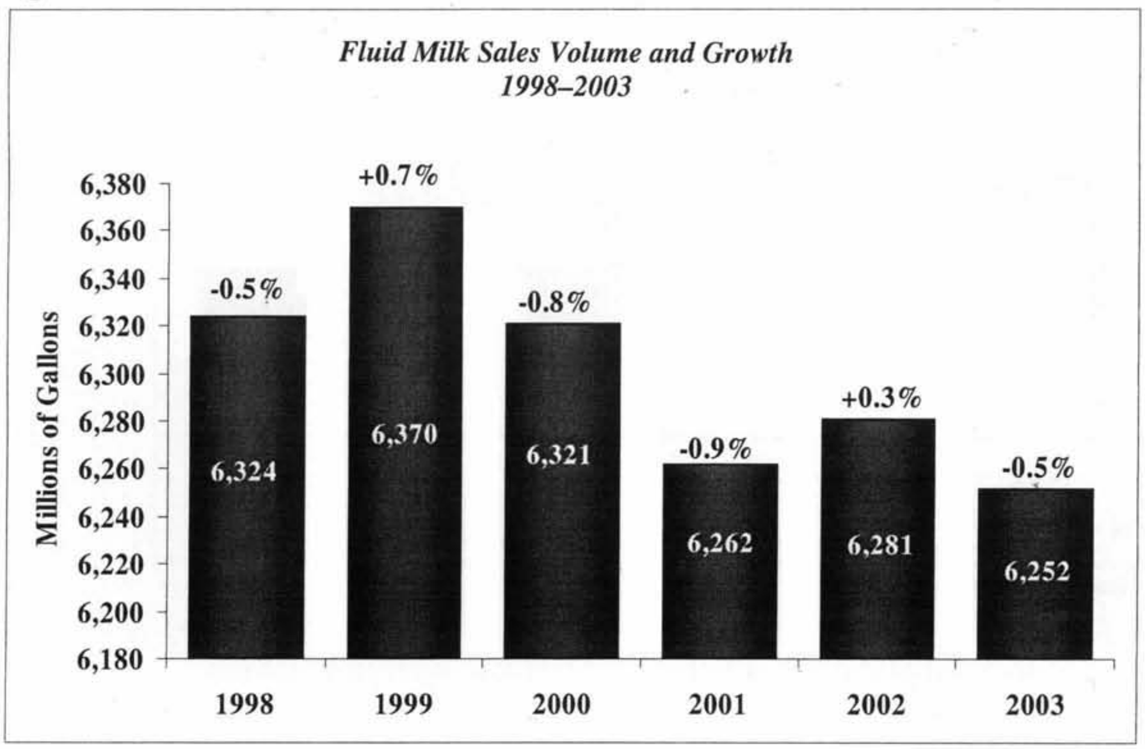
Chapter 4
Fluid Milk Market and Promotion Assessment

For the fifth 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 fluid milk advertising and promotion programs. This review offers a subjective evaluation of the effectiveness of those programs and provides a third-party marketing perspective on these efforts. It also evaluates milk's position relative to milk's competitive beverage set, including its respective marketing efforts and market performance. BMC believes milk's competitive set includes most nonalcoholic refreshment beverages, specifically carbonated soft drinks, bottled water, fruit beverages, sports beverages, and ready-to-drink teas. This year, BMC examines 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.

Beverage Marketing Corporation's Assessment of the Current Milk Industry Environment

In 2003, fluid milk volume declined by 0.5 percent to 6.25 billion gallons after a slight volume increase in 2002. Over the last 6 years, fluid milk volume has essentially been stable, fluctuating within a narrow band of volume between 6.2 and 6.4 billion gallons.

Figure 4–1



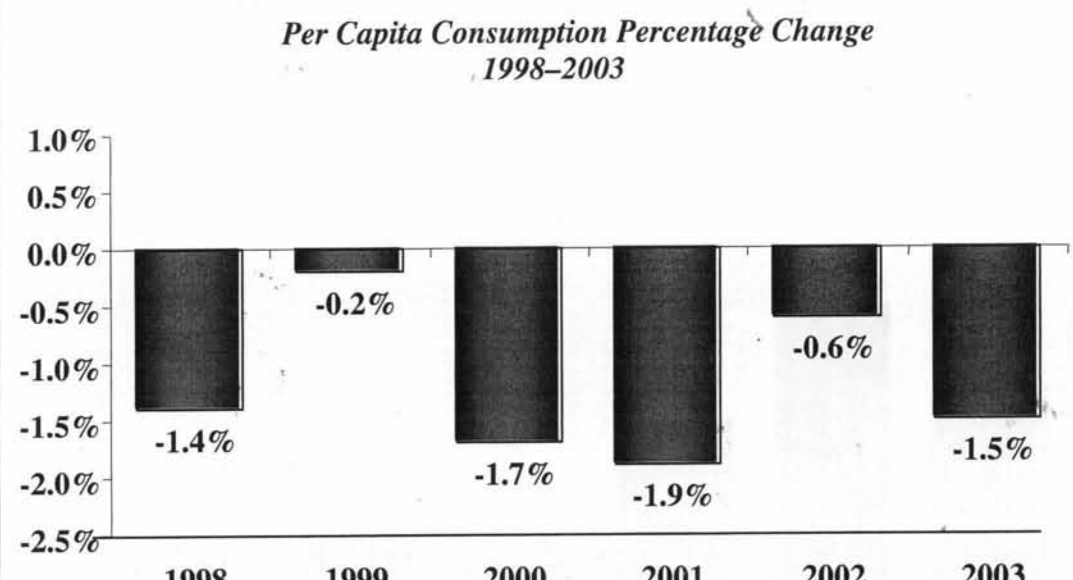
Source: Beverage Marketing Corp. of New York

