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Talking Points: Adapting to the Ever-changing Consumer Environment

Reporting on Rabobank's Food & Agribusiness Summit

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Summary

At Rabobank's recent Food & Agribusiness Summit in New York, my colleague Tom Bailey and I ran a session entitled, "Adapting to the Ever-changing Consumer Environment," digging into some of the topical trends of the last twelve months and to what extent they will continue to play out in the new year. Looking back over all the developments of this year, or indeed the three years since the start of the Covid pandemic, it could be easily argued that "ever-changing" is just a polite way of saying "permacrisis," the Collins Dictionary Word of the Year recently described as "the feeling of living through a period of war, inflation, and political instability" – a meaning familiar to all of us. But let's get back to the session, where we covered a lot of ground. Here are some of the highlights from three questions that generated the most discussion:

1) Inflation: Has It Finally Peaked?

2) Plant-based Sales Are Vegetating – What Is Going Wrong?

3) Will "Climate-friendly" Products Be the Next Big Trend in Food?

1) Inflation: Has It Finally Peaked?

Tom, together with many of our colleagues, has been talking inflation all year, both the impact on companies and on consumers. In 2022, it has been front of mind for everyone, or as Tom put it, "We are all seeing and feeling it." (Listen to this Consumer Foods-to-Go podcast for a fuller discussion on the causes of inflation.) According to my colleagues' estimates, food companies on average have seen their direct costs, cost of goods (such as food ingredients), staffing costs, and energy expenditures grow by 12% in 2022, the largest increase this century. Similarly, consumers have had to adjust to higher food prices, which (fingers crossed) peaked in August at 11.4% YOY – a level the US has not experienced since the 1980s. Although overall food price inflation has eased slightly since then to 10.6% in November, some food groups continue to rise, most notably egg prices, which are 49% higher compared to a year earlier.

The million-dollar question debated at the session was of course, "When will inflation end?" As we begin to lap the initial highs of last year, many felt that the worst is probably behind us on the CPI front. The decline from the summer highs and the November CPI of 7.1% have subsequently endorsed this. But it is not over. For food companies and the wider food industry, the challenge of high input prices remains and will persist into 2023. Take the animal protein industry, where my colleagues anticipate that input cost pressures, such as higher energy, fertilizer, and labor costs, are not expected to ease substantively in 2023.

Another area of discussion centered around the resilience of consumers who, despite high inflation, declining real wages, and falling confidence in the economy's outlook, have continued to "spend robustly." The US Census Bureau's data consistently reports that retail sales remain strong. The advanced monthly sales report for October put grocery store sales up 8% over the past year and restaurants (foodservices and drinking places) up 14%.

This is in line with what the large food and beverage companies have been reporting. Many have been pleasantly surprised by how well demand has held up, certainly beyond expectations despite multiple price rounds. Yes, volumes are down, but not by as much as expected or witnessed in past downturns. Consequently, year-on-year sales among the larger players have remained elevated, at about 12% higher on average (and about 8% over the past two years), even if that hasn't translated to the bottom line because of higher input costs. A number of reasons were suggested by the group as to why consumers have seemed willing to pay these higher prices to date. These included:

• **Everything is going up.** Yes, food prices are rising, but so are most of life's other essentials, including utility bills and rent.

• **Unemployment is low.** Consumer spending is buoyed by a tight labor market, where unemployment is less than 4%, coupled with elevated bank balances relative to pre-pandemic levels.

• **Brand loyalty is higher.** Consumers have developed a stronger attachment to their favorite brands during the pandemic, suggesting they are willing to continue paying more for them to help sustain a feeling of normalcy during such an unsettling time.

• **Consumers suffer from money illusion.** Even though nominal wages are rising at faster-than-historical rates at about 5%, in real terms, with double-digit inflation, they are declining. But consumers may not be thinking in real terms.

