CHAPTER 4

FLUID MILK MARKET AND PROMOTION ASSESSMENT

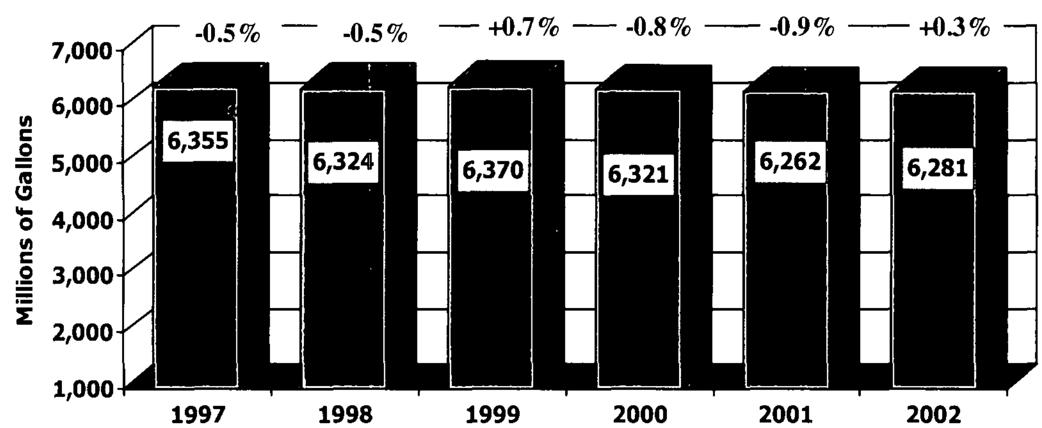
For the fourth consecutive year, Beverage Marketing Corporation (BMC) has been commissioned by Dairy Management Inc. (DMI) and the National Fluid Milk Processor Promotion Board to review the generic fluid milk advertising and promotional programs. This review offers a subjective evaluation of the effectiveness of those programs. BMC evaluates milk's position relative to milk's competitive beverage set — its respective marketing efforts and market performance. BMC believes milk's competitive set includes most non-alcoholic refreshment beverages, specifically carbonated soft drinks, bottled water, fruit beverages, ready-to-drink teas, and sports beverages. This year BMC examines both the overall milk industry's performance as well as the effect that targeted advertising and promotion have had on milk consumption by the crucial demographic cohorts. The following summarizes our findings based on the analysis of available data.

BMC'S ASSESSMENT OF CURRENT MILK INDUSTRY ENVIRONMENT

In 2002, fluid milk volume increased after two years of significant decline. Milk volume gained close to 20 million gallons, or 0.3%. Over the prior two years, the milk market had decreased by a total of 108 million gallons, down 0.8% in 2000 and 0.9% in 2001. The increase in milk volume in 2002 is noteworthy because it was the first positive movement in three years. The history of volume changes for fluid milk sales over the past six years is shown in **Figure 4-1**. Milk's compound annual growth rate (CAGR) for the 5-year period 1997 to 2002 was –0.2%, an improvement from the prior five-year period (1996-2001) when CAGR was –0.3%.

