Is your capital allocation strategy driving or diminishing shareholder returns?

Spotlight on the consumer industry

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Consumer product companies face a complex and ever shifting landscape, fraught with significant penalties for missing emerging consumer trends. Every day, they consider their portfolios as they judge whether finite capital should be invested in existing power brands or newer ideas. Layered on top of this is the continual need to improve processes and cut costs to remain price competitive. When these initiatives falter or bad decisions are made, pressure from investors and activists can be intense. Activists can appear who seek to increase the return to equity holders or even break up the company.

69%

of consumer CFOs say there are parts of their capital allocation process that could be more efficient and effective

The best of these companies are rethinking the processes they use to make informed capital decisions. They have become more nimble and use significant analytics in their decision-making. This has allowed them to think more creatively and see more success when considering an emerging trend, a new geography or even a technology that is synergistic to their existing portfolio.

Not all consumer companies are there however. EY recently conducted a survey of 536 CFOs across sectors, including 109 from the consumer industry. The vast majority of consumer CFOs (69%) say their capital allocation process is only "somewhat successful." The responses also suggested ways that consumer products manufacturers may be able to improve their capital allocation process.

Consider alternatives to current strategies

The best consumer companies have evolved their capital allocation programs to reflect the changing world. As an example, companies are being more thoughtful about the balance between investing for the future versus returning capital immediately to shareholders. For many years, consumer companies have focused on returning some portion of capital to shareholders through dividends and/or share repurchases. Although these programs can certainly make sense, the prevalence and significance of these programs are higher than other industries that are more focused on top line growth such as technology or life sciences.

34%

say their primary motivation for buying back shares is increasing earnings per share (EPS)

47%

say consistent processes are always followed and capital allocation decisions are free from bias and politics

66%

of those with a formal capital allocation process say it is linked with their strategic plan

91%

say their company has the ability to fund all projects that meet approval criteria

Improved decisions with better data and analytics

One of the challenges that consumer companies face is the complex and ever-changing landscape of customers. As a result, the data necessary to make informed capital allocation decisions – or the tools and expertise for analyzing and understanding that data – can be a barrier for consumer companies. This is in fact a notion we see in the survey: insufficient data is seen as the biggest obstacle to optimal capital allocation, with 45% of consumer CFOs naming this as the primary impediment.

This may seem counterintuitive as consumer companies, unlike those in many other industries, have always been known to having access to lots of data on their operations and external information such as POS data. However, much of the data is backward looking and is not as helpful when trying to figure out what consumers may want in the future.

Consumer companies need to move past metrics such as historical sales growth on the existing portfolio and instead use information and analytics to identify new areas where growth is just beginning to bubble up. Best in class companies are using demographic, geospacial, social media and survey data, as well as in-depth consumer interviews that can spotlight the most promising future trends.

Chobani is an example of a company taking steps along this line. It has brought areas including product innovation, commercial marketing, e-commerce, demand finance and others together in one demand department, erasing a siloed structure that Chief Marketing and Commercial Officer Peter McGuinness called "an impediment to our growth" in a 2017 interview with AdAge.

Unilever is another company that has invested in systems to gather and process different types of data and to make sure the data is available to the people who need to use it to make capital allocation decisions. At a 2019 industry conference, the company said it pulls 150 different internal and external data sources into its cloud-based system, helping it better understand its consumers and reach them in a targeted way, while also using the data to inform supply chain and operations decisions.

Many of the best consumer companies recognize that investing capital in building data processes leads to better capital allocation decisions, which in turn leads to better returns and more capital that can be invested in the business.

Focus on long-term strategy

It is not all difficulties for consumer companies when it comes to capital allocation programs. In some areas they appear to be ahead of their peers. For example, they tend to be better at making unbiased decisions, aligning capital allocation goals with long-term strategy, and having the ability to fund projects that meet investment approval criteria.

Almost half (47%) of consumer company CFOs say consistent processes are always followed and capital allocation decisions are free from bias and politics, compared with 40% overall.

Meanwhile, 66% of consumer CFOs whose companies have a formal capital allocation process say it is directly linked to the overall strategic plan, compared with 63% overall . At the same time, the vast majority (91%) say they are typically able to fund all investment opportunities that meet approval criteria, compared with 84% overall. This enhanced ability to fund investments may also be the reason why consumer companies are also more likely to return capital through dividends or share repurchase programs. The real question, however, is whether there are more areas of potential investment that would be apparent with better data and analytics.

Conclusion

Consumer companies can feel stymied in terms of where to invest capital effectively due to lack of perceived viable opportunities which in turn can lead to lowered shareholder return. Improving the capital allocation process can help them make unbiased investment and divestment decisions that can enable a company to meet what consumers want today and tomorrow. In order to do this, they need better tools and analytics and more forward-looking data to make decisions. The best consumer companies are implementing these processes into their capital allocation programs in order to be better positioned for the demands of the future consumer.

The recent EY Capital Allocation paper, *Is your capital allocation strategy driving or diminishing shareholder returns?* poses three questions CEOs and CFOs need to be able to answer:

1. Can we react quickly enough to opportunities and threats?
2. Are we making objective, unbiased decisions?
3. Are we returning cash to shareholders at the right time, and in the right way?

This sector spotlight article examines capital allocation challenges and opportunities in the consumer industry. Other articles examine capital allocation in advanced manufacturing, life sciences and technology.

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