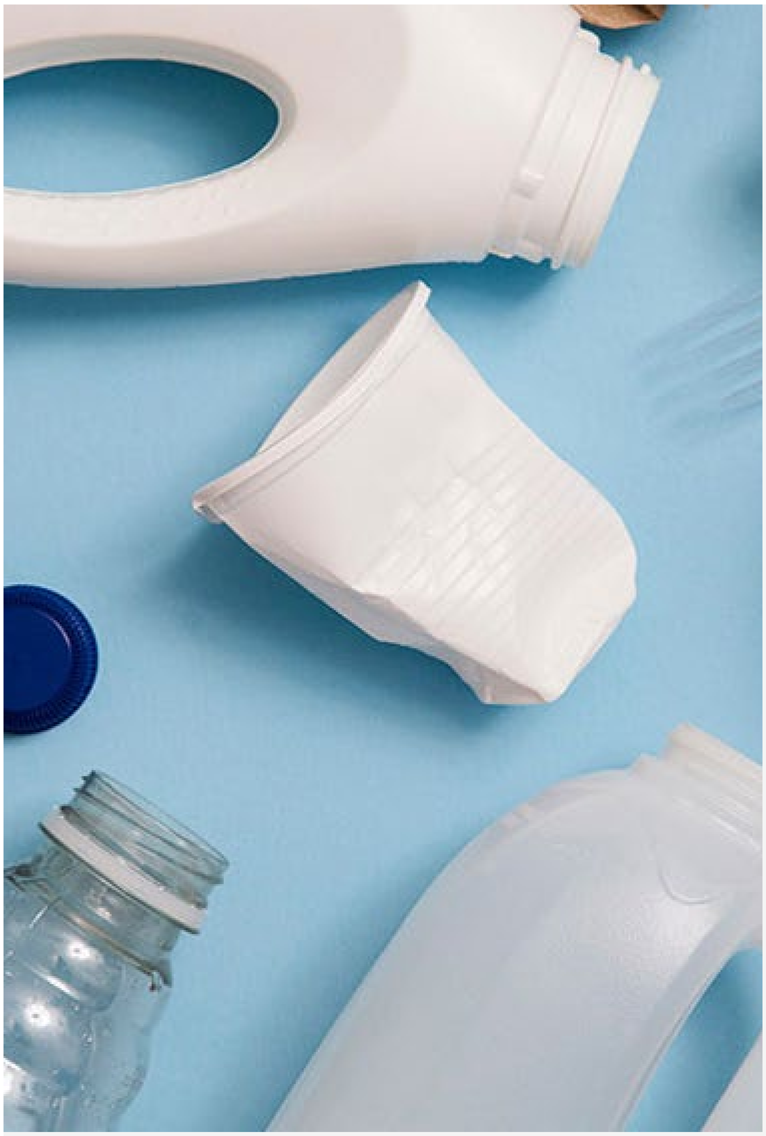

It's a Wrap? How Consumer Behavior Is Shaping the Future of Plastic Packaging

Consumer goods companies are being pressured to reduce or eliminate single-use plastics from product packaging. This presents an opportunity and a challenge. One thing seems certain: companies that ignore demands for eco-friendly packaging do so at their peril.

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6-minute read | 3-minute video

Key Takeaways

- Packaging is becoming an important purchasing decision factor for socially aware consumers.

- A combination of growing government regulation and consumer outrage over pollution is forcing many companies to replace single-use plastics with eco-friendly alternatives.
- The cost of developing environmentally friendly packaging can hurt companies’ margins.
- Companies that fail to respond with urgency to the shift in consumer behavior will lose out.

Harding Loevner’s Sergei Pliutsinski and Alec Walsh, CFA, discuss how consumer goods companies are reacting to rising concerns about the impact of plastic packaging on the environment.

Plastic is almost miraculous in its versatility. Its low price, light weight, strength, transparency, barrier properties, and extreme durability all go to explain why it is the ubiquitous workhorse of the modern economy, a material found in every home and used in virtually every industry.

Paradoxically, plastic’s durability is also its downfall. Since plastic generally is not degradable or readily recyclable, it is significantly more prone than, say, aluminum or paper, to end up in an ocean or a landfill. It is estimated that more than 90% of all plastic ever made is still present in our environment, and most likely will be for centuries to come. For the sake of convenience, many have ignored the polluting effects of plastics, such as the leaching of toxins into our groundwater from landfills. But with environmental awareness growing, younger consumers in particular now attach a stigma to some plastic products—especially single-use items such as packaging, water bottles, straws, and cutlery—that was once reserved for fur coats and tobacco. As the days of unrecyclable plastics are drawing to a close, the conundrum now facing many consumer packaged goods (CPG) companies is how best to adapt.

