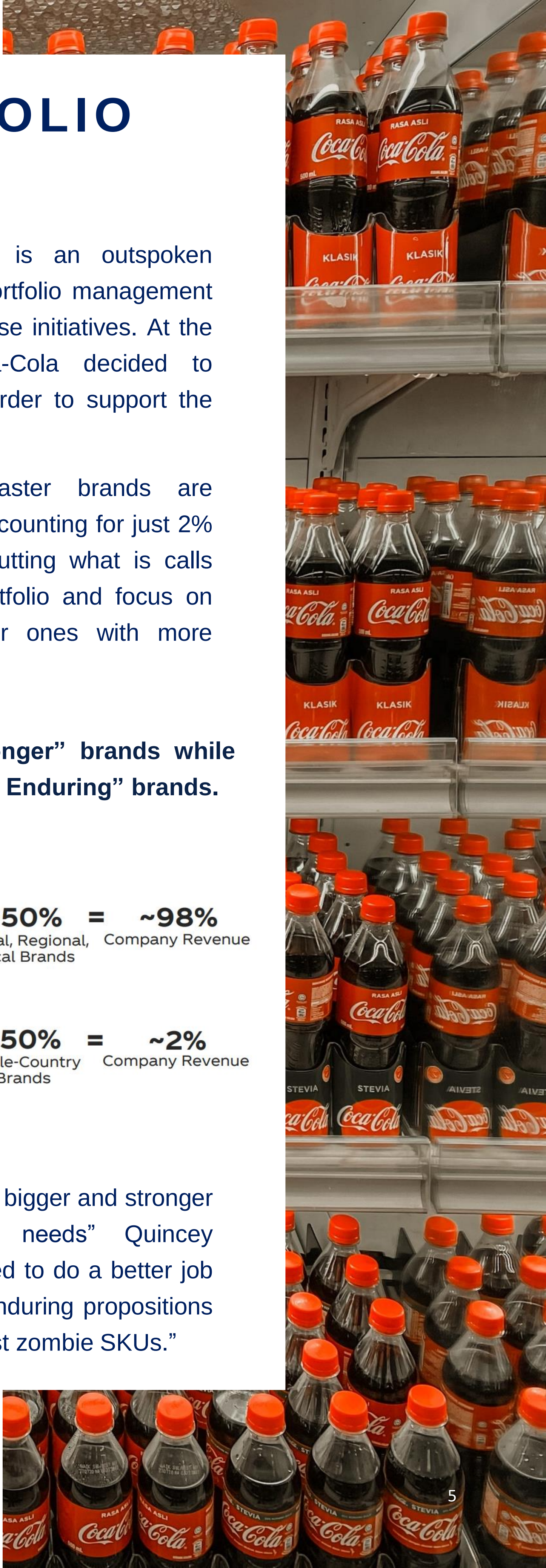
Coca-Cola's CEO James Quincey is an outspoken supporter of active brand and SKU portfolio management and the pandemic has accelerated these initiatives. At the beginning of the pandemic, Coca-Cola decided to "ruthlessly prioritize" core brands in order to support the supply chain.

Many of the company's 400 master brands are commercialised in only one country, accounting for just 2% of total revenue. Coca-Cola Co. is cutting what is calls "zombie brands" to streamline its portfolio and focus on more successful brands and smaller ones with more potential.

