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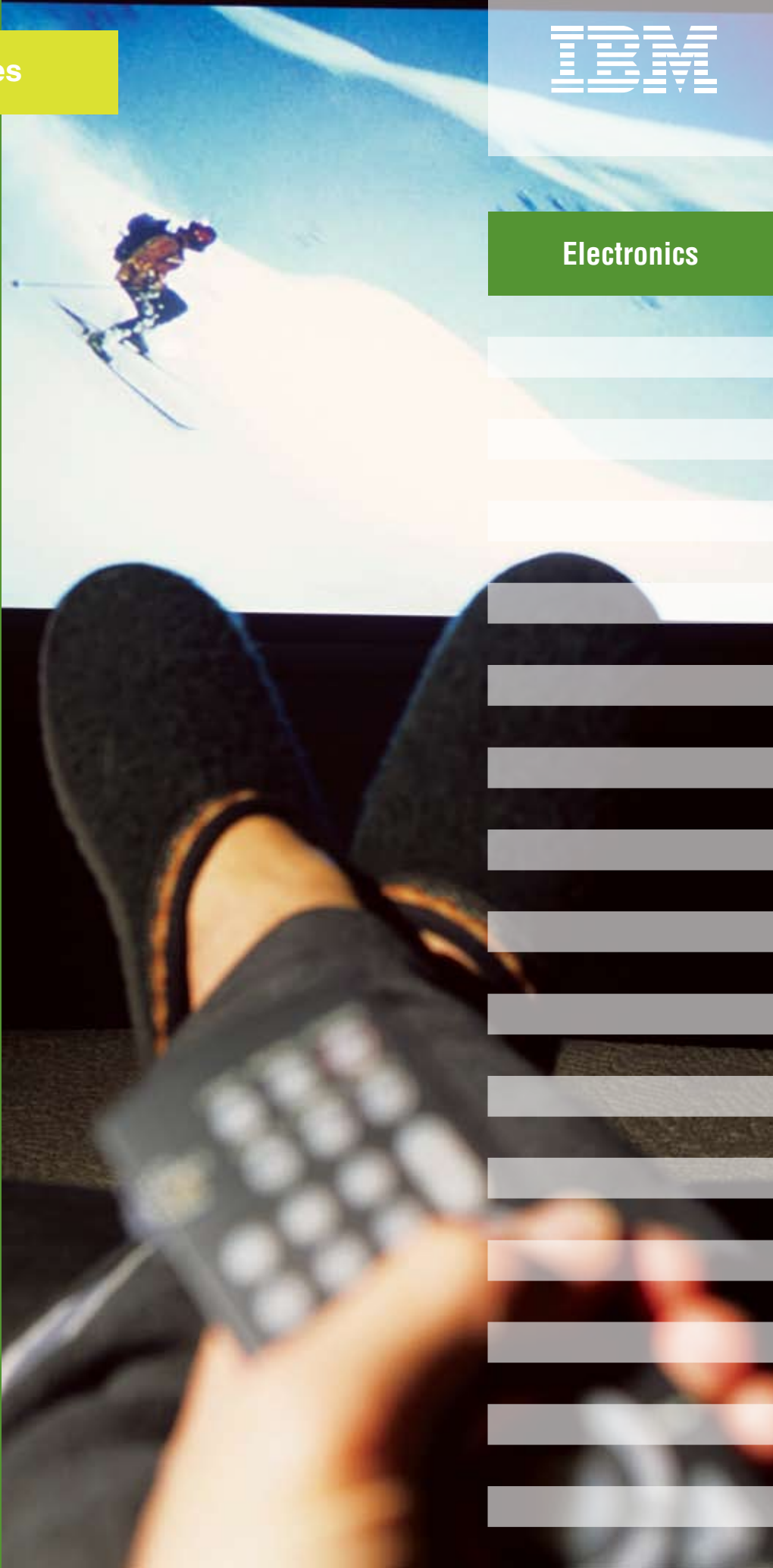
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# Not business as usual

Changing channels in  
consumer electronics

Electronics



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# Not business as usual

## Changing channels in consumer electronics

By Christian Seider and Sean M. Lafferty

*For decades, consumer electronics (CE) manufacturers have focused on creating products and retailers have focused on selling them. But things are changing. CE manufacturers and retailers are moving into each other's business space while still being dependent on each other. We believe that CE manufacturers need to quickly learn more about their end consumers, and rethink their channel strategy mix to best reach their target CE customers, all without alienating existing retail channel relationships.*

It used to be a lot easier for consumer electronics (CE) manufacturers. Just create new CE products with new technology, fancy features, neat design or a clear cost advantage. Then send the products to a bunch of retail stores where they would generate lots of profits for the manufacturer.