One final point here. We may now be at or fast approaching an inflection point. In a recent Rabobank note, exclusive spending data from Earnest Research confirms that consumers are reining in spending at grocery stores and restaurants, with a greater focus on value shopping, as evidenced by increased visits to grocery discounters and warehouse clubs. This suggest that the ability of food companies to continue to pass on costs to the consumer will diminish in 2023, despite the investments they have made in their brands, especially as supermarkets begin to pay more attention to their private label offerings, an area that was pretty dormant during the pandemic.

2) Plant-based Sales Are Vegetating – What Is Going Wrong?

The changing fortunes of the plant-based food market, particularly alternative meats, in the US was another topic discussed. Consider the following market developments:

• **Sales down.** The volume of plant-based meat sales has been in decline for the past twenty-two months. After double-digit growth during the pandemic, the demand for alternative meat hit a wall in the US in 2021, with 0% growth and little improvement this year suggesting consumers have lost interest for now. According to IRI data quoted by FoodNavigator-USA, year-on-year sales of frozen and refrigerated meat alternatives for November 2022 were down about 4% in value and 11% in volume. Contrast that to the wider inflation-fueled food and beverage market, where sales were up 10% and unit volumes down 3%

• **Stocks down.** The share price of several listed companies, such as Beyond Meat, Oatly, and Tattooed Chef, are down by about four-fifths this year (compared to the S&P being down one-fifth), with accompanying job cuts and restructuring.

• **Second thoughts.** Many of the major animal protein companies had a change of heart on their plant-based portfolios this year. For example, JBS closed Planterra Foods, its plant-based meat division in the US, and Maple Leaf Foods cut its plant-based foods division by one-quarter in part because, according to their CEO, "This transformational outcome did not materialize… and we no longer believe that it will materialize."

• **Rising meat demand.** According to USDA data for 2021, the last available year, per capita consumption of red meat and chicken continues to consistently trend upward.

During the session, we reflected on what has gone wrong with alternative meats. There were no shortages of possible explanations, ranging from the lack of differentiation between plant-based products to unsustainable business models overly reliant on cheap credit. When looking to the future, most of the conversation focused on the need to work more on the taste profile, to strive toward a lower, more competitive price point, and to have an ingredients list that does not raise eyebrows. Here are some of the points made:

• **On price.** Brands are asking consumers to pay a premium for a product that is functionally inferior and doesn't taste as good as "the real thing" during a cost-of-living crisis. Is it any wonder it is not selling well?

• **On taste.** The poor taste of many products is a huge issue. Companies have spent too much time focusing on the branding and not enough on getting the basics right. Perhaps food is not like software; if the 1.0 version tastes bad, you don't come back for the 2.0 one.

• **On ingredients.** Plant-based meats may score higher on metrics such as water usage and animal cruelty, but the long ingredients list remains problematic. Consumers have been primed on the benefits of clean labels (fewer ingredients, less artificial ingredients) for some time.

A final point here: It was not all doom and gloom. There was recognition that some categories and subcategories (frozen over chilled, for example) and some companies that have achieved price parity, such as v2food in Australia, were doing well. Similarly, some felt there were particular lessons to be learned from the alternative milk market, which has fared relatively better, with sales up 7% this year and now approaching the equivalent of one-fifth of liquid milk sales. And this is despite running up against the same challenges as plant-based meats, such as typically performing worse on taste tests, being more expensive, and having a poorer nutritional profile relative to milk. Suggestions from the audience as to why this might be included:

• **Hype-free.** In contrast to alternative meat, which "overpromised and overhyped and completely underdelivered," plant-based milks did the opposite with a more gradual, slow-burn growth story and ultimately "overdelivered in terms of availability, price point, and marketing."

• **Smarter marketing.** On that last point, better-targeted marketing, such as the "Animals don't drink other animals' milk" campaign, really resonated with consumers in contrast to plant-based meats, where "It is not enough to call something 'plant-based' and think consumers are going to buy it."

• **A ready market.** Whereas only 1% to 2% of the US population are vegans, an estimated one-third of adults in the US are lactose intolerant.

3) Will Climate-friendly Products Be the Next Big Trend in Food?

