

How to Survive the Coming Shakeout in the Nutrition Products Industry

It feels almost as good as running an internet service firm. Just make sure a few key words are in the business plan, like e-commerce or nutrition products, and the world beats a path to your door. In the case of nutraceuticals, compound annual growth in the U.S. exceeds 12%, compared with 1-3 % for the overall food business. But watch out: the heady growth, strong profits and the big party in nutrition and nutraceuticals may only continue for those with a serious business focus combined with great execution. Too many companies will struggle in the next five years because the owners or managers failed to realize the need for change and failed to begin implementing strategic planning as an enabler of change.

Nearly 2,000 manufacturers and distributors compete for the consumer's affection in the \$23 billion nutraceuticals industry, according to Nutrition Business Journal. Although only a specialized fraction of the \$400 billion + U.S. food industry, many nutrition segments are much less consolidated than one would find in other industries. The top 3 natural products retailers have only a 25% market share, while the top 4 drugstore chains command over 70% of drug retailing. Similarly, over 11 dietary supplement companies are required to reach half of that market, while in more mainstream categories, two disposable diaper companies own 70% of the market, and three cereal companies corral over 65% of U.S. sales. Other recent non-food consolidation examples include banking, telecommunications, computer operating systems, airlines, etc.

"Competition is getting much tougher for the small company," mused Mike Chase, managing partner for Health Business Partners, a Warwick, Rhode Island investment bank and venture capital fund for this industry. He went on to explain that the competitive environment is changing quickly: increasingly larger retailers and distributors are placing bigger demands for service on the niche manufacturer. In addition, peer manufacturing companies now include Bayer, American Home Products and others who have immense marketing budgets. This combination of factors will make it difficult for a small "generalist" company to succeed.

Fast-growing companies have one choice for success and one for failure. To succeed they must understand and pay fierce attention to their specific market niche and execute with perfection. Success here allows continued independence, growth and potential acquisition, or it may be allow the company to sell to the appropriate suitor at the highest possible multiple. The road to failure includes trying to attempt too many things at once, do nothing particularly well, or capitulate a market niche to others. In other words, not having a plan and not executing well. Large nutrition companies or divisions face the same fate: without a strategic focus, they risk market demand shifting away from them, or perhaps more dangerous, the risk of management's support shifting to other company priorities.

Strategic planning can be a pejorative term in business, as too often strategic planning may used as a substitute for action or real change. To the Greeks, strategos was the term for "general" or the practice of arranging the forces before the battle began. There is no single definition of strategic planning in the nutraceuticals business, but most would agree it includes a market focus, an understanding of internal capabilities, the firm's goals and careful cross-functional coordination.

Dozens of strategic planning models exist today, and it may be difficult to determine the quality of one compared to another. Strategic planning is like exercise, however: it is more productive to start the process and stick to it than it is to try to optimize at the beginning. Successful large firms such as Sony, FedEx and Home Depot have incorporated planning into their culture, their language and communications and their view of the market, so companies new to the process need to give it time for adaptation.

A simple how-to model of strategic planning is shown below that is flexible and expandable. It can act as a starting point for the small high-growth nutraceutical company all the way to the large nutraceutical division of a multinational firm. Flawless execution of a clear strategic plan may be the most effective path to market success.

Mission: Impossible?

The mission, or statement of purpose, acts as a cultural glue to allow various departments and functions to work independently while still providing their fair share of the overall corporate goal. It can be as helpful to identify what the company is not as it is to define what the company is providing to the market. Most executives have been participants in this type of exercise, often yielding some of the longest sentences and poorest grammar found in business today.

In our strategy work with nutrition companies, we like to test the initial mission claim to see if it applies specifically to the firm. One client developed: "to provide value-added nutritional products to consumers worldwide while making a fair return for our shareholders". After realizing this statement would work equally well for each of the 2,000 nutraceutical firms in the U.S., a more focused statement was penned to help form the basis for market differentiation.

Mission statements can also be more useful if they are created after the management team has reviewed and assessed both the external market and the firm's internal limitations. By first developing a common understanding of consumers and markets, it is easier and more effective to discuss how the company can excel in that environment.