But the world has changed. Product innovation and excellence are now just the ante that gets you in the CE game. You win the jackpot by adapting with innovative business models, in addition to creating innovative products. Innovative business models for "how to sell" are now almost as important as innovative products. The CE manufacturer's ability to deftly manage and innovate with its mix of sales channels is a crucial factor for continuing success.

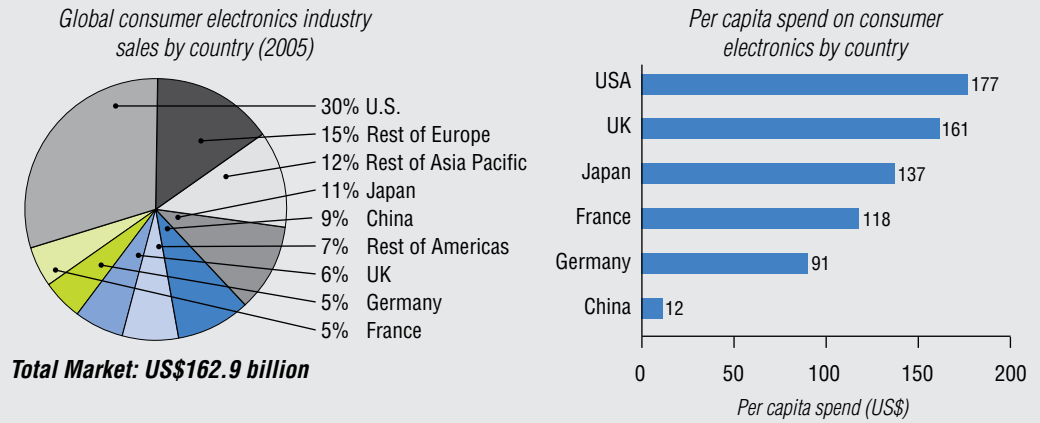
### A quick look at today's CE market and its drivers

The CE industry is big and growing (see Figure 1). By 2010 it is forecasted to reach US\$200 billion, which is greater than a 20 percent increase over 2005.<sup>1</sup>

The CE industry continues to be a difficult place to do business:

- *Cutthroat competition:* It's very difficult for one manufacturer to gain market share, and it's easier than ever for new competitors to enter the market
- *Very short product life cycles:* Manufacturers need to hit very small opportunity windows with the right product at the right price
- *Increasing product commoditization:* Many CE products are interchangeable and unit prices continue to fall.

FIGURE 1.  
**Total consumer electronics market is forecasted to reach \$200 billion by 2010.**



Source: Datamonitor, "Global Consumer Electronics Report 0199-2033," June 2006. IBM Institute for Business Value analysis.

Perhaps the biggest problem today is that net margins for CE manufacturers remain thin, even while manufacturer revenues are reaching record highs. Although revenues are up nearly 50 percent from 2001,<sup>2</sup> net margins are still around 2 to 4 percent.<sup>3</sup>

Underlying this profit problem is the realization that "how to sell" in CE today is nearly as important as "what to sell." Reaching the consumer in new and innovative ways is crucial to gaining competitive advantage. This contrasts sharply with what has been important for CE success in the past. Years ago, technology alone could lead to a product's success. Then new types of

products, or newly featured products took turns as key success factors. After that, getting to low cost through efficient supply chains could unlock success.