Milk volume declined by about 30 million gallons in 2003, after increasing by approximately 20 million gallons in 2002. The history of volume changes for fluid milk sales over the past 6 years is shown in Figure 4–1. Milk's compound annual growth rate (CAGR) for the 5-year period of 1998 to 2003 was –0.2 percent, a reflection of the negligible swings in year-over-year milk consumption since 1998.

These narrow consumption swings from year to year actually extend back several decades. Consider that as long ago as 1985, fluid milk consumption was 6.25 billion gallons—identical to the fluid milk consumption in 2003. Over this span of time, however, the U.S. population has increased, resulting in slight declines in per capita consumption of fluid milk. In 2003, per capita consumption of milk declined by 1.5 percent to 22.1 gallons per person. (See Figure 4–2.) BMC believes these declines in per capita consumption are not a reflection of the promotional and advertising efforts of the industry, which in fact may have actually been successful at preventing more sizeable declines in consumption.

Industry efforts targeting teens, a critical demographic target, appears to have had an enduring impact on increasing teen milk consumption. For the third consecutive year, teen consumption increased in 2003. (See Figure 4–3.)

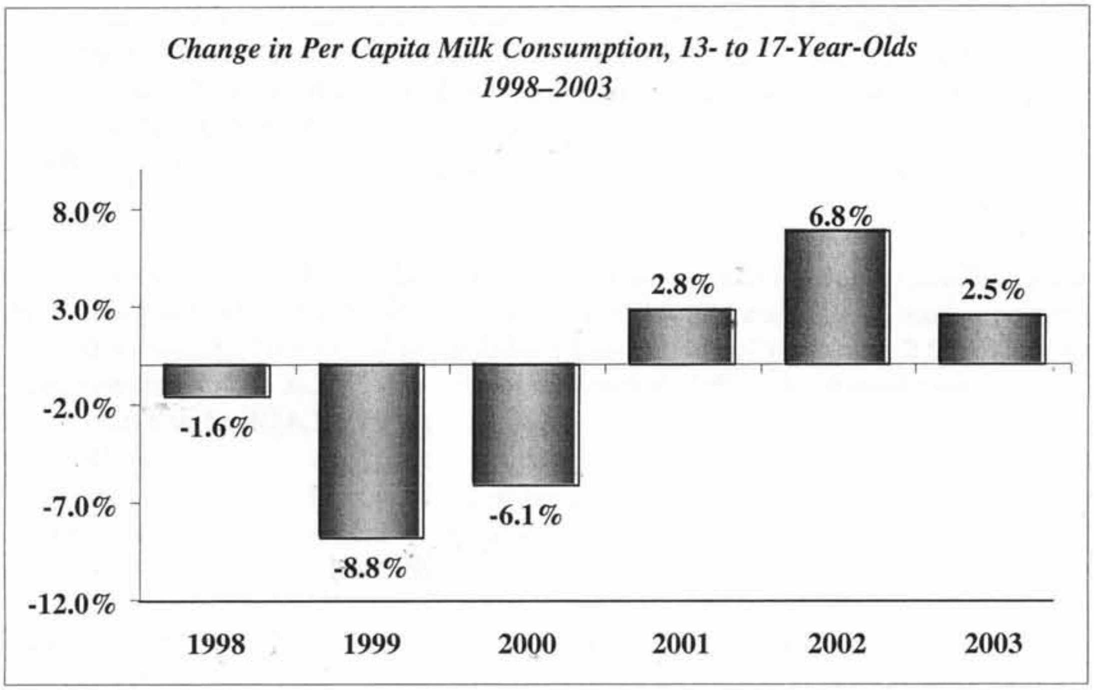
Figure 4–2



	1998	1999	2000	2001	2002	2003
Per Capita Consumption	23.4	23.4	23.0	22.5	22.4	22.1

Source: Beverage Marketing Corp. of New York

Figure 4–3



Source: Beverage Marketing Corp. of New York, SIP

Figure 4–4

Per Capita Consumption Gallons and Change 2002–2003

	Gallons		**Change**
	2002	**2003**	**2002/03**
CSD	54.2	53.8	-0.7%
Milk	22.4	22.1	-1.5%
Bottled Water	21.2	22.6	6.3%
Fruit Beverages	15.0	14.9	-0.7%
Sports Drinks	2.8	3.1	12.1%
RTD Tea	1.8	1.8	-0.7%