We ended the session with a bit of crystal ball gazing by asking, "What's next?" As the excitement over plant-based meat appears to be diminishing, what categories are likely to excite consumers in the future? What will be the new "new thing"? There is certainly no lack of innovation, and to help stimulate discussion, we offered up some recent examples of product news and trend predictions:

• **Category creation.** Companies are hoping to develop a new take on portable meals with a category of products that do not have to be heated in an oven or microwave, such as Nestlé's Hot Pockets Deliwich "thaw-and-eat" sandwich and Smucker's Uncrustables brand. Pitched at the on-the-go crowd who want something convenient and "fresh," one simply takes the product from the freezer and eats it a couple of hours later once it has thawed.

• **Category crossover.** PepsiCo's Gatorade is already a USD 6bn brand, but the company is exploring ways to take the brand "beyond the beverage" into new growing categories such as functional gummies that provide immune and recovery support, which can play to the brand's image of optimizing performance as well as help shore up the brand from competitors that have been stealing market share, like BodyArmour.

• **Butter boards.** A quick review of trend predictions being forecast by ADM, Whole Foods Market, the Specialty Food Association, and the National Restaurant Association, to name a few, throws up quite a diverse range of suggestions. For example, ADM is expecting greater consumer interest in "balanced wellness" with a focus on food and mental health, whereas Whole Foods thinks that in the future pasta will be made from green banana or cassava. Or consider TikTok's viral hit of "butter boards" (#butterboard has 415m views), where it seems you just cover a chopping board with butter and then add whatever you like to eat, including bacon, cheese, etc.

Whereas translating a butter board into a CPG product might prove challenging (although 7-Eleven is providing its own take), when you look through these lists of trends the only one that seems consistent – the trend of trends, if you like – is around "climate-friendly" products or menu items that "engage consumers' emphasis on sustainable, upcycled, and zero-waste foods." The language and messaging around these products is still evolving (and a little opaque), such as "environment friendly," "sustainable food solutions," "climate positive," "earth healthy," or in Whole Foods' speak, "climate consciousness." But all identify the market potential of consumers becoming aware that their "eating habits impact the planet" (which should, at face value, be a motivation to eat more plant-based foods.) One example we shared at the session was Oat Clouds, an oat-based cracker from Airly Foods, a Missouri-based climate-friendly snack company that came of Post Holdings' Bright Future Foods incubator, where each box of crackers removes about 20 grams of carbon dioxide from the air. Another example would be Moonshot crackers, "taking a bite out of climate change," whose packaging is a masterclass in communicating regenerative agriculture and climate change in an engaging manner (the trick it seems is to not say "climate change"; it is a turnoff for consumers).

The discussion of these trends led to a deeper conversation around how food and agriculture companies are attempting to reverse climate change, including reducing their indirect (scope 3) carbon emissions. This included setting science-based targets and the adoption of carbon-farming practices encouraged in part by the rapid uptake by CPG companies of commitments around regenerative agricultural practices.

To some, the concept of regenerative agriculture – like many concepts and buzzwords in food and agriculture (think "sustainable," "natural," "circular," etc.) – lacks a common definition, though all definitions point to ways to capture more carbon in the soil. But that has not stopped a growing list of food companies from committing to targets to expand regenerative agricultural practices across their supply chains. For most packaged food companies, scope 3 emissions from their supply chains account for more than 90% of their total emissions and include purchased inputs such as food ingredients and packaging.

From an agricultural perspective, many felt that a lot of the agricultural practices that fall under the regenerative agriculture umbrella are already widely established and adopted, though it is to be welcomed if consumers are looking for and may even be prepared to pay a premium for such practices. One client discussed how they had being doing regenerative farming practices such as rotating crops and no tilling (in all but name) for the past thirty years for the simple reason that it was "all about the carbon content of the soil…. The more carbon I get in the soil the greater the yield." Farmers, it is felt, are likely to adopt such practices, to the extent that they are new, if the incentives, risk mitigation, and value addition are clearly perceived over and above the extra cost, time, and work (and form-filling!) they entail.

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