How will cost inflation track for Consumer Products companies in 2023 and what do they need to do as the cost-of-living crisis bites and consumer demand starts to contract?

Last year’s AlixPartners Cost Inflation Outlook predicted an increase of more than 10% in consumer goods company input costs, potentially reducing manufacturing EBITDA by 20-30%.

Given the added pressure of the war in Ukraine and the intense need for companies to respond with mitigating actions, we have revisited the opinion of industry executives and experts for the year ahead, providing another insightful set of predictions for 2023 and a view of the strategic actions that leadership teams are taking to counter inflationary and other disruptive forces.

In support of the study’s findings, you will also find in this report the thoughts of our global team of industry experts, as they reflect on the lessons learned in 2022 and the critical actions to consider in the next 12 months, including:

- Increased analytical capabilities to stress-test pricing strategies
- The importance of product portfolio management
- Greater transparency, flexibility and action in forecasting and addressing supply chain issues
- The opportunities presented by a “no-stone-unturned” business mindset

Cost inflation will remain a persistent issue for many Consumer Products companies – 73% of our respondents expect overall costs to rise by 5% or more in 2023.
COST INFLATION OUTLOOK

Summary insights from AlixPartners’ H1 2023 Cost Inflation Outlook flash survey.

2023 FORECASTS AND 2022 REFLECTIONS

73% of respondents anticipate further cost inflation in 2023

4 IN 10 told us input costs (direct and indirect) increased by 11% or more in 2022

STRATEGIC SOURCING INITIATIVES

were the most important lever used in 2022 to counter the effects of inflation

Consumer demand, supply chain resilience, and further cost inflation are priority concerns for 2023

What are your main concerns for your business/businesses in 2023?

ACTION PLANS

53% Will be prioritizing contract price fixing

40% Will be redesigning products to reduce cost

The top five capabilities being strengthened in 2023 are:

1. OPERATIONAL COST IMPROVEMENT
2. CASH MANAGEMENT
3. PORTFOLIO AND SKU OPTIMIZATION
4. COMMERCIAL/SALESFORCE IMPROVEMENTS
5. DIGITAL TRANSFORMATION

AlixPartners H1 2023 Cost Inflation Outlook flash survey was conducted during December 2022 and January 2023
COST CHALLENGES AHEAD?

Despite many feedstocks and energy and transport prices declining, most respondents and other industry sources believe other factors will cause most input costs to rise further.

DIRECT COST PREDICTIONS FOR 2023

- **PLASTICS**
  - 0-6 Months: △
  - 0-12 Months: △

- **STEEL/METALS**
  - 0-6 Months: —
  - 0-12 Months: ▼

- **CHEMICALS**
  - 0-6 Months: △
  - 0-12 Months: △

- **FATS & OILS**
  - 0-6 Months: △
  - 0-12 Months: △

- **SUGARS**
  - 0-6 Months: △
  - 0-12 Months: △

- **FLOURS**
  - 0-6 Months: △
  - 0-12 Months: △

- **CHOCOLATE**
  - 0-6 Months: △
  - 0-12 Months: △

- **MEATS**
  - 0-6 Months: —
  - 0-12 Months: △

- **ELECTRONICS**
  - 0-6 Months: △
  - 0-12 Months: △

- **TIMBER**
  - 0-6 Months: —
  - 0-12 Months: ▼

INDIRECT COST PREDICTIONS FOR 2023

- **TRANSPORTATION**
  - 0-6 Months: —
  - 0-12 Months: ▼

- **CORRUGATED PACKAGING**
  - 0-6 Months: △
  - 0-12 Months: △

- **LABOR**
  - 0-6 Months: —
  - 0-12 Months: △

- **PLASTIC PACKAGING**
  - 0-6 Months: △
  - 0-12 Months: △

Sources: AlixPartners analysis and H1 2023 flash survey, Mintec, Trading Economics, Chemicals Processing, The Economist
WHAT DO OUR EXPERTS THINK?

ANNA DEL MAR
Partner & Managing Director, London
adelmar@alixpartners.com

In 2023 consumer businesses will need to be sharper and faster – identifying the symptoms that their business is displaying quickly and pinpointing where they sit on the inflation management curve.