Figure 4-1

Fluid Milk Sales Volume* and Growth
1997 – 2002

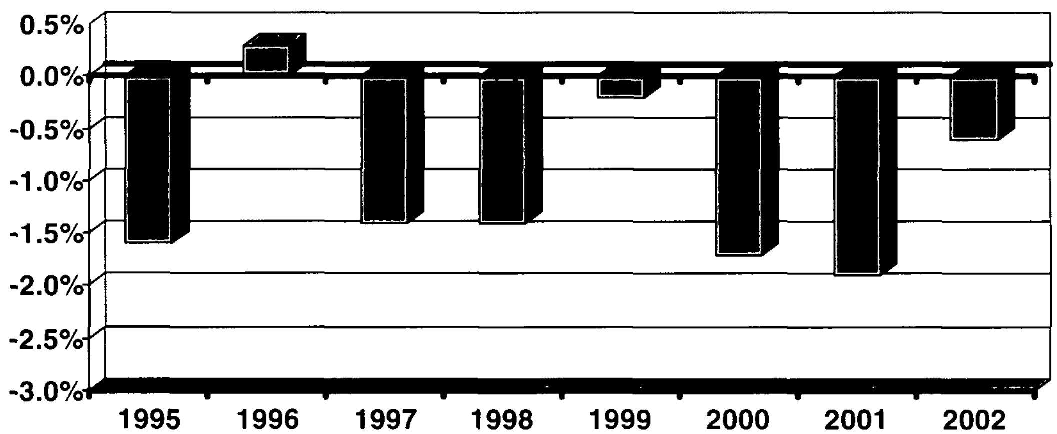


* In millions of gallons
Source: Beverage Marketing Corporation; USDA

For the last 30 years, total fluid milk volume has remained within a somewhat narrow range, between 6.2 and 6.4 billion gallons, with slight fluctuations up and down. Generally, milk volume has been flat. However, with steady population growth, milk per capita consumption has been decreasing over time. Despite positive volume growth for milk in 2003, per capita consumption declined once again, down 0.6%. See **Figure 4-2**. However, BMC continues to believe that fluid milk per capita consumption declines and volumetric trends would have been greater without the effect of the national generic fluid milk advertising and promotional programs. While the Cornell University econometric model was unavailable for this analysis, preliminary indications suggest a return to positive growth in the benefit/cost ratio of advertising and marketing spending, supporting BMC's belief.

Figure 4-2

Per Capita Consumption Percentage Change
1995 - 2002



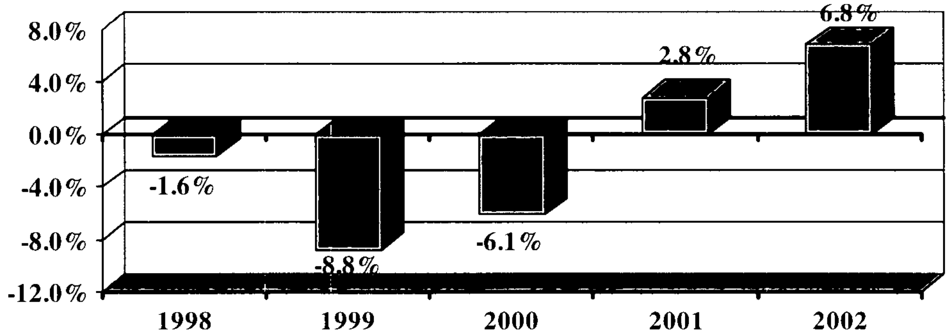
Per Capita Consumption*	24.0	24.1	23.7	23.4	23.4	23.0	22.5	22.4

* In gallons
Source: Beverage Marketing Corp., USDA

While the overall milk per capita consumption rates continue to decline, there has been positive movement in one of the most important age group targets for milk, namely teens. After declining significantly each year for several years, per capita consumption of milk for 13- to 17-year-olds has increased for two consecutive years, a likely consequence of expanded, targeted programs against this critical demographic cohort. **Figure 4-3** shows the five-year trend in teen per capita consumption changes.

Figure 4-3

Change in Per Capita Milk Consumption – 13 to 17 Year-Olds
1998 - 2002



Source: Beverage Marketing Corp.; SIP

The data of **Figure 4-4** compares the per capita consumption performance of milk with its competitive set. Milk ranks second in per capita consumption within its competitive set, however with the rapid growth of bottled water it is likely to lose that second position in the next year or two. All competitive beverages outperformed milk in 2002; however, only bottled water and sports drinks realized positive per capita consumption growth.