Source: Beverage Marketing Corp. of New York

Within its competitive set, milk is the third-largest beverage category by volume. (See Figure 4–4.) In 2003, milk was surpassed by bottled water, which has shown dramatic growth for more than a decade. Carbonated soft drinks remain by far the largest category within the competitive set, with per capita consumption at 53.8 gallons in 2003, but carbonated soft drink per capita consumption has experienced slight declines in recent years. In 2003, bottled water and sports drinks were the only categories in the competitive set that achieved per capita consumption increases.

In 2003, the combined categories of the competitive set increased by 1.8 percent to 33.5 billion gallons, up from 32.9 billion gallons in 2002. From 1998 to 2003, the competitive set grew at a CAGR of 2.0 percent. (See Figure 4–5.) Without milk, the performance of the competitive set would have been slightly better—increasing at a CAGR of 2.5 percent from 1998 to 2003. Without bottled water, the competitive set grew by a CAGR of just 0.6 percent over the same 5-year time span. Bottled water accounted for approximately 75 percent of the volume increase of the competitive set in 2003. Absent bottled water, milk's performance was only slightly weaker than the performance of the competitive set, a possible indicator of the effectiveness of the advertising and promotional programs.

Beverage Marketing has studied milk's share of the volume increase compared to that of the entire competitive set annually over the last 15 years. This index reveals whether milk has gained or lost competitive share over this time span. 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 onset of the year. An index greater than 1 indicates that milk is improving its share and thus outperforming the competitive set; an index less than 1 reveals that milk's share of the competitive set is declining. In Figure 4–6, this index is illustrated over a 5-year period for each of the competitive set categories.

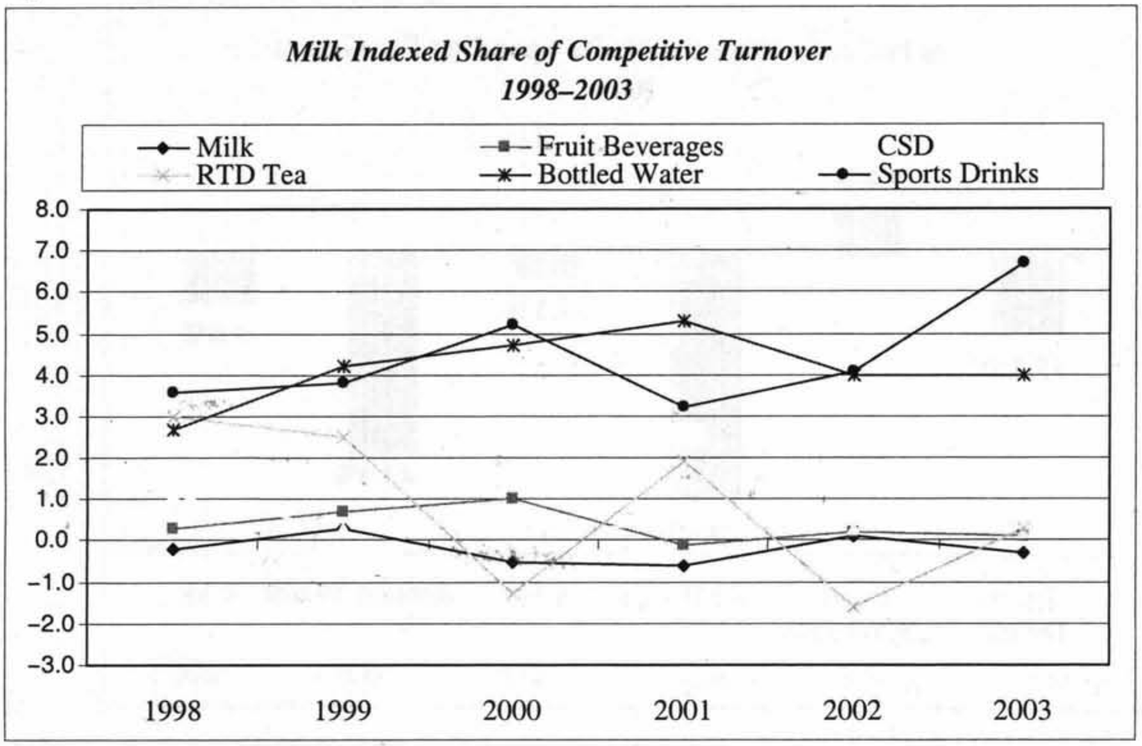
Figure 4–5

Volume Growth of Milk and Its Competitive Set
1998–2003

	Milk	Competitive Set Total	Competitive Set Without Milk	Competitive Set Without Water
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%	3.0%	0.8%
2003	-0.5%	1.8%	2.3%	0.5%
98/03 CAGR	-0.2%	2.0%	2.5%	0.6%