CP companies will need to continue strengthening cost forecasting and sourcing, also applying more nuanced pricing with customers to minimize volume loss. I also expect them to take a hard look at their product mix – in 2022 we found most companies had c.15-20% unprofitable products in their range. Taking tough decisions to streamline the product range is not just the preserve of distressed businesses – it will strip out unprofitable products and improve operating efficiency.

ANDREW SEARLE
Partner & Managing Director, London
asearle@alixpartners.com

For brands unable to fully pass through higher input costs to customers, the associated cash and cost burdens have bitten hard in 2022 – distress is entering the CP space in a way we haven’t seen for many years.

Even big brands have suffered volume hits as consumers trade down to manage their disposable income. With demand down overall, I can see many companies running the risk of further stock and cash issues due to full warehousing.

MARCO ECHELI
Partner & Managing Director, Milan
meccheli@alixpartners.com

Consumers are changing, trading down to new retailers in pursuit of better discounts or product value.

Operators must recognize that these new customers are not typical discount customers, so categories such as premium private labels could come to the fore in securing their spend for the long term.

Adaptation is key. Traditional retailers losing customers to discounters must build and cement loyalty quickly with those that remain, whether through greater personalization and individual offers or more artisanal premium produce that can deliver a point of differentiation. In these testing times, loyalty will be critical.

OLIVIER SALOMON
Partner & Managing Director, Paris
osalomon@alixpartners.com

What I’ve found interesting is the limited understanding of inflation on the cost of producing products.

Many industry players have found it hard to deal with supplier price hikes and understand whether it’s a fair increase or not. In our work last year, we found that supplier prices have risen 20-25% more than justified in many cases.

This level of darkness is dangerous. In shaping forecasts and KPIs for a new world in 2023, management teams need to map the underlying cost structures of their vendors and proactively track commodity rates – at some point some will decrease.
WHAT DO OUR EXPERTS THINK?

SANJAY BAILUR
Partner & Managing Director, London
sbailur@alixpartners.com

I believe we are now at a point where excellence in inflation management is no longer just a defensive exercise focused on risk reduction, instead becoming a potential source of competitive advantage.

Instead of thinking purely of supply chain risk management, top performers are thinking about how they can shift gears in operational and commercial levers to drive improvements in customer and product profitability, margin management, and Design-to-Value, as well as deliver a step change in cost efficiency.

Opportunities may also arise in the current M&A environment. While it remains hard to diligence the potential impact of inflation ahead of any acquisition, there may be market-adjacent assets under increasing stress that become attractive targets.

JULIAN SHORT
Partner & Managing Director, London
jshort@alixpartners.com

The inflationary landscape in 2023 is one that companies cannot cut their way out of, so effective pricing will continue to be key.

Of course, the pricing measures that can and cannot be taken by individual organizations will be very context-specific. A differentiated and/or highly valued product set may provide more room for maneuver vs discretionary or commoditized products where the customer has more choice.

Certainly “discretionary” for one group may be essential to others, and every market will have varying levels of competition. A granular understanding then of your customer (and, if applicable, the end consumer), what they value, and what they will be willing to pay for is vital.

RANDY BURT
Partner & Managing Director, Chicago
rburt@alixpartners.com

In what I term ‘the Peloton Effect’, many companies mistook pandemic-fueled demand spikes for a change in long-term growth trajectory.

Those companies generally over-built organizations and infrastructure and many are now restructuring their cost base to align to the current market conditions. Regardless of how your organization is positioned as we enter a new business cycle in 2023, continuing to build agility and responsiveness into both the commercial and operational elements of your business will be essential to success. The old saw “there’s no constant except change” has changed – it’s now “there’s no constant except disruption”.

TIM THIELE
Partner & Managing Director, Düsseldorf
ttthiele@alixpartners.com

The concept of reviewing and rationalizing core product lines will be a key priority for retailers, and not just in physical stores.