The financial results of two nutritional supplement companies, Leiner Health Products and Solgar Vitamins may help illustrate the value of vision and focus. Leiner, the largest North American dietary supplement manufacturer, prides itself on marketing a broad portfolio of mostly private label retail supplements as well as a moderately successful broadline brand business. Leiner is simply everywhere with nearly every imaginable product. Yet Leiner's earnings have been limited in the last few years and management has yet to consummate its desired initial public offering despite its revenue strength. Conversely, Solgar has narrowly focused on providing the highest possible product quality primarily in one sales channel: natural foods. Solgar was snapped up last year by American Home Products at a price nearly three times annual sales! AHP was clearly convinced of Solgar's brand equity and earnings potential (i.e. focus) despite its limited size.

No Idle Threats

Philip Kotler defines a threat as "a challenge posed by an unfavorable trend or development in the environment that would lead, in the absence of purposeful marketing action, to the erosion of the company's position". Too often, companies minimize the notion of erosion, preferring to look for landslides or major catastrophic events that would seriously injure the company. Kellogg's, for example, has steadily lost market share in the cold cereal aisle in the late '90's, believing that continuing the same product development and promotional processes would succeed as in the past. Nimble competitors, meanwhile, introduced low-cost bagged cereals, co-opted to private label production or developed truly innovative niche products at high margins.

Threats can be uncovered by projecting current business issues into the future. What happens if our best customers continue to consolidate and place entirely new service requirements on us such as requiring consignment-only sales? Is there a technological barrier to be broken that will recalculate the economics of our product or service niche? (the surging adaptation of e-commerce is one example threatening catalog companies, for example). Quantitative analysis can be used to estimate the seriousness of impact if a threat happens multiplied by the likelihood of occurrence. Scenario planning can be used to create preventative or defensive action plans to be brought out later as "jumper cables" should the threats emerge.

Opportunities are the opposite of threats. A slight modification of Kotler's definition looks for environmental areas that if seized, serve to enhance the company's position. Like threats, they must be scrutinized as broadly as possible because many emerging practices and market segments are not well organized. Nutritional ingredient development, like drug discovery, is loaded with potential opportunity. Much of the potential may not be proprietary, however. One client proudly recites its composition patent for a nutritional ingredient affecting joint pain and arthritic conditions. They had yet to fully understand the number of substitute products already in the market for this condition, including physical therapy, prescription drugs, other nutritional supplements, magnets, etc. After management spent time on defining the broader market, they were better positioned to create and explain their market niche and value.

My Weaknesses are Strengthening

What is unique to your company that brings special value to the supply chain? Are you a "product development machine"? Do you "own the distribution channel" where you can bring a constant flow of new products? Understanding the firm's internal strengths and weaknesses is sometimes the easiest part of strategic planning. Every employee and customer can offer an opinion on what the company needs to do better. Some detective work can flesh out key issues so that they can be put in context of the marketplace. Look at recent market wins: why was the firm's product or service chosen over the competition? The answer may provide clues about strengths. Examples may include superior customer service, knowledgeable salespeople, most scientifically valid research, best equipped financially to support a customer's growth, etc.

A thorough business review will also create a good understanding of company strengths and weaknesses. By understanding performance by product line, customer groups, products, channels and the profitability of each, the company can determine what internal actions led to these results.

The strategic action plan will hinge on the company's strengths. Sometimes, those strengths are not relevant to the target market. "Small enough to respond to our customers' unique needs" may help a food ingredient company win the Kashi cereal account, but may be perceived as negative when negotiating a contract with Quaker Oats, for example. Some firms make too many

assumptions about their strengths: some of our new clients make claims like "we already know what we're good at"; or "just launch the product, the market is hot!". Even if management "knows" the company's key strengths, they may not be well understood or internalized within the organization, due to turnover, lack of communication or other issues.

Weaknesses can sometimes be strengths carried to extremes. A well-known Fortune 500 food company is renowned for analysis and fact-based decision making. No one knows the market and consumer quantitatively like this company. However, they are totally incapable of serious product innovation, and have been unable to create a truly new product out of all the significant new product research effort expended each year.