Source: Beverage Marketing Corp. of New York

Figure 4–6

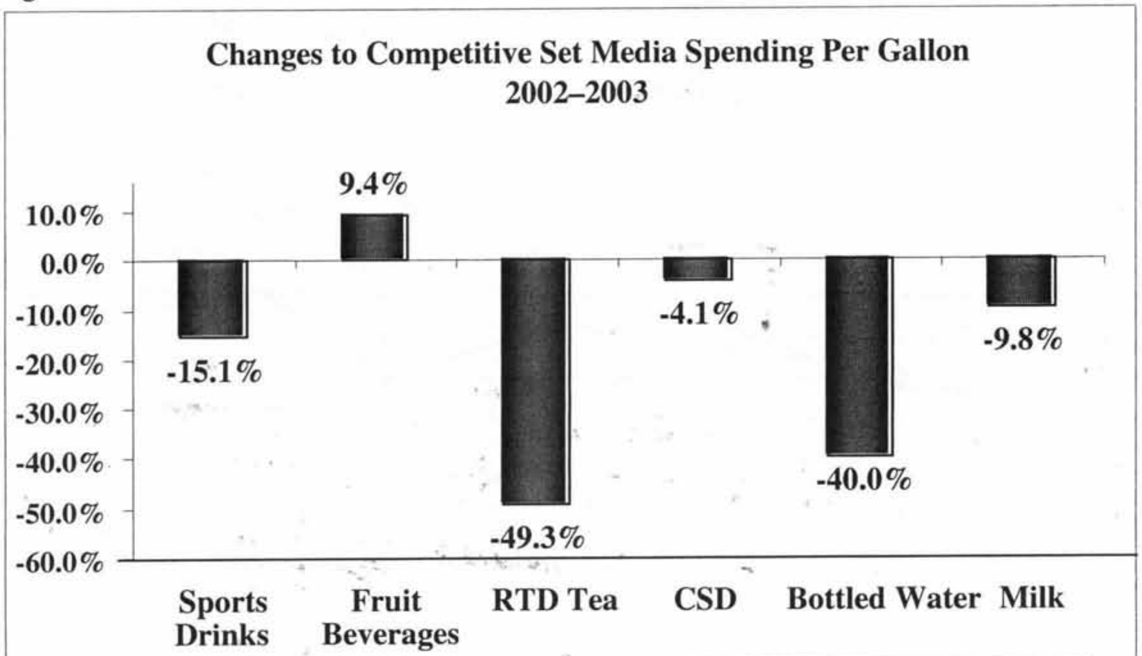


Source: Beverage Marketing Corp. of New York

Milk has consistently underperformed the competitive set and has thus lost competitive share each year since 1998, as the diagram illustrates. Conversely, bottled water and sports drinks have consistently outperformed the competitive set and have gained competitive share. Bottled water, in particular, has shown dramatic growth in recent years, driven primarily by heightened consumer demand for healthier beverage alternatives.

While there are many factors associated with these consumption trends, advertising expenditures is one factor that is easily measured. In 2003, all of the competitive set except fruit beverages experienced a decline in media spending per gallon. (See Figure 4–7.) Just as in 2002, milk remains the second lowest in media spending per gallon, with bottled water last. The milk category spent 2 cents on advertising for every gallon of milk sold whereas the carbonated soft drinks category spent 4 cents for every gallon sold. Bottled water's success has been primarily distribution and consumer driven and has come without significant marketing dollar expenditures in recent years.