The benefits of redefining assortments stretch beyond mitigating the effects of inflation, and unfortunately the times of being able to extend ranges to attack every sales opportunity is fast reversing.

It is also vital that companies invest in meaningful tools to deliver real-time supply chain visibility. This hasn’t always been a “must-have” due to the limited incremental value that it could drive, but now access to early indicators of disruption is absolutely critical.

Click here to read our experts’ full outlooks for 2023
I believe the theme of portfolio rationalization will flow from an individual SKU and customer level right up to strategic M&A.

I expect M&A activity to pick back up in 2023 despite the challenging climate, as businesses look to both strategically acquire assets but also carve out and divest non-core businesses.

The latter will enable companies to monetize assets deemed non-core, and help enhance liquidity and cash positions, while also removing potential distractions at a time where leadership teams must have absolute clarity on where they want their business to play and where they have a right to win.

Some of the extremes of last year may resurface in 2023, where companies simply had to stop producing, unable to find their way out of a distressed situation.

We may see this particularly amongst medium-sized organizations that do not have the financial spine of support from a larger group, sparking restructuring activity on both CP and retailer sides.

To that end, organizational effectiveness will be absolutely key. Portfolio rationalization and rejuvenation is also a critical activity, but it is complex, cross-functional, and not purely a scientific exercise focused on marginal contribution.
HOW WE CAN HELP

The AlixPartners team can help you mitigate a wide range of inflationary impacts

OUR OFFERINGS AND EXAMPLE LEVERS

WHOLE COMPANY TRANSFORMATION

MARGIN DEFENSE

PRODUCT PORTFOLIO OPTIMIZATION
- Strategic Re-pricing
- SKU Rationalization
- Design-to-Value

SUPPLY CHAIN TRANSFORMATION
- Manufacturing Footprint Optimization
- Distribution Footprint Optimization
- Strategic Sourcing

OPERATING MODEL ENHANCEMENT AND ORGANIZATIONAL RESTRUCTURING
- Workforce Effectiveness
- Organizational Right-sizing

M&A
- Carve-outs & Divestments

DIGITAL TRANSFORMATION
- Process Automation
- Tech Implementation
- Cloud Migration

CASH MANAGEMENT

WORKING CAPITAL IMPROVEMENT
- Payment Terms Optimization
- O2C/P2P Process Improvement
- Inventory Planning and S&OP
- Collections Management

CASH FLOW FORECASTING
- 13-week and 26-week Cash flow Forecasts
- Creditor Negotiations

ZERO-BASED BUDGETING
- Business Plan Validation
ABOUT US

For more than forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it’s not what we do that makes a difference, it’s how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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EXPERT INSIGHT

In 2022 companies lost the predictability of their supply markets and margins and were forced to suddenly exercise inflation defence and cost pass-through muscles that their team had not needed for 20 years. Unsurprisingly many were unprepared and ill-equipped.

At first, we observed a lack of early warning systems and sudden cost increases that could not be negotiated away. Many delayed imposing price increases to customers (and were unable to catch up lost revenue), while in some cases blanket price increases caused volumes to fall. In the second half of 2022 we saw the need for more nuanced and careful margin management to pass through the right price increases in time to recover cost but also minimize the risk of volume and customer loss.

In 2023 consumer businesses will need to be sharper and faster – identifying the symptoms that their business is displaying quickly and pinpointing where they sit on the inflation management curve. Companies will continue to need to source not just better but differently, apply a range of margin improvement levers in addition to pricing, and re-design their products and portfolio.

In the food industry, ingredient prices are likely to rise further forcing the need for far-reaching changes to product ranges and how companies operate overall – particularly in combination with the consumer pressures and sustainability dynamics they must also contend with.

Re-thinking the product portfolio is likely to be a critical opportunity to address this year. Taking tough decisions to streamline the product range is not just the preserve of distressed businesses – it will strip out unprofitable products and improve operating efficiency.

“In 2023 consumer businesses will need to be sharper and faster – identifying the symptoms that their business is displaying quickly and pinpointing where they sit on the inflation management curve.”
When commodities increased at the end of 2021, I saw a traditional, blanket approach to single-digit price rises across all SKUs. As the situation worsened throughout 2022, a more selective, category-based methodology was needed.