Figure 4-4

Per Capita Consumption Gallons & Change 2001-2002

	2001(r)	2002	Change
CSD	54.3	54.2	-0.2%
Milk	22.5	22.4	-0.6%
Bottled Water	19.3	21.2	9.8%
Fruit Beverages	15.0	15.0	0.0%
Sports Drinks	2.5	2.8	12.0%
RTD Tea	1.8	1.8	0.0%

r= Revised
Source: Beverage Marketing Corp.; USDA

As shown in **Figure 4-5**, the total competitive beverage set, including milk, grew at a CAGR of 2.3% from 1997 to 2002. Without milk, competitive set volume would have risen at a CAGR of 2.9% in the same period. A large contributor to recent competitive set growth has been bottled water. The competitive set *excluding bottled water* grew at a CAGR of just 1.0% from 1997 to 2002. For 2002, the competitive set excluding bottled water grew just 0.9%. In that context, milk, which grew 0.3%, did not significantly under-perform its competitors.

Figure 4-5

Volume Growth of Milk and Its Competitive Set
1997-2002

	Milk	Total Competitive Set	Competitive Set Without Milk	Competitive Set Without Water
1997	-0.4%	2.8%	3.8%	2.0%
1998	-0.5%	3.2%	4.2%	2.3%
1999	0.7%	2.4%	2.9%	1.1%
2000	-0.8%	1.4%	2.0%	0.5%
2001	-0.9%	1.7%	2.3%	0.2%
2002	0.3%	2.5%	3.1%	0.9%
97/02 CAGR	**-0.2%**	**2.3%**	**2.9%**	**1.0%**