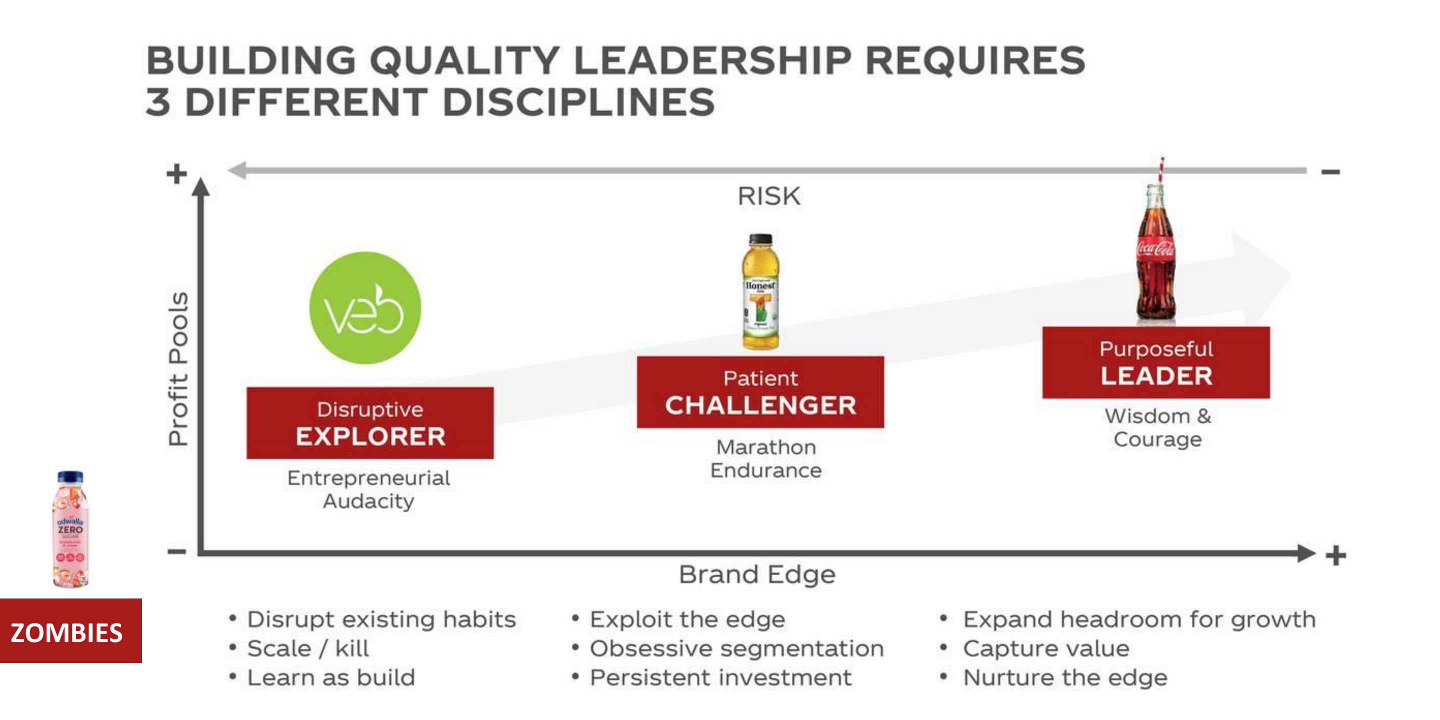
Prioritizing fewer "Bigger and Stronger" brands while doing a better job nurturing "Smaller Enduring" brands.

"We are shifting to prioritizing fewer but bigger and stronger brands across various consumer needs" Quincey announced. "At the same time, we need to do a better job nurturing and growing smaller, more enduring propositions and exiting some zombie brands not just zombie SKUs."

Source: The Coca-Cola Company. Second quarter 2020 Earnings Call.



Building quality brand leadership requires focusing on and activating three brand categories: Disruptive Explorers, Patient Challengers and Purposeful Leaders and the goal is to grow brands from Explorer, to Challenger, to ultimately the Leader in it’s category. On average, brands with Leadership status have margins 1.5 times greater than the nearest competitor and these brands are the biggest profit contributors.



The company has been quick to act, beginning with identifying those brands that add value and those that do not. Delistings started in July with the Odwalla juice brand removed from the US portfolio. “This gives us the flexibility to support our investments in brands like Minute Maid and Simply and to continue to scale rising stars like Topo Chico,” Quincey said in the July analyst call. Topo Chico is a brand of sparkling mineral water, a fast growing category.

Source: The Coca-Cola Company Growth Strategy. investors.coca-colacompany.com/strategy/growth-strategy.

TOWARDS A MORE DISCIPLINED INNOVATION MODEL

The company will also be sorting and lowering its efforts to innovate and instead establish a more disciplined framework as it goes on in a post-pandemic market. An analysis showed that the rate of innovation increased by ≈150% all along whilst increasing the tail of low performing SKUs.

The way forward for the Coca-Cola brand portfolio is characterised by a strong focus on scalable initiatives with a defined set of success criteria:

- Lead with global big bets;

- Support with regional plays;

- Only critical local projects

In conclusion, as Coca-Cola amplifies its focus on what consumers want and focuses more on the brands in demand, it would ultimately streamline the investments and thus boost stronger brands. This, in turn, is expected to generate more revenue.

Source: The Coca-Cola Company. KO Organizational Refresh Guide. September 2020.