This requires much greater analytical competencies, interlinking classic margin/profit predictions with more qualitative customer perception models to effectively stress-test price elasticity in different categories. Further sophistication must be applied if regional product classification is also needed – the rationale may not be overly strategic, but it is still difficult to execute.

As we move into 2023, I see companies’ planning efforts focused on worst-case scenarios related to commodity and energy pricing trends, in anticipation of more dramatic events.

Energy remains a huge concern for the food and beverage sector, so reliant on the actions of states and governments (and exacerbated by the war in Ukraine) – more so than commodity costs. For the latter, businesses may already have engineered coverage for further inflationary fluctuations, but frozen or chilled companies and bakeries, for example, really are at the mercy of energy prices.

Consumers are changing, too, trading down to new retailers in pursuit of better discounts or product value. Operators must recognize that these new customers are not typical discount customers, so categories such as premium private labels could come to the fore in securing their spend for the long term.

Adaptation is key, traditional retailers losing customers to discounters must build and cement loyalty quickly with those that remain, whether through greater personalization and individual offers or more artisanal premium produce that can deliver a point of differentiation. In these testing times, loyalty will be critical.

“As we move into 2023, I see companies’ planning efforts focused on worst-case scenarios related to commodity and energy pricing trends, in anticipation of more dramatic events.”
In the early part of 2022, I was surprised by the reluctance of management teams to realize the scale of change required to deal with the inflationary challenges they’ve seen.

Many internal processes have simply become irrelevant. Businesses have so often looked at performance in terms of revenue growth but, in inflationary times like these, that doesn’t mean anything anymore. Planning for next year needs a much sharper focus on volumes and a greater understanding of the categories where there’s flex to be aggressive in pricing.

What I’ve found interesting is the limited understanding of inflation on the cost of producing products. Many industry players have found it hard to deal with supplier price hikes and understand whether it’s a fair increase or not. In our work last year, we found that supplier prices have risen 20-25% more than justified in many cases.

This level of darkness is dangerous. In shaping forecasts and KPIs for a new world in 2023, management teams need to map the underlying cost structures of their vendors and proactively track commodity rates – at some point some will decrease.

On the pricing side the same level of tracking is needed – market prices change almost weekly. A finger on the pulse here will build greater agility, informed by robust data – anything that helps create agility at this time is key.

I see some healthy, good performing businesses from six months ago now very concerned about how cash constrained they are, with high inventories not shifting. Reducing cash commitments, effectively managing inventories – players need to think about the current situation as if they were a distressed company, even if they’re not. This mindset will be vital in 2023.
I believe we are now at a point where excellence in inflation management is no longer just a defensive exercise focused on risk reduction, instead becoming a potential source of competitive advantage.

Instead of thinking purely of supply chain risk management, top performers are thinking about how they can shift gears in operational and commercial levers to drive improvements in customer and product profitability, margin management, and Design-to-Value, as well as deliver a step change in cost efficiency.

Opportunities may also arise in the current M&A environment. While it remains hard to diligence the potential impact of inflation ahead of any acquisition, there may be market-adjacent assets under increasing stress that become attractive targets.

Ultimately, a “no-stone-unturned” mentality will present multiple opportunities, many of which are not directly related to inflation. For example, reviewing and rationalizing sales approaches can offer huge profit enhancement potential. Truly understanding what customers value will also be key, aiding strategies that design to cost and value, reformulating products, packaging, and shipping solutions that allow them to move operations beyond efficiency to effectiveness.

I’ve seen much closer, coterminal collaboration between retailers and suppliers as a result of 2022’s market disruption, improving market transparency and managing the impact upon cash-strained consumers. In challenging times, there is always an opportunity to reinvent business models and effectively navigate this extraordinary period.

“Truly understanding what customers value will also be key, aiding strategies that design to cost and value, reformulating products, packaging, and shipping solutions that allow them to move operations beyond efficiency to effectiveness.”
The inflationary landscape in 2022, and now moving into 2023, is one that companies cannot cut their way out of, so effective pricing will continue to be key. That said, as customers have less discretionary spend and are therefore likely become more price sensitive, increased prices may also affect sales volumes.