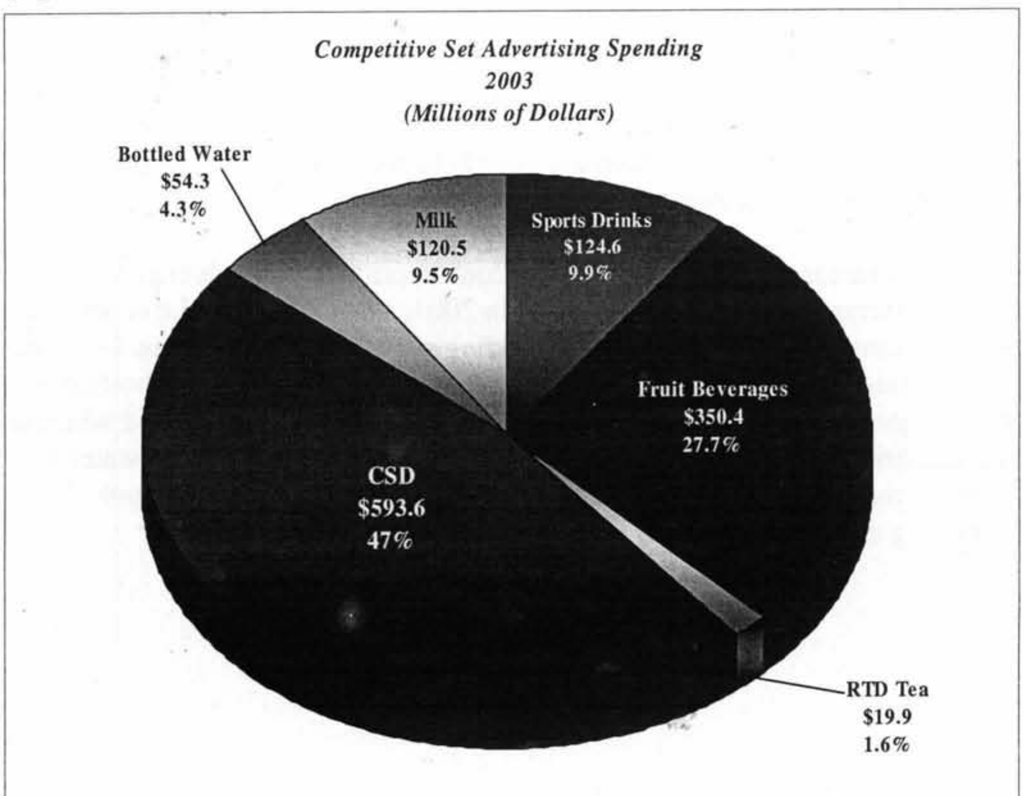
Figure 4–7



$ per Gallon	$0.14	$0.08	$0.04	$0.04	$0.01	$0.02

Source: Beverage Marketing Corp. of New York

Figure 4–8



Source: Beverage Marketing Corp. of New York

In 2003, all categories in the competitive set except for fruit beverages spent less on advertising than they did in 2002. (See Figure 4–8.) Carbonated soft drinks once again accounted for nearly half of all advertising dollars spent within the competitive set at nearly $600 million. At $350 million in spending, fruit beverages accounted for nearly 30 percent. At $120 million in spending in 2003, milk ranked fourth within the competitive set, accounting for nearly 10 percent of spending. The spending is comprised primarily of the national generic campaign as well as regional generic spending and branded product spending. While such spending is significant, milk accounts for nearly 19 percent of the volume within the competitive set and remains significantly underrepresented in share of voice.

Unfortunately, simple measurement of advertising spending does not take into account the effectiveness of the campaigns and does not measure the impact of millions of dollars spent on promotions. Promotional expenditures cannot be measured in an objective manner because companies tend not to divulge this data. Nevertheless, it is known that many millions of dollars are spent on promotional programs within the competitive set. Beverage Marketing believes milk continues to be outspent on promotion programs and that this is a contributory factor to milk's flat volume performance.

Furthermore, the milk category finds itself at a disadvantage to all of the other categories in the competitive set for several other reasons, outlined below. While the category has begun to make progress in many of these areas, for the most part it trails the other categories in the competitive set in all of them.

Consumer Attention

Beverage product innovation has accelerated in recent years for all categories within the competitive set. This innovation adds news and excitement to categories, bringing more focus and attention to them compared to their less innovative counterparts. While there has been innovation in the milk category, it has lagged behind the others in the competitive set in new product introductions. The net result is that consumers have more choices than ever. This has the effect of increasing the impact of advertising. Many of these new products, such as soymilk or orange juice with calcium, have even co-opted milk's healthy positioning.

In 2003, milk lagged behind the competitive set in its share of advertising expenditures in contrast to its volume share within the set. But this low share of voice has occurred consistently over a number of years and is likely to have a cumulative negative impact on milk consumption.

Product Attributes and Innovation

Innovation in the milk category has centered on flavored milk—primarily chocolate—in single-serve packaging. While this represents an improvement after years of very little innovation, other categories in the competitive set have been more aggressive, with a wider variety of product innovation and a greater assortment of packaging shapes and sizes.

In 2003, new milk product introductions declined by 9.0 percent to 202, compared to 222 in 2002. Milk ranked third in the competitive set for new product introductions in 2003 behind fruit beverages and carbonated soft drinks, its principal competitors. But the category is in need of more innovation rather than less in the coming years.

Branding

One of the more significant disparities in milk versus its competitive set is the distinct lack of big milk brands. In comparison, the competitive set is dominated by megabrands that have been built and honed by world-class marketing organizations.

The milk category is mostly dominated by private label. In 2003, milk lagged behind the competitive set with only 31.5 percent of its volume in the grocery channel accounted for by brand products. No other category in the competitive set has less than half its volume accounted for by brand products like the milk category. Beverage Marketing believes this disparity places milk at a distinct disadvantage with the rest of the competitive set because of the challenges inherent in marketing a category versus brands.

Distribution

Milk is widely available; nevertheless, its availability does continue to have some significant limitations. Availability is concentrated in take-home retail channels such as supermarkets. In other outlets where milk is available, it often does not have the range of packaging and flavor options offered by other products in the competitive set. This places milk at a competitive disadvantage.