INNOVATION MUST DELIVER ONE OF THREE OBJECTIVES

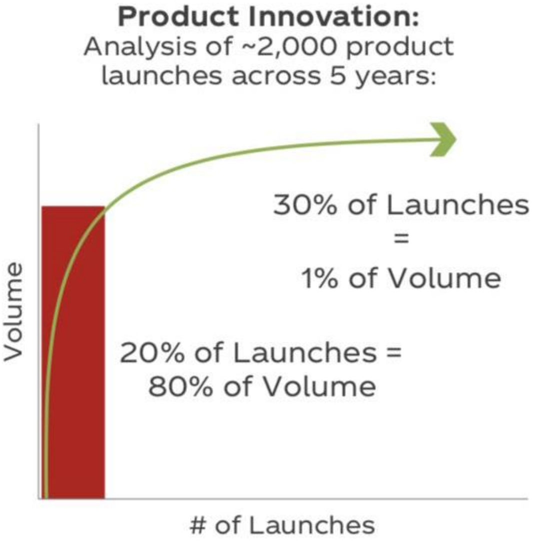
1. Significantly increase new drinkers (weekly+)
2. Significantly increase the frequency of existing drinkers
3. Significantly increase the value of each existing transaction (if no additional drinkers / frequency)

KILLING ZOMBIES

A key component of Coca-Cola's growth strategy is a process called "killing zombies", a quarterly curation which analyses what's working and what's not working with the objective of identifying and eliminating underperforming products, referred to as "zombies," to make room for newer products.

When a product is launched into a category, it has to be growing faster than the category because otherwise, the launch will never be on track to leadership. There are plenty of tiny brands and SKUs in the Coke system which have a very low share and are growing slower than the category. These products consume management time and resources and don't have any long term potential, they are dead but not actually dead, hence the name zombies.

Coke analysed about 2,000 beverage product launches over the past five years and found that the bottom 30% of launches contributed only 1% in volume. Conversely, the top 20% of launches delivered 80% of volume. This analysis helped to identify more than 700 zombie products eliminated in 2018, more than 600 in 2019 with the pace further accelerating in the first half of 2020.



The company developed a playbook to help major markets identify and kill zombies using a streamlined and disciplined process. Typically, zombies are defined as products or pack formats that despite best intentions and efforts have not grown over a three-year period.

The initiative is driven from the top with CEO James Quincey consistently requesting "zombie reviews" as part of overall business reviews in each priority geography. In addition, Quincey highlights the portfolio efforts during the financial results calls, in the July call he said that "it is critical to reduce complexity to ensure the sales force is focused, the supply chain is efficient and the innovation pipeline gains more space and visibility at the point of sale. To that end, we've been identifying and killing zombie brands and SKUs while focusing our teams on the work that matters most".

"We have not historically been good at getting rid of these things. We've made some great progress in parts of the world… but we haven't done as good a job as we should have done on finishing off the zombies and recycling the money and the resources into the business."

Source: Success. Failure & Zombie Hunting. Francisco Crespo. The Coca-Cola Company. www.coca-colacompany.com/news/success-failure-and-zombie-hunting.

> *Zombie-infested organizations often say, 'there is no harm in keeping this product'. The reality is that the unseen costs of zombies actually harm an organization. Imagine the costs related to material management and procurement, production, inventory costs, distribution, salesperson time and, most of all, the opportunity cost of putting a better product in its place.*
>
> Francisco Crespo, Chief Growth Officer TCCC

CASE STUDY 2

Mondelēz International

"Your supply chain costs go down because of longer runs, less changeover, less inventory, less waste, and it also has a big benefit on your cash."

Dirk Van de Put CEO and Chairman Mondelēz International

STRONG PERFORMANCE IN H1 2020 FOR MONDELĒZ

Mondelēz International is the global snacking leader. The $26b business has been resilient during the pandemic with Q2 revenue growth of +0.7% and +3.7% for the first half. The combination of the strength of its brands and superior execution helped the company to drive unprecedented market share gains during the pandemic.

The company sees consumers turning to brands and products they trust. “We have many of these trusted brands around the world. Within our category, there is also a shift to segments that are better fit for at-home consumption. So we are stronger in these segments like tablets versus pralines or bars in chocolate. And our supply chain has kept functioning quite well throughout a shortage of labour or lockdowns providing us with a competitive advantage.”

Approximately 90% of the manufacturing plants are running in line or above historical performance. Due to ongoing momentum combined with overall cost savings and the market share momentum, the company announced increased brand building investments for H2.

GLOBAL BRANDS
~44% OF NET REVENUES
9 GLOBAL LEADERS

LOCAL JEWELS
~47% OF NET REVENUES
60+ LOCAL JEWELS

Source: Mondelēz International. Leading the Future of Snacking. July 2020.