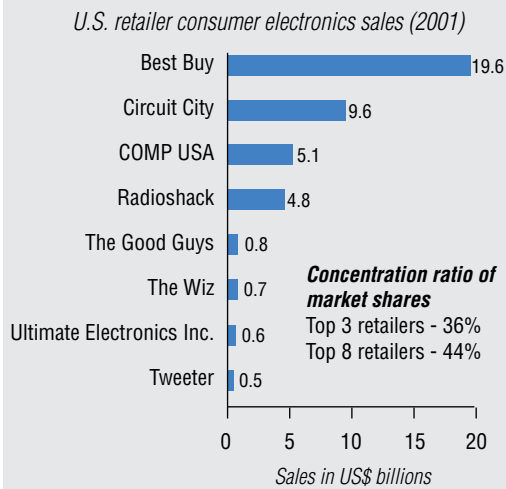
But today, a CE manufacturer needs to be "consumer centric," knowing the intimate details about the end consumers in market segments it is trying to reach. It has to know what those target consumers really want, and has to reach those consumers effectively. However, the consumer relationship has largely been managed by traditional CE retailers. CE manufacturers have neglected it, but cannot continue doing so.

# Not business as usual

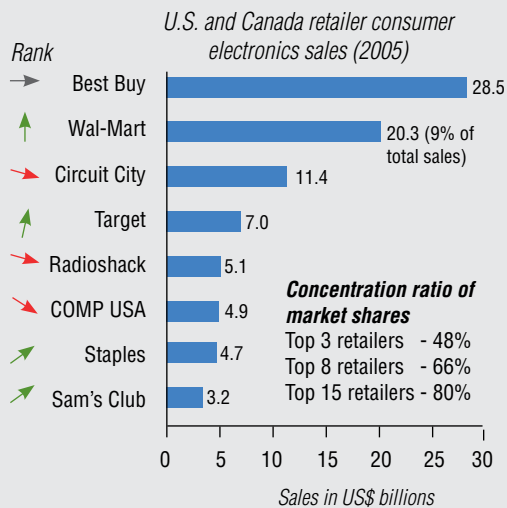
## Changing channels in consumer electronics

The marketplace for consumer electronics (CE) retailers has undergone a significant concentration between 2001 and 2005.<sup>4</sup> The mix of top CE retailers in North America has shifted (see Figure 2).

**FIGURE 2**  
There is a big shift in the mix of North American retailers.



Source: DSN Retailing Today.



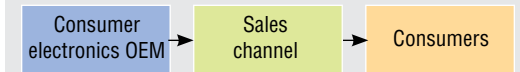
Source: Dealerscope estimates.

Also in 2005, the top three retailers accounted for 48 percent of the North American market – an increase of 33 percent compared to 2001.<sup>5</sup> A glance at Europe shows that retailers are also expanding across country borders – the top two retailers (Metro Group and DSG International) account for 60 percent of the market.<sup>6</sup>

### Today's sales environment

Figure 3 is a simple depiction of the downstream environment for CE: a manufacturer sends its products through the sales channel to consumers.

**FIGURE 3.**  
The traditional downstream sales environment for CE.



Source: IBM Institute for Business Value analysis.

But the downstream environment today is much more complex than that simple picture implies:

Until recently, "sales channel" mostly meant the CE retail stores. But today, the manufacturers themselves are getting into the sales channel with their own Internet stores, or with manufacturer-owned brick and mortar stores that aim at a specialty segment. General retailers such as Wal-Mart and amazon.com have also entered the CE sales channel in a big way and are finding great success there. CE manufacturers used to be the only ones that created CE products. But retailers are

**Significant change in the U.S. retailer landscape, in combination with more savvy and influential CE consumers, has created the need for robust sales channel strategies.**

starting to move into this manufacturer space (via partnerships), attempting to take market share, which is a direct threat to the manufacturers' revenues.

The U.S. retailer landscape has concentrated significantly, putting more power in fewer hands. In 2005 two U.S. retailers accounted for 40 percent of the market – five years ago, it took five retailers to account for the same share.<sup>7</sup>

Finally, the consumers of electronics products are wielding greater power today than ever: they have more options regarding what to buy, and can easily comparison shop on the Internet to select exactly the solution they want and where they will buy it.

In a nutshell, all of this means that CE manufacturers need to learn to create robust sales channel strategies, which will identify the behavior of their target consumers and the right mix of sales channels.