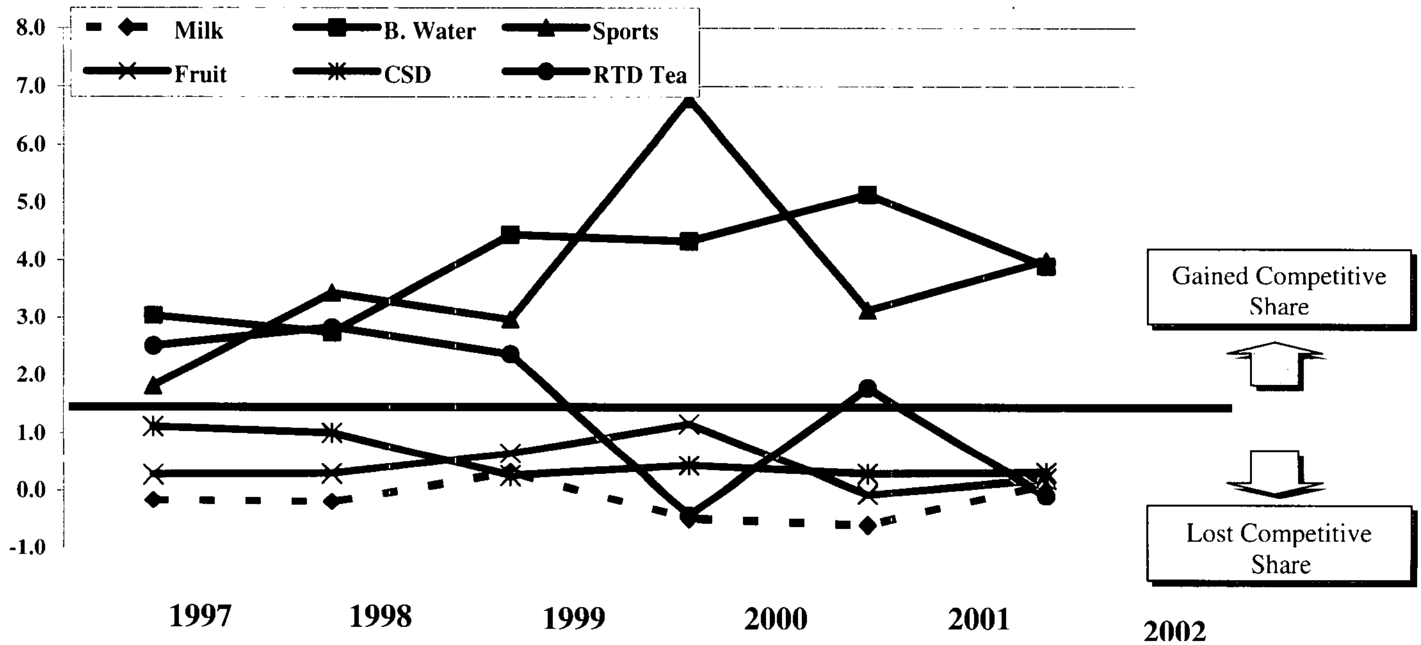
Source: Beverage Marketing Corp.; USDA

BMC analyzed milk's annual share of the volume increase of the entire competitive set over the past 15 years. This measure of milk's performance is an index based on its share of competitive volume change, divided by milk's market share of the competitive set at the beginning of the year. When this index is greater than 1, milk is improving its share. When it is less than 1, milk's share of the competitive set is declining. Milk's share of competitive turnover from 1997 to 2002 is shown in Figure 6, along with data for the competitive set. From 1997 to 1999, and again in 2002 milk showed improvement in competitive turnover rates, though still losing share to competitors. For milk, 2002 was the second consecutive year of improved share of competitive turnover, and was positive for the first year since 1999.

The analysis of competitive turnover is illustrative of the impact that bottled water has had on the entire beverage marketplace. See **Figure 4-6**. Bottled water has apparently taken share not only from milk but from almost every other beverage category, as well. (Sports beverages have been gaining share also, but from a very small volume and share base.) Bottled water fits squarely with the lifestyles of today's consumers who are active, always on the go and trying to consume healthier beverages.

Figure 4-6

Milk Indexed Share of Competitive Turnover
1997 - 2002



Source: Beverage Marketing Corp.; USDA

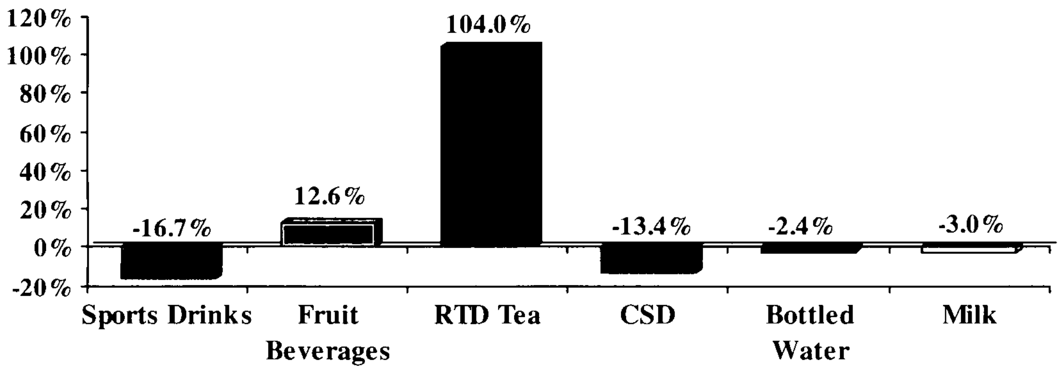
Milk's competitive environment remains one of the most challenging in beverage history. Recent years have seen the increasing breadth and strength of major beverage brands, especially in the bottled water business, which raised the level of competition for consumers' minds and dollars. However, with the tough economic landscape of 2002, many beverage brands were unable to continue the high advertising spending levels of recent years, and total media spending was down for most beverage categories, including milk. See **Figure 4-7**.

In 2002, at $0.021 per gallon, milk spent significantly less on media advertising per gallon than all of its competitors except for bottled water, for which just $0.014 per gallon is spent on media. In 2002, $134.2 million was spent on milk media advertising. The large majority of that spending came from the national generic fluid milk program, with a small but increasing share – roughly 18%, being spent by individual processors on their own brands.

Again in 2002, carbonated soft drinks accounted for essentially half of all advertising spending of the competitive set. See **Figure 4-8**. Milk's $134.2 million represented 10% of total media spending against the competitive set. Thus, with volume share of more than 19%, milk remains significantly underrepresented among its competitors in terms of media share of voice. It is interesting to note the low level of media spending against bottled water, as the category continues to realize significant volume growth through other means, including expanded packaging, distribution gains and pricing. Milk is limited in its ability to leverage these other means.

