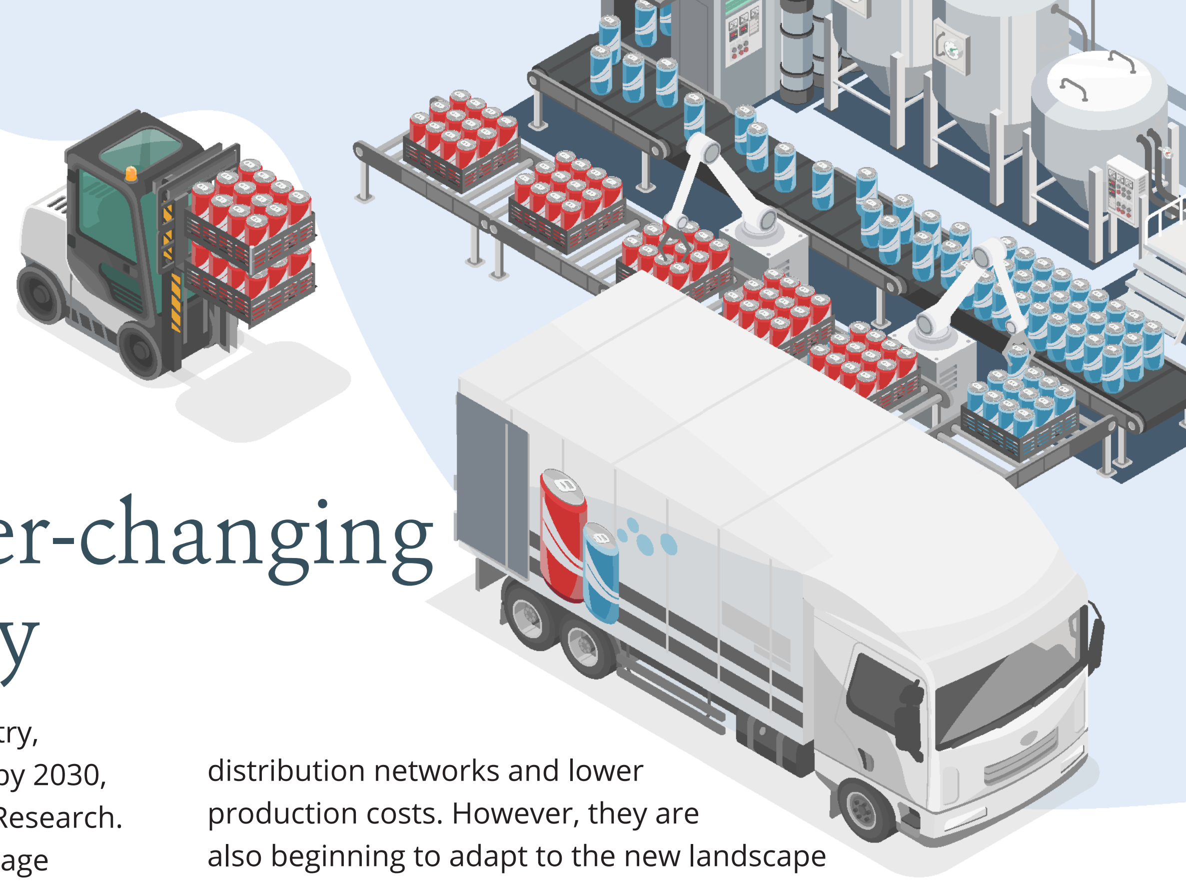
BroadBranch Advisors



The Thirst for Success: Driving growth in the ever-changing beverage industry

The beverage industry is a huge, dynamic industry, projected to be worth more than $1,185 billion by 2030, according to a report published by Grand View Research. Despite demonstrating stable growth, the beverage space is also rapidly evolving at a pace that rivals tech, cybersecurity, and healthcare – largely due to rapidly shifting consumer preferences. The race to keep up with consumers makes achieving consistent growth difficult for producers of all sizes.