A "balance sheet analysis" of these strengths and weaknesses can help pinpoint the company's differential advantage in the market. AMBI, a diversified nutritional products company, realized it wasn't set up properly to conduct biotech research, its original mission. After shedding these business units, it refocused on delivering proprietary nutrition products, but primarily those products that could be sold direct to the consumer. AMBI understood that a unique infrastructure and significant overhead is required to nurture and support mass retail brands. What retail business it does have is licensed through alliances with companies who already have the overhead to support that channel, such as American Home Products/Whitehall.

Can I Show You My Portfolio?

A review of each individual business unit can now be made after understanding the external opportunities and the company's internal strengths. Again, analytical methods are often used here to chart the company's offerings in the context of market interest. A quadrant analysis is popular where market growth appears on one axis and market share on the other. Each business unit is plotted on the quadrant with a bubble; the larger the business, the larger the bubble. The four quadrants are labeled "Stars", "Dogs", "Cash Cows" and "Problem Children" or some similar metaphors. The portfolio is used to help make investment decisions for each business. If a major product line is in shrinking market, there is less to gain by increased investment in that product vs. other more promising ones.

In the book "The Discipline of Market Leaders", Michael Tracy encourages companies to discover and define their value proposition, or to "provide the best offering in the marketplace by excelling in a specific dimension of value." He outlines three major value dimensions: operational excellence, product leadership and customer intimacy. Great companies do well in all three, but hang their hat (differentiate) on one specifically, while getting even better every year on that core competency. These market leaders develop an operating model or "machine" around this central focus. WalMart's distribution processes, Disney's movie products and Nordstrom's legendary customer service are a few examples.

It is just this kind of focus that not only allows companies to do well, but also makes growth and acquisition much more straightforward. Imagine you are a food ingredient company with a well-oiled operating machine that gets products to all the key food producers. A simple strategy would be to acquire ingredient innovators with no expertise or market clout in getting their innovations distributed. Similarly, Starbucks knew its next sales frontier was distribution to grocery stores. After some initial test markets, it delegated the entire sales and merchandising effort to Kraft-General Foods' pre-existing sales force, which was already selling Maxwell House coffee!

I Object!

Objective setting is the logical connection between the mission and the understanding of the internal and external situation. Now that we know who we are, what we're up against and what we stand for, what are we going to do about it? Objectives, be they strategic or tactical, share certain qualities to make them useful for management. They must be specific so they can be communicated throughout the organization without misunderstanding. They must be measurable in a way that relates to the overall strategy. Customer service, for example, could be measured by ontime shipments or it could be better measured by ontime deliveries, which are more meaningful to the customer. Achievability is also key, particularly when management needs to implement significant change. Achieving large organization cultural change involves many steps over many years. Finally, objectives must be consistent with both the overall mission and over time. How well the company manages its objectives will dictate successful strategy implementation.

Alternatives In Action

Understanding strategic alternatives is the checkpoint that recognizes strategies can be accomplished a number of ways. One of our clients wanted to expand its pharmaceutical delivery system dominance into new supplement market segments who had yet to embrace their systems. The leadership objective could be achieved a number of ways: 1) they could simply discount and promote their products vs. other forms; 2) they could research and develop breakthrough scientific methods that would provide product superiority; or 3) they might acquire competitors in that segment. Each alternative would have led to major differences in objectives and resources required to support the strategy. After reviewing the market and their internal competencies, they

determined that product innovation was the best fit to their capabilities.

Let's Review

Some experts estimate that up to 3/4 of corporate strategic plans are never fully implemented. The ongoing review of progress vs. plan is absolutely critical to market success and organizational change. We all know this as fact but it remains difficult to get done. This culture of accountability needs to permeate the management organization. What are the ways the review process can be successful?

- Develop simple, prioritized objectives and identify, by name, "owners" of the objectives;
- Regularly measure the marketplace in ways that connect achieving objectives with in-market success. Reducing promotional expenses could be measured by decreasing the percent of sales on deal as measured by IRI data in the mass retail channel, for example;
- Incorporate objectives into compensation plans. One client in a high-capital industry wanted to increase sales and profits without increasing its production asset base. Sales managers' compensation was changed from being measured on unit sales to being measured on gross margin dollars. The product mix quickly shifted to better-grossing lines!
- Be willing to change and modify objectives as the market shifts or new information comes in.

High-growth nutraceutical companies still have time to shape their own destiny in a booming market, but it will require deliberate and strategic planning.