Figure 4-7

Changes to Competitive Set Media Spending per Gallon
2001 - 2002



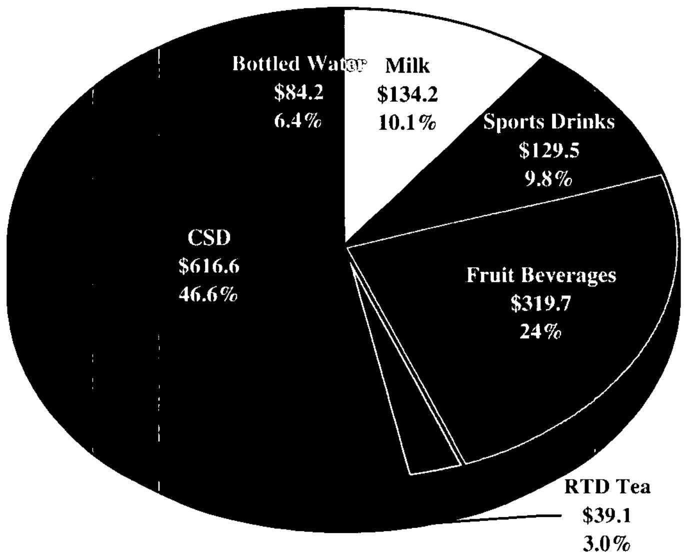
$ per Gallon 2002	$0.17	$0.18	$0.08	$0.04	$0.01	$0.02

Source: Beverage Marketing Corp.; USDA; CMR Multimedia Service

Quantitative analysis of competitive beverages' promotional expenditure is not possible because the data are kept confidential by brand owners and there is no syndicated source for the information. However, BMC believes that milk is overspent by the competitive set to an even greater degree on promotion and other marketing programs than it is on advertising. This competitive disparity is undoubtedly a key contributor to milk's flat sales performance.

Figure 4-8

Competitive Set Advertising Spending
2002
(Millions of Dollars)



Source: Beverage Marketing Corp.; CMR Multimedia Service

BMC continues to believe that despite notable industry progress in the last several years, milk remains at a competitive disadvantage in several important respects, as outlined below. In many cases, these gaps can not be addressed through the generic marketing programs. Further progress will arise from individual producer and processor efforts against their specific operations, brands and market approaches.

Consumer attention

- An ever-increasing array of non-milk beverage products are competing for the attention of the consumer, including fruit juices and drinks, soymilk and others. Many have co-opted milk's product attributes, such as a good source of calcium.
- Continuous low share of media voice for milk likely has a cumulative negative effect against strong competitive category brands.

Product attributes and innovation

- With consumer-attractive single-serve packages and the addition of new flavors for immediate consumption becoming common in the milk industry, they are still limited primarily to one size and primarily to chocolate and represent a very small portion of milk's volume. Milk still offers limited new packages, products and flavors compared to the competition.

- In 2002, milk was coming off a five-year high in the number of new product introductions, and the number of new products was down more than 16%. Double-digit increases were seen in most of the other categories. To remain competitive, milk must institutionalize ongoing innovation.

Branding

- Milk's competitive set is dominated by world-class marketing organizations with powerful brands. Milk has only a handful of large brands and is still largely viewed as a commodity.

- The majority of milk volume is private label (60.5%, according to IRI data), while just a fraction of the competitive set is accounted for by private label (1% to 35%, depending on the category). This lack of strong milk brands continues to hamper milk's ability to compete, as we believe branded product marketing and advertising in particular is more effective than generic advertising in the beverage industry.

- Entry into the marketplace by national brands such as NesQuik®, Hershey's®, and Looney Tunes® have helped drive growth, but still account for a small share of volume.

Distribution

- Despite the generic program's efforts against fast-growing, non-traditional retail channels, including vending, foodservice and convenience, milk remains a primarily supermarket-purchased, take-home product. Many of the competitive categories sell as much as 50% of volume through these immediate consumption channels, versus 18% for milk.

- The industry is slowly learning of the potential for milk vending, and it could become an important channel for processors, with the potential to improve the availability, merchandising and consumption of milk in numerous locations. However, the capital investment required is a hurdle for many processors and vend operators, and milk vending remains underdeveloped relative to the competition.