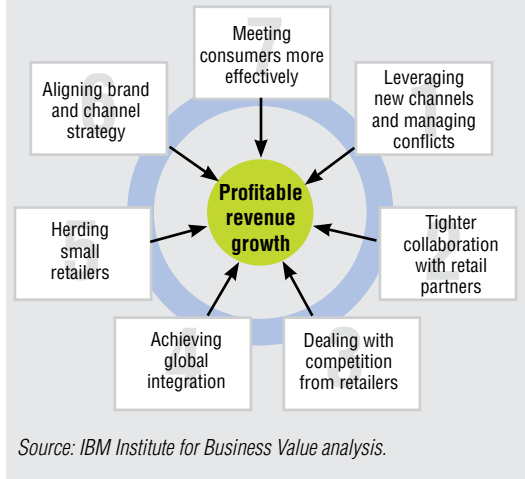
### How can CE manufacturers succeed in the changing sales environment?

CE manufacturers need to take specific actions to deal with the changing sales landscape today (see Figure 4).

Each of these actions will be discussed in the following sections:

1. *Leverage new sales channels and manage channel conflicts* – Re-evaluate current channel strategy and analyze the potential use of direct channels and how channel conflicts can be mitigated

FIGURE 4.  
**Seven key success factors for a channel.**



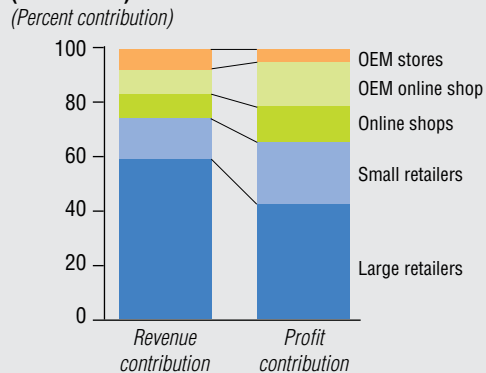
2. *Tighten collaboration with retail partners* – Establish common supply chain processes
3. *Deal with competition from retailers* – Develop strategies to proactively drive new solution development in alliances with large retailers
4. *Achieve global integration* – Leverage full power by establishing a truly global enterprise
5. *Herd small retailers* – Efficiently manage relations with smaller retailers
6. *Align brand and channel strategy* – Evaluate the need for alignment
7. *Meet consumers more effectively* – Understand customer wants and needs to deliver truly valuable solutions.

## 1 Leverage new sales channels and manage channel conflicts

The complex sales environment that CE manufacturers encounter today makes channel conflicts more likely. The manufacturer wants to do something one way, but the retailer wants to do it another way. And there's more than one retailer for the manufacturer to deal with.

The key to sales channel management is knowing the value each channel brings – in terms of revenue, profit and other strategic advantages – and then balancing all the channels (see Figure 5).

FIGURE 5.  
**Revenue and profit contribution by channel (illustrative).**  
(Percent contribution)



Source: IBM Institute for Business Value analysis.

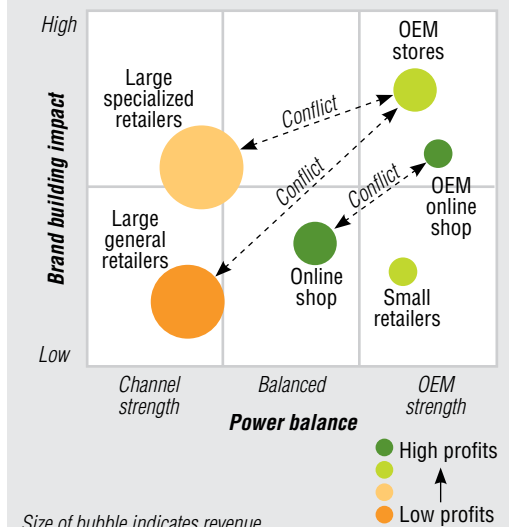
Sales channel management will require CE manufacturers to:

- Know which sales channel adds the most value to each customer segment
- Foster relationships with large retailers as these are likely to generate the largest part of the manufacturers revenue
- Define strategies to prevent channel conflicts and manage any conflicts efficiently.