THE PLAN TO ELIMINATE 1 OF EVERY 4 PRODUCTS

During the pandemic the company was already forced to work with a smaller number of SKUs in order to make sure that the core SKUs were available on the shelf. Seeing the fact that the consumer is driven more to its core offerings, and retailers request great customer service levels and cleaner shelves, the stars seem to have lined up for a large-scale simplification initiative.

The company leadership decided 2020 is an ideal moment to simplify both the SKU portfolio and the innovation pipeline in order to focus on value-driving core assortment. In July the company announced a 25% reduction of SKUs which will simplify the supply chain, reduce cost basis and inventories and increase sales and customer service levels.

Mondelēz produces thousands of SKUs, and every year, thousands of innovation projects are added to its global innovation pipeline. Dirk Van de Put, the company's CEO, described the current momentum as "an opportunity for a long-overdue overhaul of the system by which new SKUs are created at Mondelēz".

Source: Mondelēz International, Inc. 2020 Q2 Results Earnings Call Presentation.

The company leadership was looking for a reason to break this chain because they believe there is a much better way to do this. Van de Put stated that “We have an opportunity to simplify our business and in my experience in many other consumer goods companies is that in general, what has happened over the years is that people are chasing growth. And as a consequence, they keep on launching new products. And that gives you a short-term benefit. But at a certain stage, you need to clean that up. You need to look at your SKUs. You need to take a look at your innovation pipeline, and sometimes also at your brands and say, can this be simpler?”

Revenue Growth Management remains an important focus area and the company confirmed that it will continue to roll out the planned price pack architecture launches and channel specific sizes and formats. The announced 25% SKU reduction is net of innovation and new pack sizes but it will not happen in one go, the delisted SKUs and new launches will be gradually phased in and out over the following quarters.

25% SKU REDUCTION

OBJECTIVES

1. Simplify the supply chain
2. Reduce cost basis
3. Reduce inventories
4. Increase sales
5. Improve customer service level

LOWER COSTS & HIGHER REVENUE

In addition to hanging onto market share, executives expect to see cost savings and productivity gains begin to accrue in Q3 and offset the increased costs of operating amidst a pandemic in Q4. Even though the 25% of SKUs to be reduced only represent 2% of revenue, the initiative will not be easy internally.

As a consumer goods veteran, Dirk Van de Put worked in leadership roles with Coca-Cola, Mars, Novartis, Danone, and McCain Foods before joining Mondelēz. “It's always a big discussion because the teams feel uncomfortable doing it," he said. “Although if you maintain the same shelf space, and I've done it several times in my career, what you will see is that not only do your sales increase because now the best selling items get more space. Your supply chain costs go down because of longer runs, less changeovers, less inventory, less waste, and it also has a big benefit on your cash. So it's a good exercise to do.”

Asked about the anticipated impact of the initiative, Van de Put commented “Our sales are better, the shelf looks cleaner, and we get some benefits from it. So we're kind of pushing through using the opportunity to say, this is the moment we do it. And I think we will see no effect from taking them out. We will have a much cleaner SKU portfolio, a much cleaner innovation portfolio, and hopefully, we can also clean up a few brands, so that we're lean as a company at the end of this”.

Source: Mondelēz International. Earnings Call Q2 2020. 28th July 2020.

CRITICAL SUCCESS FACTORS

LEADERSHIP ENDORSEMENT

Successful portfolio optimisation programs are driven from the top, with the CEO and leaderships team actively involved in the decision making and publicly endorsing the initiative.

CROSS-FUNCTIONAL EFFORT

Complexity is a business problem that crosses organisational boundaries which is why it is often owned by everyone and no one. To effectively reduce complexity, a company needs to strike the right balance between customer needs and the cost of complexity and this can only happen if several functions are actively involved.

COMPLEXITY COSTING

A typical P&L does not accurately reflect the cost of a proliferating SKU portfolio because the data on the true cost of additional features or variations is not easily visible. When eliminating complexity, approximate the true cost of complexity on SKU level to help decision making and reduce risk.

EXECUTION FOCUS

A good plan, violently executed now is better than a perfect plan tomorrow. Use rapid diagnostic to identify the major drivers of complexity and build an end-to-end plan to transform your SKU portfolio.

NEED SOME HELP GETTING STARTED?

Simplification Institute™ is Europe's first complexity management firm specialised in Consumer Goods with a proven track record of successful delivery. Get in touch with one of our experts www.simplification.eu

WHAT SETS US APART

Simplification Institute™ is a complexity management firm specialised in consumer goods. The firm is built on the core belief that simplicity drives value. Our proprietary approach, the Simplification Roadmap™ has delivered major efficiencies and multi-million-euro savings. Our clients include leading Fortune 500 corporations and medium-sized local companies.

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