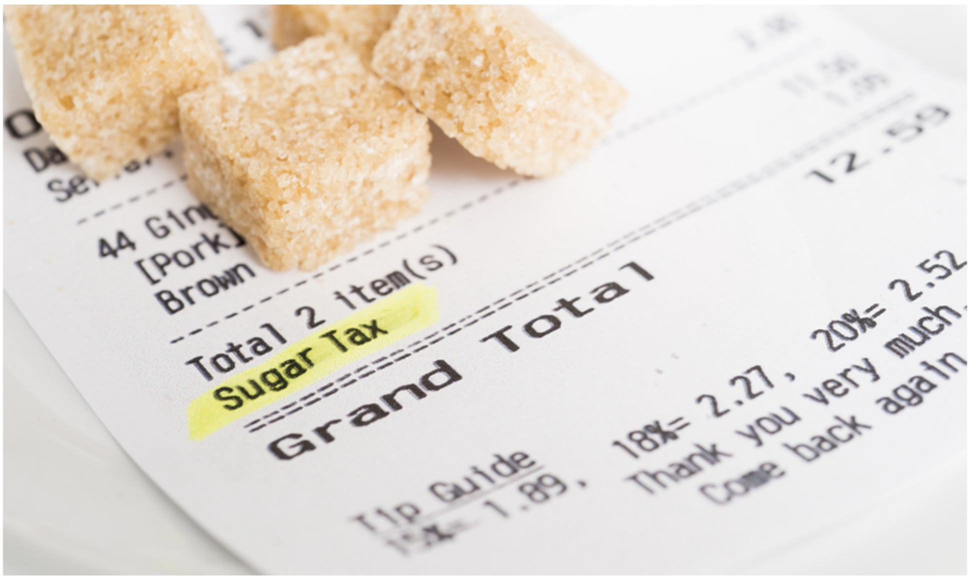

RISK & INNOVATION

How To Respond To Disruption: Lessons From The Food Industry

OVERVIEW

It has become a cliché to say that we are living in an age of disruption. Yet when most people think of "disruptors", they think of start-ups entering an established sector – using technology in radical new ways, overturning existing business models and overthrowing long-standing sector leaders.

Technology has become the dominant example, but there are other factors that can be just as disruptive to the established dynamics of a sector: shifting consumer sentiment and regulatory change. With customers increasingly voicing their opinions about products and services online, consumer sentiment is shifting faster than ever. At the same time, we are entering a fresh period of geopolitical uncertainty following the U.K.'s Brexit vote and the election of President Trump in the U.S. – which could prompt new approaches to regulatory frameworks, both nationally and globally.

When such disruptions hit, how can organizations respond to minimize negative impact and refocus their strategies to maximize the positive? The food and drink industry offers a number of insights.

IN DEPTH

"External factors – simply put, risks – impact organizations each day and influence their growth", explains Ciara Jackson, Ireland-based Director, Agri-Food & Beverage Practice Leader, Aon Risk Solutions. "Forward-looking strategic risk management is vital so teams can better understand what's on the horizon and plan accordingly."

The trends impacting the food and drinks industry today have long been signposted by subtle (and not so subtle) shifts in consumer and governmental attitudes. The response of consumers, governments and businesses within the sector serve as a good illustration of how established organizations can identify and adapt to longer-term risk trends, without significantly impacting their operational effectiveness.

Reacting To Long-Term Trends

Worldwide, a number of serious, non-contagious health issues have been becoming increasingly prevalent for decades. Excess weight and obesity rose by 27.5 percent for adults and 47.1 percent for children between 1980 and 2013. The number of diabetes sufferers has nearly quadrupled since 1980. Health issues related to the combination of a rise in sedentary lifestyles and higher-calorie diets are impacting the working-age population. As a result, health care costs are increasing, and the productivity levels of businesses are suffering.

Awareness of the problem is growing. In a number of countries, a cultural shift towards healthier lifestyles has begun, and efforts to improve health have encompassed individuals, school systems, companies, non-governmental organizations and governments.