However, many CE manufacturers don't have the customer or channel intelligence data they need to analyze their channels accurately. By implementing globally integrated CRM applications, manufacturers can establish a comprehensive global view of detailed sales by channel (see Figure 6), especially when the data is used in combination with market intelligence on customer segments and buying behavior. Furthermore, analyzing channels is often a new activity for many CE manufacturers, and they will need to develop the skills to do that analysis on an ongoing basis.

Today, some manufacturers are acting as their own channels. Internet shops represent increasingly important sales channels for CE manufacturers. Online sales of CE products are estimated to grow from US\$9.8 billion in 2006 to US\$17.3 billion in 2010, a compound annual growth rate (CAGR) of 15.3 percent.<sup>8</sup>

FIGURE 6.  
**OEM-controlled direct channels represent new sales avenues but may alienate retailer relationships (illustrative).**



Size of bubble indicates revenue.

Source: IBM Institute for Business Value analysis.

Internet shops of CE manufacturers are in direct competition with those of large retailers (channel conflict) and can directly threaten their revenues. Also, some manufacturers – such as Apple – are opening their own brick and mortar stores that will compete with the stores of their retail partners.

CE manufacturers will move toward these kinds of direct channels to deliver the total customer experience when they find that the retailers are not being effective.

### **Apple: Boosting revenue through direct sales channels**

Historically, Apple mostly sold products through the traditional retailer chain. But in 2001, Apple launched its storefront program for the new Mac (“center of digital lifestyle”). It now has 155 stores worldwide (mainly U.S., Canada, Japan and the UK) with 17 million visitors during 2Q06, generating US\$2.4 billion revenue in 2005 (100 percent growth year-to-year).<sup>9</sup> Apple’s revenues from traditional indirect channels grew 43 percent in the same period. Also Apple’s online music store iTunes commands 88 percent of legal U.S. music download market (1.5 billion songs downloaded).<sup>10</sup> With its own stores, Apple has greater brand control and can offer more services – such as the genius bar (hands-on technical support), the studio (creative advice for movies, songs or photos), Pro Care (a deeper level of service and support) and workshops (a variety of free one-hour workshops).<sup>11</sup> While revenues from its direct channels are growing rapidly, profit margins are still lagging those of the traditional business (6.3 percent versus 10 percent in 2005) – a lag Apple mainly attributes to major investments required for the stores.<sup>12</sup>

### **Bang & Olufsen (B&O): Profiting from a variation on the traditional retail channel<sup>13</sup>**

Facing financial problems in the early 1990s, B&O opened its franchised retailer system, avoiding selling through traditional retailers. Since then, this new channel strategy has significantly contributed to the company’s financial health. Its B1 shops generate 73 percent of revenue, with the remainder coming from “Shop in Shop” outlets. New shops are opened regularly, with growth focused in regions like China and India. Today, B&O has 1400 retailers in 60 countries. B&O’s financial recovery seems to indicate that sales of its exclusive portfolio are strongly nurtured by this innovative channel strategy.

## ***2 Tighten collaboration with retail partners***

CE manufacturers are highly skilled at making products, and retailers are highly experienced in selling products. But success today requires that the CE manufacturers and retailers work much closer together. Manufacturers need a goal of transforming current supply chain processes into collaborative, integrated processes, based on up-to-date information technology. Today, tighter collaboration with the retailers is one of the few effective means to manage the ever-shortening CE product life-cycles and ever-higher volumes.

CE manufacturers and retailers can form stronger supply chain links by implementing advanced business processes that are already enabled by mature technologies, such as collaborative demand planning and forecasting, the exchange of point of sale data or vendor managed inventories. Wal-Mart pioneered tight supply chain integration with strategic partners like Procter & Gamble. As a CE retail power, Wal-Mart will likely require closer integration from CE manufacturers and drive industry change.



This threat to CE manufacturers, which is still small at this time, can be met by:

- Cooperating with selected retailers to proactively partner on new solutions
- Competing against solutions from retailers with products of their own
- Increasing volumes with “neutral” retailers who are not delivering competing solutions
- Focusing on direct channels like Internet shops or brick and mortar stores.

Almost certainly this trend will increase competition in the CE marketplace and will ultimately benefit consumers, but CE manufacturers need to gear up for stormy seas.