As consumer lifestyles become more and more "on-the-go," consumer products manufacturers have been forced to respond by developing products in convenient single-serve packaging distributed in immediate consumption channels such as convenience stores and foodservice. In 2003, only about 18 percent of milk volume was sold for immediate consumption, whereas more than half the volume of carbonated soft drinks, sports drinks, and ready-to-drink tea is purchased for immediate consumption.

A recent audit of 500 convenience stores in 26 markets revealed that flavored single-serve milk was available in 94 percent of the sample. While that result appears strong on the surface, it is notable that most of that availability can be accounted for by national brands such as NesQuik and Hersheys. Local flavored brands are virtually nonexistent in convenience stores. Furthermore, while chocolate and strawberry are widely available, other flavors are not.

Pricing

Price promotion is a key tool that beverage marketers have used to spur sales, and this is true of all categories in the competitive set except for milk.

In 2003, milk had the largest consumer price index increase of all the categories in the competitive set tracked by the Bureau of Labor Statistics. In particular, the milk category experienced rising prices in the fourth quarter which have continued into 2004 and which are likely to place milk at a competitive disadvantage in its competitive set.

Beverage Marketing Corporation's Assessment of Current Milk Marketing Programs

Beverage Marketing believes the marketing campaign developed under the Dairy Act and the Fluid Milk Act has served to stem declines in milk consumption in the face of vastly heightened competition. While over the last 5 years there has been a slight decline in milk consumption, Beverage Marketing believes these declines would have been more significant without the campaign.

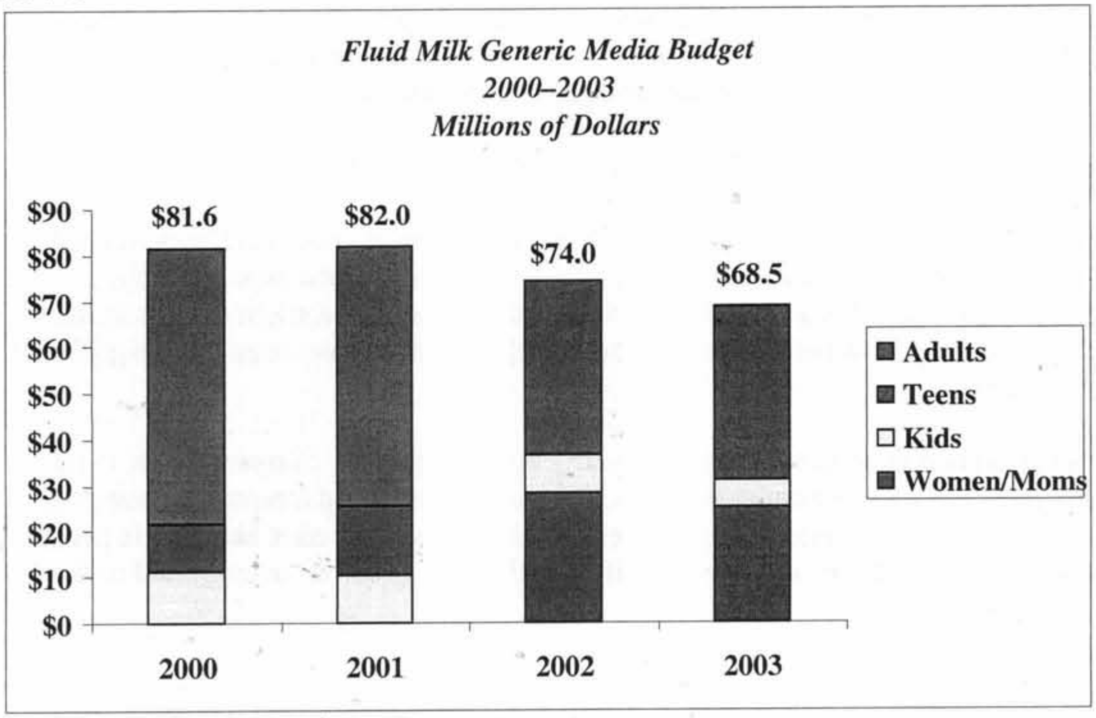
Even with the campaign, milk remains at a disadvantage against the competitive set in the areas highlighted earlier—consumer attention, product attributes and innovation, branding, distribution, and pricing. Without improvements in these areas, the milk category is likely to remain at a competitive disadvantage even with a strong and effective generic fluid milk marketing campaign.

In particular, Beverage Marketing believes pricing has become a significant issue for the milk category in the last year. An uptick in retail prices in late summer 2003 appears to be continuing in 2004. There are several factors contributing to the pricing environment: a decrease in the overall milk supply based on fewer cows on farms, higher feed prices, and the higher cost of replacement dairy cows. Higher prices that were seen in 2003 and that have continued in 2004 are likely to have an overriding impact on milk sales no matter how effective any of the other programs are. Price increases in the fourth quarter of 2003 may be obscuring some of the impacts of the Healthy Weight With Dairy campaign, which was launched in October 2003. In addition, the Healthy Weight With Dairy campaign displaced some of the focus on teens and flavors during the rest of 2003.