- Product perishability limits promotion and display efforts and eliminates retailer and consumer stock-up. BMC believes that higher in-home inventories of beverage products can lead to increased consumption levels. However, new pasteurization and packaging techniques are beginning to create distribution, display and stock-up options. Consumer perception of these products and their "freshness" needs to be modified in order to make them truly viable.

Pricing

- The milk industry is limited (structurally and legally) in its use of price promotion. Specifically, product perishability as well as state regulations limit the industry's ability to use price promotions.
- Milk's competitive set uses price promotion aggressively to promote consumption and stock-up.

BMC'S ASSESSMENT OF CURRENT MILK MARKETING PROGRAMS

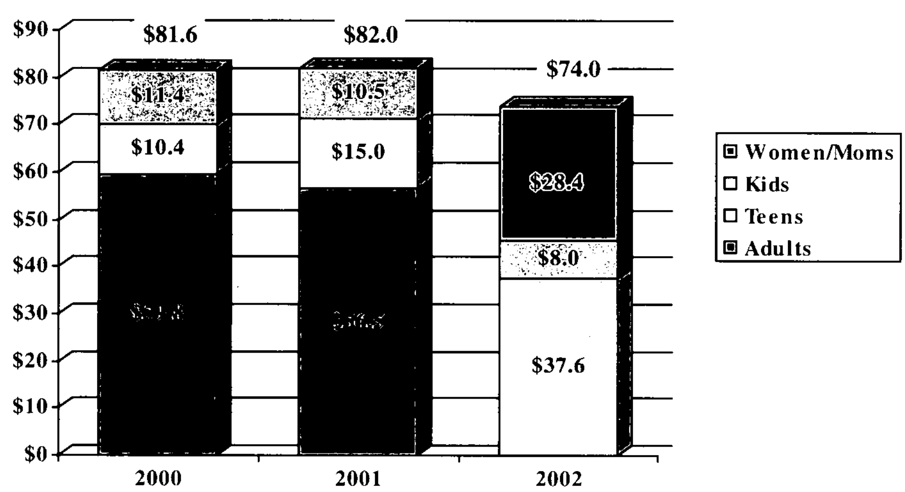
Beverage Marketing believes the marketing campaign under the Dairy Act and the Fluid Milk Act has successfully slowed milk's long historical slide in per capita consumption dating back to 1970. While in last year's report BMC suggested that milk's volumetric downturn in 2000 and 2001 may have been evidence of a lagged effect of the decline in milk's media spending and share of voice, it is also likely that the recent shift in monetary resources from media to other marketing programs targeted against key consumer groups (including events, sponsorships, and public relations) has been effective.

Figure 4-9 shows the decline in generic media advertising in 2002. The budget for the teen target increased more than two-fold, while the budgets against younger children and adults declined. The industry has successfully targeted teens specifically with new advertising that focuses on single-serve and flavors, the key growth segments within the milk category. This likely contributed to the resumption of growth in teen per capita milk consumption. The program also continues to utilize and evolve the Milk Mustache campaign, which maintains markedly high awareness rates among target consumer groups.

In line with past BMC recommendations, the milk campaign has recently been more focused on key segments likely to drive future industry growth (e.g., flavored milk, Hispanics, kids, and teens) and has reduced efforts against non-core users, including male adults.

Figure 4-9

Fluid Milk Generic Media Budget
2000-2002
(Millions of Dollars)



Source: Beverage Marketing Corp.; Bozell

Beverage Marketing believes milk's consumption declines would be greater without the national generic program. The milk marketing campaign has effectively defended milk against strong competition and has done so with less advertising spending per gallon than almost any other segment in the competitive beverage set. However, it is little surprise that milk per capita consumption is shrinking when we consider how it has been competing for consumers. Milk has experienced five consecutive years of decreases in advertising spending while no competitive category has had two consecutive years of substantial decreases. Milk's competition is leveraging substantial, steady advertising expenditure for higher share of voice.