In many regions, the shift in perception started with awareness campaigns designed to promote the voluntary adoption of healthier habits. Today, the public's understanding of the impact of having too much sugar in their diets or being overweight is greater than ever before. Soda, or fizzy drink, consumption, for example, has been dropping in the United States for more than a decade. Demand for organic, vegetarian and vegan diets has risen. According to the International Food Information Council (IFIC) Foundation's 2016 Food & Health Survey, ever more people understand that beverages with low-calorie sweeteners are a good option for diabetics, can reduce calorie intake, and help people lose weight.

For governments, following the public mood on such issues makes sense politically, socially and economically – in an age of rising health care costs. "Consumers are moving towards healthier eating with a view to combating obesity, heart disease and other illnesses. That in turn should reduce the burden on public health services", explains Jackson. Employers are also keen for action, says Stephanie Pronk, Senior Vice President, National Health Transformation, Aon: "by focusing on three major risk factors, employers can save an average of $700 per employee per year in health care costs and productivity improvements."

These complimentary desires and changing consumer preferences have seen a growing trend towards legislation designed to encourage the industry to respond. Legislative actions include new restrictions on levels of sugar and types of fat in foods, obligations to make packaging more informative, and taxes on consumables considered unhealthy – from carbonated drinks to salty snacks.

This trend has begun to cause significant disruption to the food and drinks industry – at least, to those who failed to see it coming.

Reacting To Changing Consumer Sentiment

Disruption can inspire a search for new technologies, products and services. "As consumer tastes shift, companies are shifting product mix and investing in research for new product innovation", explains Tami Griffin, U.S. Practice Leader, Aon Food, Agribusiness & Beverage Practice Group.

According to Jackson, the food and drink sectors "are reformulating their products, for example by reducing their sugar and fat levels, diversifying their product range, and allocating their research and development budgets toward healthier options".

In 2010, Nestlé founded its Nestlé Health Science division to research new ways that food can not only get more healthy, but actively help improve people's health. This pro-active response has helped the company retain its industry-leading position, and even opened up new markets. Its new range of healthy frozen foods launched in 2015.

Nestlé's research promises more breakthroughs. In 2016, it announced its scientists had discovered how to create hollow sugar crystals containing fewer calories, reducing the sugar content of its chocolate by up to 40 percent when they are introduced next year.

Yet while companies will often react to changing consumer sentiment, sometimes regulators still feel the need to step in.

Reacting To New Taxes And Regulations

The IFIC's 2016 Survey revealed that food companies are the least trusted source of information on food safety and recommendations – calling for more transparency on nutrition, ingredients, sustainability and their supply chains.

Lack of transparency can pose a serious risk to food brands and associations. In January 2017, the Coca-Cola Company became the target of a lawsuit alleging that the company had spent "billions of dollars on misleading and deceptive promotions" designed to hide the impact of its sugary drinks on health. In the European Union, regulators have rejected hundreds of unjustifiable nutritional claims on food packaging, while consumers have continued to demand easy-to-understand, transparent information about these products, continuing the pressure on legislators to force the industry to comply.

Beyond simply ensuring that the public are equipped to make an informed choice, demand from consumers for new taxes and regulation on unhealthy food and drink has gathered pace around the world. Fat and sugar taxes have been implemented in countries including India, Denmark, France, Hungary, and Mexico with similar announcements in both Ireland and the United Kingdom planning to introduce such taxes within the next few years. Although New York City was the first in the United States to try to pass a soda tax, the action was blocked by a judicial order. U.S. cities that currently have a soda tax in place include Berkeley, Oakland and San Francisco as well as Boulder and Philadelphia – with Cook County, Illinois, the U.S.'s second-most populous county recently passing a sugary beverage tax.

There is also demand for more tax and regulation from multilateral organizations. The World Health Organization (WHO) has called for a reduction in premature death from non-communicable diseases (such as weight-related diabetes and heart-disease) of 30 percent by 2030. WHO Member States have agreed to work towards limiting salt intake to 5 grams per day per person by 2025, and to reduce the marketing of foods high in saturated fats, trans-fatty acids, free sugars and salt, to children.