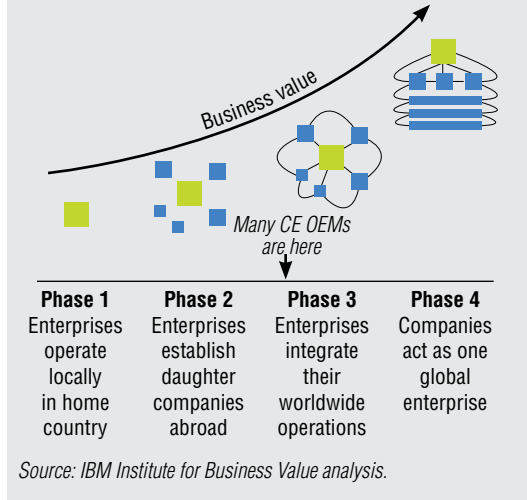
**CE manufacturers should aim for greater global integration of their own companies; many are beginning to transform their business models to reap the benefits of a more unified enterprise.**

#### ***4 Achieve global integration within the manufacturer’s internal boundaries***

Many CE manufacturers are multinational companies with autonomous organizations spread across multiple countries and continents – and sometimes such regional organizations may not all be pulling in the same direction. Sometimes branding is the only thing shared across a company’s regional organizations, along with the consolidated income statements and balance sheets.

The manufacturer thus misses the opportunity to leverage the clout of a single large organization pulling in one direction. Because leading retailers like Wal-Mart and Best Buy are getting larger with more buying power, CE manufacturers must be able to match them. The manufacturers must overcome their own internal resistance to true global integration and start acting as a single company (see Figure 8).

FIGURE 8.  
**Evolution of business structures.**



As they move toward greater intra-company global integration, CE manufacturers will need to:

- Set a clear strategic agenda for the company overall
- Gain buy-in from major internal stakeholders to support transformation plans
- Rectify business models and processes to match the overall strategy by: leveraging transformation leading practices across geographies to improve repeatability; and switching from geographical to functional orientation – for example, by using global product development teams instead of many local teams.

**It's important for CE manufacturers to clearly segment retailer relationships to be able to identify which retailers have the most strategic importance.**

### ***5 Herd small retailers***

In the past, many CE manufacturers tended to work with many different retailers, often without regard for the size or strategic importance of the retailer. But today, CE manufacturers need to clearly segment retailer relationships, and after segmenting, may have to de-select some of the retailers.

The bulk of today's market share is fast becoming concentrated in only a few CE retailers – which means that CE manufacturers need to give them the most attention. As a result, manufacturers cannot spend sufficient time with smaller retailers. However, many CE manufacturers lack a clear understanding of which retailers are strategically important and which are not. What's more, they don't understand which business models and processes can support managing small retailer relationships without moving too far away from end consumers.

CE manufacturers will need to set thresholds for annual sales orders to do direct business. One result is that small retailers will either have to go through distributors or affiliate with purchasing associations to sell the manufacturer's products. Or, a manufacturer can evaluate self-service for smaller retailers that provide automated support services and optimize doing business while maintaining a closer relationship.

### ***6 Align brand and channel strategy***

Branding lets target customers see the CE manufacturer as more than just a manufacturer, and its products as something more than similar products. When branding is done well, it attracts sales and improves customer loyalty.

Many manufacturers have skillfully established highly reputed brands. But because today's CE marketplace has changed, manufacturers need to better align their branding with both their corporate and sales channel strategies. The company's brands need to be supported by a business model and channel strategy that let the manufacturer skillfully execute and deliver the total experience that the branding promises to consumers. To accomplish this, CE manufacturers must identify and resolve inconsistencies between their brand and channel strategies.

### ***7 Find innovative ways to reach consumers more effectively***

Historically, the retailers have "owned" the relationships with CE customers. CE manufacturers developed, manufactured and delivered products to the retailers and were not involved much with the customer relationships.