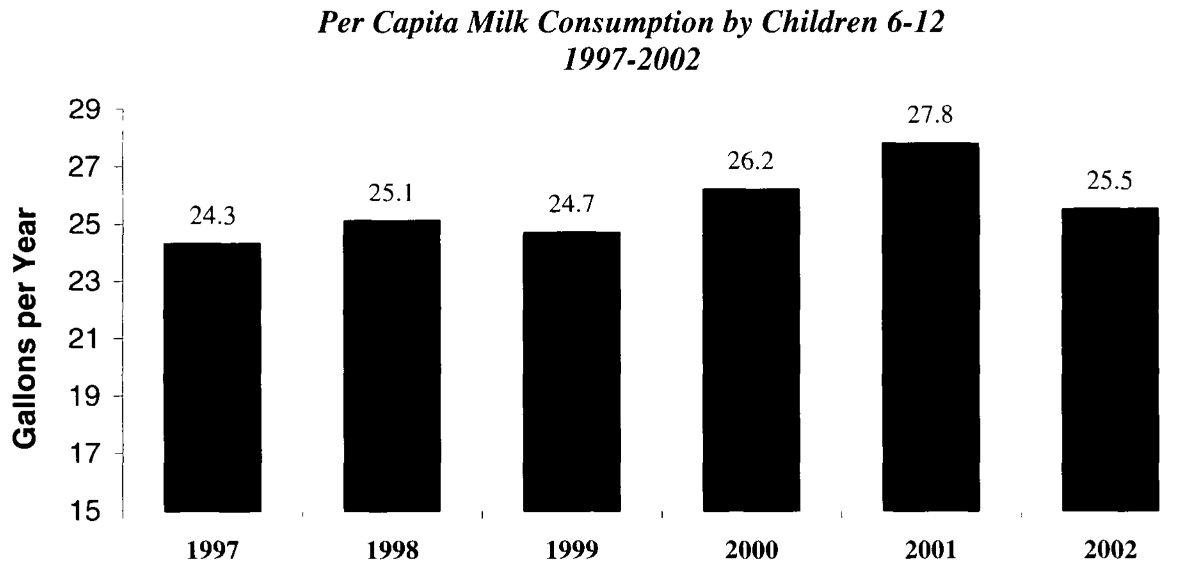
Advertising expenditure is one very large and critical piece of the total generic milk campaign; however, reductions in advertising expenditures have largely been shifted to increased promotional efforts and various strategic and operational initiatives, such as supporting and encouraging processors to innovate and market their brands, and the further development of retail and school related programs. It is BMC's belief that these initiatives, supported by the strong advertising campaign, are slowly beginning to impact milk consumption, but more importantly will have cumulative, enduring affects on milk's image, usage, availability and consumption.

In 2002, generic program elements (i.e., media, PR, events, etc.) became increasingly integrated and aligned with the program's core messaging. In addition, the programs have become more targeted to specific demographic groups, largely age cohorts. For example, the Milk Mustache Mobile had, in previous years, focused on retail venues such as supermarkets. In 2002, when the Mobile changed its focus and began targeting events and locations where teens congregate, participation increased three-fold. Schools, where kids and teens spend the majority of their time, have been another important target for the program in 2002.

The targeted strategy appears to be a powerful tool for increasing milk consumption. Teen consumption increases, as discussed above, were likely driven by increased focus and spending against that target, both through advertising as well as other marketing programs. The increasing availability of flavors and innovative milk packaging for single-serve products was likely also an important contributor to this growth. BMC believes that positive change will be based on a dual platform for growth, consisting of strong, targeted generic programs and industry innovation in products, availability and branding.

The crucial 6- to 12- year-old demographic group had shown increases in per capita consumption for two ears. In 2002, however, per capita consumption for children ages 6-12 declined significantly, to below 2000 levels. See **Figure 4-10**. One year does not make a trend, however; this reversal may have been driven in part by the cumulative effect of decreased media spending over the last two years.