“It’s an issue that is growing in importance in C-suites of all of the food companies, beverage companies, and any companies that are using packaging to sell their products. What we are seeing around the world is that consumers are more focused on the social issues, and they are looking for brands that have a purpose behind them,” says Harding Loevner Analyst Sergei Pliutsinski. “Consumer goods companies that fail to heed what customers are demanding are probably going to be at risk of having their brand-equity diminished, and as a result their businesses are going to suffer.”

Eco-Conscious Customers

In a 2018 global survey conducted by market research firm GlobalWebIndex, more than half of respondents said they are now making a conscious choice to use less disposable plastic than they were a year ago. The proportion of consumers who said they would be willing to pay more for eco-friendly products grew from 49% in 2011 to 57%.

“In the past, purchases have largely been driven around price and quality of the goods, and the consumer would then make a decision based upon those two. I think we have a third ingredient now, which is the packaging and whether it is recyclable, whether it’s compostable, whether it’s biodegradable, and that’s going to help drive the consumer decision,” says Harding Loevner Analyst Alec Walsh, CFA.

Shifting public opinion is being reflected in a flurry of new government measures, with at least 127 countries and many more cities imposing bans or taxes to reduce single-use plastics. Earlier this year, for example, the Canadian government and the European Parliament announced plans to ban a wide range of single-use plastics starting in 2021.

“In countries where a ban or limitation on the use of plastics is in place, companies clearly have no choice but to comply. In other cases, such as in the US where we’ve seen a relaxation of environmental standards under the current administration, consumer companies are really acknowledging not so much what the government is dictating through regulation, but what their consumers are dictating through their behavior. Generally, companies are playing a longer game than politicians and they want to be seen as good citizens in the eyes of their consumers,” says Pliutsinski.

Plastic: Challenges and Opportunities

Many CPG companies are signing pledges to satisfy the demands of customers and government regulators. Procter & Gamble has, for example, committed to reducing packaging by 20% per unit of production by 2020, and to use only 100% recyclable or reusable packaging by 2030. Colgate-Palmolive’s goal is to use 50% recycled content across all its packaging materials by next year, while PepsiCo has announced plans to make all its packaging recyclable, compostable, or biodegradable by 2025.

Over the past decade, Nestlé, the leading manufacturer of bottled water and one of the world’s largest users of plastic packaging, has substantially reduced the amount of plastic in its bottles. Nestlé uses somewhere in the neighborhood of 1.7 billion tons of plastic a year, and only a small fraction of that is currently being recycled, according to the environmental organization Greenpeace. This is due to a combination of factors; not all of this plastic is recyclable, and, on the other end, consumers are not recycling all the products that are recyclable.

Last year, Nestlé set up a research institute to develop more environmentally friendly packaging for its products and reduce plastic waste, and in June 2019 the company claimed to have developed a way to wrap candy bars in recyclable paper, a technological breakthrough it has promised to share with other companies. Nestlé is also one of more than a dozen other major CPG companies working with UPS and New Jersey recycling company TerraCycle to offer consumers name-brand products, such as Procter & Gamble’s Tide detergent and Crest mouthwash, or Häagen-Dazs ice cream (licensed to Nestlé in North America), in reusable metal containers that can be shipped back for cleaning and reuse for the next customer.

Packaging can be a differentiator—an opportunity for companies both established and new to meet customer demands.

“We have seen some startups offering products that are really driven by their packaging,” says Walsh. One example is Michigan-based Boxed Water Is Better, which sells generic water in packaging made of recycled paper products that, unlike plastic bottles, are fully biodegradable. “So in an extreme, that’s an example of a company that is using packaging as its primary marketing force.”

Investing with a Long-Term View

The shift away from plastic packaging and search for alternatives can have a temporary negative impact on the margins of CPG companies. “If we look at the core of the consumer companies’ businesses, the biggest value is created with the brand and the quality of the product they have, and the message they have behind that brand,” says Pliutsinski. “As a result, some of those companies are able to generate very high gross margins and the cost of packaging is a relatively insignificant part of the overall equation on the economics of the product. If they have to pass on the cost to the consumer, if the packaging cost is less than 10% of the overall retail price, then let’s say a 25% increase in the packaging cost will result in a 2.5% increase in the retail price for the consumer. That’s manageable.”

As investors with a long-term horizon, Pliutsinski and Walsh are not concerned by what they see as temporary margin compression.

“Our typical holding period is five to seven years. So if a company were to suffer margin declines in this segment of their business for two or three years while they’re rebooting their asset footprint, we’d have no problem with that,” says Walsh. “Those companies that say they can’t suffer this short-term decline in margins because of the costs involved do so at their peril. They’re just not being realistic about how things are changing over the long term.”

Contributors

Analysts Sergei Pliutsinski, and Analyst and Portfolio Manager Alec Wals CFA contributed research and viewpoints to this piece.

Disclosures

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