The Complexity Of Emerging Risks

Sugar, fat and salt taxes are another weapon in the fight against food-related diseases. But their effectiveness depends on how consumers and companies react.

Philadelphia's recent sugary drink tax includes drinks that contain sweeteners, including artificial sweeteners, sugar substitutes, and products listed as "diet" and "zero calorie", which despite lower calorie counts than traditional soft drinks, have been linked to obesity. The tax is imposed on distributors – but is being passed on to consumers, who have seen prices rise. "Tax will put even more pressure on margins from retailers", says Jackson. "In some cases the tax has been more than the cost of the beverage", explains Griffin. "Retailers are working to make this clear to consumers, with some showing two prices on the shelf – the cost of the beverage, and the cost with the new tax included. Some retailers have said they are seeing a decrease in business as customers are buying outside of the city limits now".

It's easy to blame regulations, but such price changes are a natural part of doing business, and can be coped with if organizations have appropriate risk strategies in place. "From a risk perspective, sugar taxes put pressure on already depleted margins, but it is no different from the kind of volatility in sugar or other raw materials which manufacturers are used to coping with", says Richard Broekhuizen, Head of Client Service, Aon Risk Solutions, UK.

He points out that taxing unhealthy food gives companies an incentive to increase investment in healthier product lines and "diet" products – the best way to hedge against this new trend. But there are still challenges. "Do they have a bandwidth of sugar-free products that protect revenue that can offset potential new costs? I know they all have diet products, but do consumers believe they are lower in sugar?" Broekhuizen asks. Furthermore, Jackson points out that if margins are being pressed "in a business with multiple units, capital allocation may be an issue, as business may be inclined to invest in units that have a more positive image".

Responding to Change

Like the rapid pace of technological change, the global cultural shift towards a desire to live more healthily is unlikely to reverse. Food companies will continue to face demands for healthier options and governments are likely to continue to respond with new regulations and taxes. Over time it will become clearer which techniques are the most effective in altering consumer behavior – and winning people's trust.

During a period of disruption, the one thing organizations cannot afford to do is nothing. Those brands in the food and drink sector that spotted the trend towards healthier lifestyles earliest – and prepared accordingly have not only managed to avoid the worst of the impact, but have in many cases opened up whole new revenue streams. Chief Commercial Officer of Aon Risk Solution's Specialty Group in EMEA, Alex van der Wyck, states, "Because there is such consistent change that impacts the global and local economy, food and beverage companies, in general, are prepared for the unknown. What differentiates good companies and leadership from 'the best' is in how flexible they are in addressing change and quickly reacting.

Not every new product will be a success. But when your industry is facing seismic changes, if you do nothing you could find your existing products are no longer viable either.

TALKING POINTS

"We are looking for tools that support people in making healthy choices, and the soda tax appears to be an effective tool." – Kristine Madsen, Associate Professor of Public Health, UC Berkeley

"Welcome their proposals to reformulate their products. Then watch very closely and hold them accountable for what actually happens." – Dr Margaret Chan, Director-General of the World Health Organization

"There is no evidence worldwide that taxes of this sort reduce obesity, and it is ironic that soft drinks are being singled out for tax when we've led the way in reducing sugar intake, down over 17% since 2012." – Gavin Partington, British Soft Drinks Association

FURTHER READING

- What Not To Eat: 'The Case Against Sugar' – The New York Times, January 2, 2017
- Soda Taxes A Healthy Trend – The San Francisco Chronicle, January 22, 2017
- Decline In Sugary Drink Consumption Stalls, CDC Finds – The Journal, January 26, 2017
- Nestlé Looks For Ways To Boost Stale Growth As Consumers Snub Unhealthy Food – The Economist, January 7, 2017
- Just What's Wrong With The Sugar Tax – The Adam Smith Institute, January 4, 2017