Figure 4-10

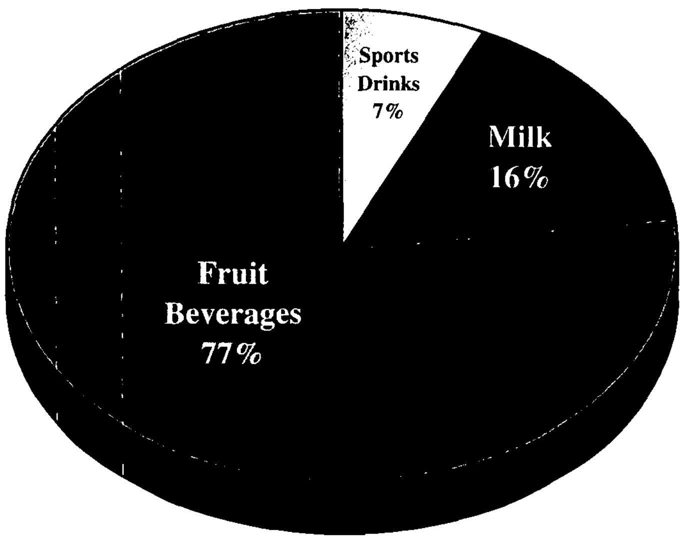


In terms of ad dollars spent against the target, in 2002, milk's share of media spending against children ages 6 to 12 was significantly less than the largest advertiser, fruit beverages. See **Figure 4-11**. This is against a share of stomach of more than 35%, thus milk's share of voice is markedly low for children. The fruit beverage industry has been very innovative in targeting children through packaging, availability and advertising. In addition, by enhancing fruit beverages with calcium and vitamins, the industry is also addressing the concerns of "Gate-keeper Moms," and may be co-opting milk's unique health positioning for kids.

Milk's gains with the 6- to 12-year-old and teen cohorts are important because it is at this age that children begin to form life-long brand and product loyalties, as well as life-long eating and drinking habits. Kids and teens have been targeted either directly through media channels, through school programs or through "gatekeepers" like parents who control the options of children. The milk industry has undertaken research and is formulating programs for increasing milk consumption specifically in schools, by upgrading the products available and consequently upgrading the image of school milk for long-term benefit. While the effect of this increased focus on schools may not be seen for some time, BMC believes that it is critical for the industry to address this venue, where milk has been losing consumption for many years.

Figure 4-11

2002 TV Beverage Media Spending against Children
Share of Voice
(000's of Dollars)



Source: Beverage Marketing Corp.; Bozell

The got milk?®/Milk Mustache Campaign has evolved into a contemporary image-based campaign that still effectively communicates the nutritional benefits of milk. However, that contemporary image is not supported by the products that children are offered in school. Additionally, a contemporary, image-based campaign is not in itself differentiating; thus, making a connection between milk's image and higher order need states/values such as self-esteem, well-being, and confidence will be crucial for milk in order to compete for consumers' attention and loyalty. As suggested by BMC in the last two annual reports, milk programs may need some strategic re-thinking to effectively drive milk's position in the beverage marketplace. The generic programs have undertaken a reevaluation of milk's generic positioning, and findings from that work will be incorporated into future programs and communications. This should allow milk's image and position to evolve to be more competitive. Additionally, as product, package, and channel innovations increase the potential usage occasions for milk, an evolution of the campaign has become necessary to fully leverage these new opportunities. The teen advertising, which features flavors and, in 2003, single-serve packaging begins to address that need.

As milk's competition grows ever more fierce, it will be critical for the generic programs to continue to focus or refocus resources against the primary targets, especially kids and teens, while evolving the messaging to link to higher-order consumer benefits and support image-enhancement. However, as has been pointed out in past industry reviews, the impact of these programs will necessarily be limited unless or until they are supported by relevant industry platforms, including the right products, pervasive availability and significant brand-building focus.

In summary, there are three crucial focus areas that the generic programs can address to improve milk's position: evolve the marketing message towards higher-order consumer need states, continue to focus or refocus on key demographics/targets, support increased development and availability of new products for more diverse usage occasions, and maximize distribution through non-traditional channels.