A second issue is the implementation of programs by the processors. While there have been isolated successes, overall processors have not been widely successful in adopting programs. For example, there is exceptionally low availability of local single-serve flavored milk brands in convenience stores. While in many instances the products are being introduced and produced, they are all too often not effectively reaching these essential channels of distribution because processors do not commit the resources necessary to appropriately deliver and merchandise these channels. Vending is another area of weakness. While vending has been identified as a potentially important driver of milk volume, processors have placed very few vendors in their markets or have not made the necessary marketing approach to independent operators.

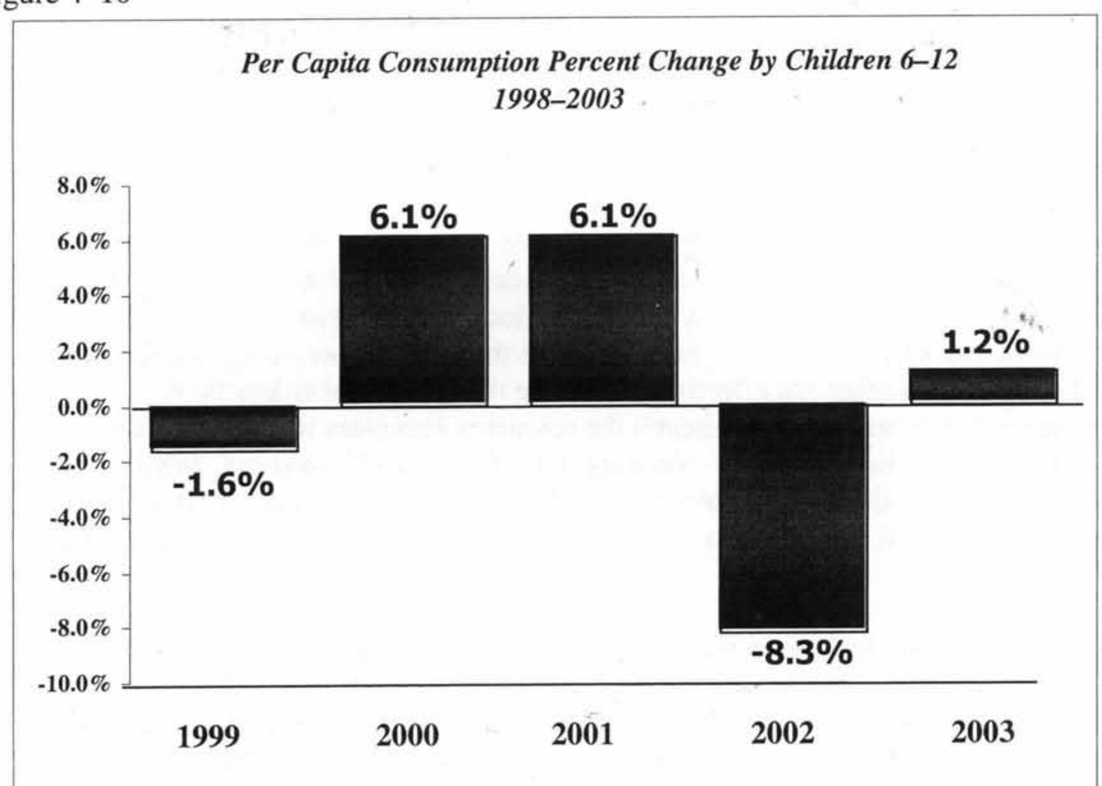
The last 2 years have seen declines in the fluid milk generic media budget—from $82 million in 2001 to $68.5 million in 2003 (see Figure 4–9). Beverage Marketing believes this decline in spending may have a negative impact on milk consumption in the face of sizeable spending by other categories in the competitive set. All of the categories in the competitive