In 2022 there were a number of pricing/commercial practices occurring that would have driven margin degradation. These occurred when companies:

1. Were too cautious to increase prices to recover the inflationary impact
2. Implemented price increases but did so late, constantly playing catch-up to rising input costs and losing value proportionately to how long they were behind the inflationary curve
3. Implemented flat percentage price increases across the board matching inflation. This type of price increase strategy penalizes the highest paying customers, risking the most profitable volume, and benefits those that pay least
4. Relied on ‘standard costs’ for their pricing, letting a delta accumulate between standard cost and true cost as inflation progresses. Note that this may be true in whole or in part, for example where companies passed through raw material costs but not energy, labor or supply chain inflationary impacts.

Of course, the pricing measures that can and cannot be taken by individual organizations will be very context-specific. A differentiated and/or highly valued product set may provide more room for maneuver vs discretionary or commoditized products where the customer has more choice.

Certainly “discretionary” for one group may be essential to others, and every market will have varying levels of competition. A granular understanding then of your customer (and if applicable the end consumer), what they value and what they will be willing to pay for is key.

Finally, although price increases to protect eroding margins will be an essential part of business strategy for 2023, companies should be careful to communicate the need for these rises and avoid any perception of opportunistic/unnecessary increases or price gouging.

Customers have historically not looked kindly on companies that have engaged in such practices and this is a sure route to damage productive long-term customer relationships.
Pricing alone as a lever to pull in easing margin pressure is unlikely to work in 2023. The cushion that most consumers built up from government subsidization, extended unemployment insurance, eviction relief, and other measures in the US is now dissipating, with debt rising faster than income, consumer confidence remaining near historic lows, and the job and housing markets cooling substantially.

The upshot is that businesses need to find other ways to counter the current economic conditions, using integrated margin management to execute precision pricing actions while factoring in how all costs are fluctuating — not just raw materials and packaging. This must be paired with structural productivity improvements that materially enhance profitability.

What will remain constant, though, is the need for consumer products businesses to get out in front of where their customers are headed, by channel, by region, and by category. With the specific challenges posed by the pandemic rescinding, we have already witnessed the return of some pre-pandemic habits (e.g., the recovery of foodservice). Time will tell which pandemic-driven changes in consumer behavior will stick — but effectively plotting your consumers’ course, as always, will be critical to setting the right priorities.

In what I term ‘the Peloton Effect’, many companies mistook pandemic-fueled demand spikes for a change in long-term growth trajectory. Those companies generally over-built organizations and infrastructure and many are now restructuring their cost base to align to the current market conditions.

Regardless of how your organization is positioned as we enter a new business cycle in 2023, continuing to build agility and responsiveness into both the commercial and operational elements of your business will be essential to success. The old saw “there’s no constant except change” has changed — it’s now “there’s no constant except disruption.”

“Many companies mistook pandemic-fueled demand spikes for a change in long-term growth trajectory. Those companies generally over-built organizations and infrastructure and many are now restructuring their cost base to align to the current market conditions.”
The events of 2022 created a necessary firefighting exercise for business leaders, but the fundamental change that is really needed remains on the horizon.

The concept of reviewing and rationalizing core product lines will be a key priority for retailers, and not just in physical stores. The benefits of redefining assortments stretch beyond mitigating the effects of inflation, and unfortunately the times of being able to extend ranges to attack every sales opportunity is fast reversing.

It’s also vital that companies invest in meaningful tools to deliver real-time supply chain visibility. This hasn’t always been a “must-have” due to the limited incremental value that it could drive, but now access to early indicators of disruption is absolutely critical.

Nearshoring is another important item for the boardroom agenda. Diversifying dependencies, whether for negotiation leverage, political independence, or to drive scale is an area where I’ve seen huge personnel investment for many companies.