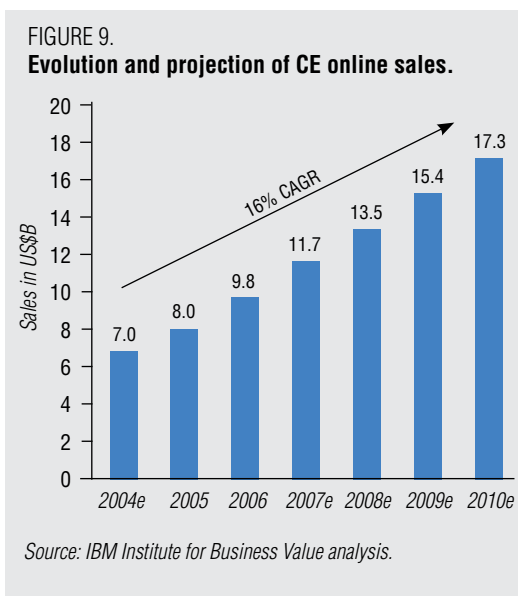
But if CE manufacturers want to increase their control in the CE value chain, they have to understand their end customers much better. Segmentation and analysis of end customer wants and needs is fundamental, requiring dedication and investment in customer research. However, this kind of data gathering and analysis may require that some CE manufacturers dramatically improve their skills in this area.

Today, consumers are gaining greater power in the CE marketplace, with control over what products are developed. Whereas in the past consumers might have been attracted by new technologies, or fancy product features, or even lowest cost, today they are looking for reasonably priced solutions to real consumer

**CE manufacturers can no longer afford to neglect the consumer relationship because reaching consumers in new and innovative ways is crucial to gaining competitive advantage.**

problems. They are often looking for solutions which integrate a CE device with content and services to optimize a buyer's experience. The Apple iPod with iTunes is already a classic example of such an innovative solution.

Moreover, the act of purchasing CE products has changed. Product information (models, features, prices) is available instantly via the Internet, which lets the consumer comparison shop at wide variety of retailers very quickly. And for many consumers, purchasing over the Internet is actually preferable to traveling to a traditional store (see Figure 9).



To succeed in this new consumer-driven marketplace, CE manufacturers need to understand who their customers are, how they can be segmented, and how they best can be reached. They will need to think deeply about what sales channels are best used for which target customers and products: Internet shops, their own brick and mortar stores, distributors or more traditional retailers.

Manufacturers need to think through the complete mix of sales channels and how the total mix interacts. They should select sales channels to complement the products being sold through them, and analyze the return from each different channel. Each new sales channel needs to add true value and differentiation to consumers, and lead to tangible incremental revenues and profits for the CE manufacturer.

### **Where do CE manufacturers go from here?**

While there is no "one-size-fits-all" approach when determining the right actions for a CE manufacturer, a detailed channel strategy for products is vital. The channel strategy identifies each channel partner and identifies ways to manage them so the manufacturer can achieve strategic business results. Sales channel management is a complex area where mistakes can be costly and difficult to correct.

In order to create a robust channel strategy, CE manufacturers need the skills and experience to create the channel strategy and manage its inherent complexity, as well as the projected and historical data about end customers and different channels.

Before developing a channel strategy, a CE manufacturer should have the information to answer these questions for each product and solution they offer to consumers:

- What is the market size for each of your solutions, by geography?
- What are your detailed sales expectations by customer segment and by product?
- How much control does each channel partner exert over each sales channel?
- How much power does the manufacturer have in each channel?
- What impact does competition have on each sales channel?

The channel strategy can then be developed to answer these questions:

- Which channels bring the most value, and how can you encourage those high-value channels?
- What channels are causing conflict, and what should be done about that? Are the conflicts strategic or tactical?
- Do some channels need to be de-selected?
- How many channel partners should sit between you and the end consumer?
- Do you have the power to push other solutions through the channel, or is it the channel that's pulling from you? Does this need to change?
- What channels use which distribution models (VMI, warehouses or others, such as direct to consumer via 3PLs)?
- To what extent do you want to be exposed to the challenges of selling directly to consumers? Perhaps you just want to be a manufacturer that leaves all that to retailers and distributors?

## Conclusion

In the CE industry today, *how to sell* is now almost as important as innovating the products themselves. CE manufacturers need to make innovations to their business models for better focus on how to sell. CE manufacturers quickly need to learn to create a well thought-out channel strategy. And, as the CE marketplace continues to evolve, they need to continue to gather customer intelligence and innovate their sales channel strategies.

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