Figure 4–9



Source: Beverage Marketing Corp. of New York and Lowe Advertising

Figure 4–10



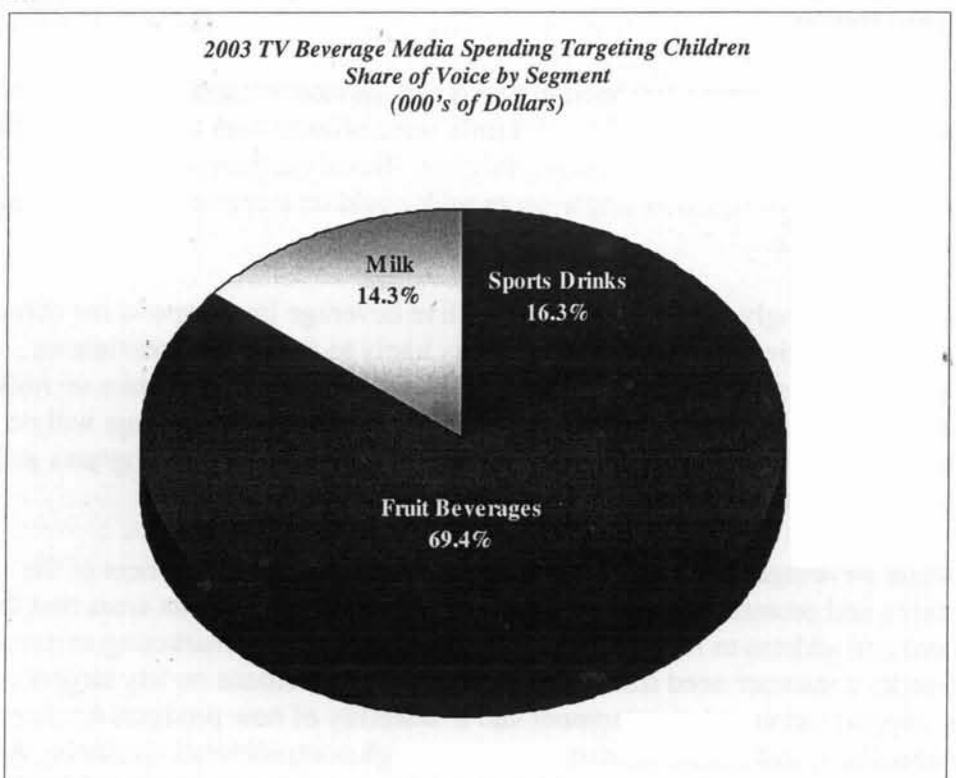
Source: Beverage Marketing Corp. of New York, SIP set (except bottled water) outspent milk in 2003 as they have in past years. In addition, milk's share of voice is roughly half its volume share of the competitive set. Beverage Marketing believes the impact of this lagged spending is likely cumulative and likely to negatively impact consumption in spite of a targeted marketing approach that has been somewhat effective at stemming consumption declines.

The focus of the spending remained much the same throughout 2003 as it did in 2002. Demographically, much of the spending went against the teens with less spending going against kids and adults. Moms were a secondary focus to teens. In addition, spending supported flavored-milk initiatives.

In spite of the decline in spending on 6- to 12- year-olds during the past 2 years, consumption may have stabilized. (See Figure 4–10.) This may be due in part to a rub-off from teen programs and the focus on moms.

Milk's share of media spending targeting children declined slightly in 2003, from 16 percent to 14.3 percent. Nevertheless, fruit beverages remained far and away the largest advertiser in the competitive set to target children, accounting for nearly 70 percent of advertising spending. Sports drinks accounted for 16.3 percent of children-targeted spending (See Figure 4–11).

Figure 4–11



Source: Beverage Marketing Corp. of New York

The year 2003 represents the peak of a 3- to 4-year marketing and promotional focus on teen consumers and flavored-milk activities. In particular, the first three quarters of the year were marked by a continued focus on marketing to teens, which has proven effective in increasing consumption in this key demographic target. In the fourth quarter, the emphasis shifted to focus on the benefits of dairy in weight-loss programs. The price changes previously mentioned make it difficult to separate any impact of this program shift.

Advertising spending is a critical piece of the industry's generic marketing campaign, and it is the one aspect of the campaign that is most easily measured and compared to the other segments in the competitive set. Nevertheless, it is not the only aspect of the generic fluid milk campaign. As dollars invested in advertising have declined, more focus and financial resources have been shifted toward promotional efforts and various strategic and operational initiatives, including working with processors to innovate and market their brands, as well as further development of retail, vending, and school-related programs. These programs have the potential to have a significant impact on milk consumption, but they are likely to have a greater cumulative impact over a number of years. Additionally, the success of these programs is greatly impacted by the effectiveness of processors' implementation.

In schools, the New Look of School Milk Program has begun to generate significant interest and volume opportunities for milk. There are now nearly 400 school districts either using or bidding out 8-ounce plastic packages for school lunch lines. This is likely to result in increased consumption among a key demographic cohort, kids and teens. The school milk program interacts synergistically with much of 2003's advertising and promotion effort targeting teens and flavors.

In foodservice, market tests were completed at two quick-service restaurant chains in which attractive plastic bottles of single-serve flavored milk were offered with kids' meals. The result was a spike in flavored milk sales during this test. Based on these results, BMC believes foodservice sales of flavored single-serve milk could be increased if the products were more widely available.

BMC foresees an increasingly complex and competitive beverage landscape in the coming years. Each of the categories in the competitive set is likely to experience continuous innovation, especially in products and packaging. This will place more pressure on milk processors to also become more aggressive. BMC believes that positive change will be based on a dual platform for growth, consisting of strong, targeted generic programs and industry innovation in product availability and branding.

In summary, while Beverage Marketing believes in the continuing effectiveness of the generic advertising and promotion programs, there are several crucial focus areas that the generic programs can address to improve milk's position: evolve the marketing message toward higher-order consumer need states, continue to focus or refocus on key targets and demographics, support increased development and availability of new products for more diverse usage occasions, and maximize distribution through nontraditional channels. All of this can be done in the context of the new weight-loss messaging focus scheduled for 2004.