What these teams are discovering is that the alternatives are not always optimal, in terms of volumes, product capabilities, and the price premium that must be paid to truly diversify. If business growth is likely to be limited over the next 12 months, CEOs and CFOs should consider whether the time is right for strategic investment now that will go on to pay dividends in the next three to five years.

In an industry where the workforce make-up is typically younger than others, business leaders need to arm the teams below them with the skills to navigate these economic scenarios not seen for decades – the true cost of high inventory levels and other direct discussions with the CFO, for example. The full impact of the consumer cost-of-living crisis has yet to fully play out, so everyone must become acutely aware of the landscape before them and agile enough to act quickly in response.
2022 was a challenging year overall for CP companies as they faced several headwinds including inflationary pressures, supply chain challenges, changing consumer behaviors, geopolitical concerns, and overall market uncertainty. There’s no doubt that many of these issues will carry over into 2023.

As consumer saving rates come down, many sectors will be at the mercy of sharply adjusted purchasing behavior. For example, in discretionary categories such as footwear, inflation is forcing a significant percentage of consumers to deprioritize shoe purchases. Other CP sectors such as Vitamins, Minerals, and Supplements may also struggle to return to growth as consumers work through their “pantry loading” stocks built up during the pandemic, pushing out any further future purchases.

In not monitoring fluctuating input costs closely enough, many businesses found themselves on the back foot, and as a result we saw a lot of companies reactively try to mitigate the volatility across raw materials, packaging, freight, and labor.

Those players who were able to proactively combat these issues (e.g. building transparent pricing models) enjoyed much more success in selling in price increases to customers – the justification was clear, and it displayed greater strategic intent than blanket rises across the board. This foundational work also revealed that not all customers were still viable, given the constant challenges that would be faced if these relationships were seen to be merely transactional and commoditized.

Rationalizing customers is a tough decision to make, yet one that can make a material difference to profitability. Moreover, another lever used to combat some of these macro headwinds was to modify the product mix. For example, to rely less on private label business and focus on more valuable – and profitable – licensed and branded businesses.

I believe the theme of portfolio rationalization will flow from an individual SKU and customer level right up to strategic M&A, and I expect M&A activity to pick back up this year, despite the challenging climate, as businesses look to both strategically acquire assets but also carve out and divest non-core businesses.

The latter will enable companies to monetize assets deemed non-core, and help enhance liquidity and cash positions, while also removing potential distractions at a time where leadership teams must have absolute clarity on where they want their business to play and where they have a right to win.
The issue of inflation was clearly building early in 2022, but I saw it only become front of mind as a concern for companies during the second half of the year, as they looked for margin to maneuver their cost base and mitigate the impacts.

This manifested itself in two ways: firstly, in cost optimization work focusing on procurement (e.g. 50%+ of the cost base for food manufacturer support, manufacturing, and supply chain) and secondly supporting CP companies in their preparations for client negotiations – retailers largely – to act on the revenue side.

Historically in France, these negotiations are a tough and emotional exercise, made even more complex today by the macroeconomic situation. With limited trust between both sides at times, it is vital that conversations focus on the rational arguments – developing as much transparency as possible regarding elements such as gas dependency, labour costs, and transportation challenges.

I don’t see 2023 as the year where decreases are widely seen in the market. Most food manufacturers will have entered the latest contract negotiation period in France with double-digit increases, which will translate into a hit for consumers, whatever the share of the burden the CP company or retailer is willing or able to bear.

Some of the extremes of last year may resurface in 2023, where companies simply had to stop producing, unable to find their way out of a distressed situation. We may see this particularly amongst medium sized organizations that do not have the financial spine of support from a larger group, sparking restructuring activity on both CP and retailer sides.

To that end, organizational effectiveness will be absolutely key. Portfolio rationalization and rejuvenation (further accelerated by ESG stakes) is also a critical activity, but it is complex, cross functional and often lacking understanding of profit-to-serve at the right level to drive it.

Companies must ensure they can continue to cover client needs with the right product while also making the right strategic decisions for their business. Consumer buying habits that changed as the cost of living increased will not necessarily go back to what they were when the picture improves, and organizations must prepare for life with a different market landscape in 2024 and beyond.