Small and large beverage companies face the same challenges from the market, but they possess different means of overcoming those hurdles and achieving sustainable growth in today's beverage landscape. Startups can play to the advantages that their small scale lends, like increased flexibility and a digital environment that helps them compete with the massive media budgets of incumbents. Incumbents can benefit from their robust distribution networks and lower production costs. However, they are also beginning to adapt to the new landscape by taking lessons from startups and tearing down bureaucratic hurdles that stifle innovation.

Making Sense of Consumer Trends

The beverage industry faces a unique challenge: there are observable macro trends, but consumers also regularly reach for new products. Undependable consumers create difficulties in pinpointing which trends will meaningfully alter the market and which are transient. Each individual macro trend plays out differently in each category. For example, increased health consciousness among consumers simultaneously led to the rebranding of diet sodas as 'zero sugar,' the rise of soda substitutes like

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kombucha, and a spike in the popularity of craft sodas made using ‘natural ingredients.’

The fleeting nature of trends is also readily apparent in the market for hard seltzers, with dozens of legacy beverage manufacturers and startups launching products in the past four years. While growth in the category was initially robust, Evercore ISI research showed that the hard seltzer market shrank by 11% in 2022. The data also indicates that White Claw (3.8% YOY growth) has massively outperformed Truly’s nearly identical product (24% YOY decrease). Furthermore, only four of the top ten hard seltzer brands remained in a podium position between 2019 and 2021.

The key takeaway from both examples is that consumers are fickle, creating an unforgiving environment for players of all sizes. Small companies can demonstrate explosive growth and go under in the blink of an eye, and large companies can pour vast amounts of resources into a product only for it to miss the market.

The Small-Brand Boom

Legacy players still dominate the beverage market, but smaller brands have consistently grown their market share and captured valuable shelf space. They have increasingly been able to hold on to their positions after large companies launch substitutes. They either innovate within existing segments or create category-breaking beverages, driving growth through their unique marketing and branding, agility, and speed-to-market.

Prime Hydration, launched in January 2022, exemplifies

Photo: Louiie Victa for EATER

Prime announced on Instagram that it had become the official sports drink of the UFC, showing how viral marketing can quickly turn a startup into a true challenger.

how unique marketing and branding can lead to explosive growth. Prime is a direct substitute for legacy players' options like Gatorade, POWERADE, and BODYARMOR, but the unique twist they use to brand their products has captured and held consumers' attention.

Prime Hydration attached itself to two influential YouTube influencers with young audiences for its go-to-market campaign. They capitalized on those influencers' reputations as 'trouble-makers' by aligning it with consumer perception of small brands as outsiders to create a distinct brand identity. They follow this up with targeted marketing through digital platforms before moving into more traditional marketing through legacy channels and sponsorships. In January of 2023, Prime announced on Instagram that it had become the official sports drink of the UFC, showing how viral marketing can quickly turn a startup into a true challenger, even in established markets.

Twitter - DrinkPRIME

Another great example of agility and speed to market driving sustained growth is the brand White Claw. They entered the space early, aggressively pursued a strategy to capture market share, and retained customers due to their early-mover advantage. The explosion of hard seltzer led to the market growing from roughly 10 to 65 brands between 2018 and 2020, but White Claw has managed to maintain approximately 45% market share due to its early

Photo: Joanie Demer

entry. Over just a few years, they complemented their core product with higher and lower ABV options, consistently launched new flavoring options for the core product, and copied successful competitor products like hard lemonades, iced teas, and premixed cocktails.

Not every product White Claw launched was an initial or sustained success, but the company has consistently iterated its product lines and taken manageable risks to keep up with consumer tastes. This commitment to rapid innovation, rather than precisely calculated product launches, has been crucial to their growth strategy as giants like Anheuser-Busch entered the category. Organizational agility and speed-to-market, paired with their early entry and viral marketing, have put them in the driver's seat of a market worth over $10 billion in the US alone.

How Conglomerates Can Adapt to the New Paradigm

Until recently, large beverage producers held a distinct advantage. Precisely calibrated product launches regularly found success in a less crowded market. When a new entrant made a splash, large companies launched a competitive product backed by superior distribution or they simply purchased the challenger to capture their customers. However, increasingly unpredictable consumer behavior has interrupted these 'traditional' growth efforts. Launches move too slowly, and acquisition risks are larger in the rapidly shifting consumer landscape, meaning large corporations must rethink their organic and inorganic growth strategies.

Starry, Pepsi's new challenger to Sprite that replaced the consistently-uncompetitive Sierra Mist, is a good example of a poorly-calibrated product launch. The product is branded with bright colors fit for the 2010s and paired

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Pepsico

with a generational marketing campaign aimed at Gen Z consumers. Data from Google Trends has shown a roughly 82% drop in interest since Starry's launch, compared to only a 44% drop for Pepsi Zero Sugar which was brought to market at the same time. While Starry's ultimate fate is unclear, PepsiCo is still clearly struggling to grow in the lemon-lime category.

To avoid these challenges, the legacy manufacturers have implemented a strategy known as "intrapreneurship." This concept combines the benefits of a startup's agility with the resources of a large manufacturer by creating small, market-focused innovation teams. These teams have wide latitude to experiment with new products and bring them to market quickly. Coca-Cola has a version of this team called the "Transformational Innovation Team." To be successful, these teams need to avoid the bureaucratic hurdles common within large, complex organizations and bring products to market at the pace of smaller manufacturers.

The downside of bringing many innovative products to market is that many will inevitably miss the mark. Larger organizations need to view these failures as minor missteps in the context of their overall scale. The strategy for larger manufacturers should be to "fail fast" while rapidly scaling-up production and distribution of winners.

Inorganic growth can be challenging for large producers because it is hard to predict how and when consumer preferences will change. The current market often creates what a 2021 Beverage Daily article calls "zombie brands" – or acquired brands that die as consumer tastes change after an initial surge in popularity.

The zombie brand problem's solution has both organic and inorganic components. Market-focused innovation shops can replace cheap acquisitions in categories with

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uncertain futures, avoiding transaction costs and reducing the downside of a product failing. When a category's future is more certain, acquirers should target leaders rather than hoping an infusion of resources will catapult a small brand into a podium position. The costs of purchasing a larger brand are offset by the decreased risk of failing to meet post-acquisition growth expectations.

Overall, sustainable growth for large producers depends on enabling intrapreneurship to meet today's fast-moving market and making less-frequent acquisitions in developed categories.

Concluding Thoughts

Players in the beverage market all face the same set of unpredictable and rapidly-evolving set of customers. The key to ensuring successful growth relies on committing to a growth culture that prioritizes innovation while also taking small and manageable risks with potentially outsized returns.

Crafting and implementing a growth strategy that enables the innovation needed to stay competitive in the current market landscape looks different for every organization. It varies based on factors such as size, portfolio and culture – it will look different for each brand based on its identity, category, and target demographic. Most importantly, it relies on understanding how to quickly and efficiently retool an organization's capabilities to align with rapidly changing consumer trends.

BroadBranch takes pride in its ability to help our clients craft game-changing strategies and has vast experience in the food and beverage sectors. If getting the most out of both your growth opportunities using our proprietary, data-driven, hybrid quantitative and qualitative strategy methodologies is of interest to you, we would love to help you do it. Please reach out to Courtney Matson (courtney@brbradv.com) or Greg Thompson (greg@brbradv.com) if you'd like to explore ways to collaborate. You can also read other market perspectives written by our team here.

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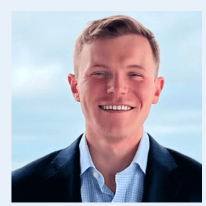

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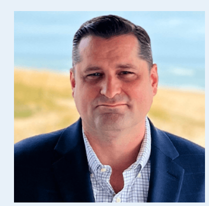

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