



## Not business as usual: Changing channels in consumer electronics

*March 2, 2007*

**Christa Fritz:** Hello everybody, this is Christa Fritz, I'm within IBM and we're here today to talk with two of our electronics experts in the IBM electronics industry. The first is Christian Seider; he's part of our IBM Institute for Business Value. Christian is based out of Germany.

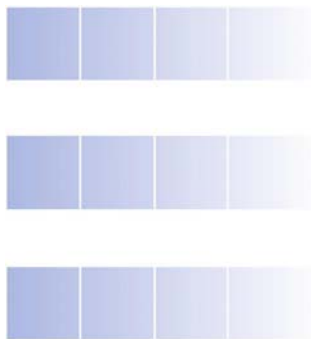
Second expert we have here today is Sean Lafferty, he's our IBM Growth and Innovation Leader within the electronics industry, he works worldwide with our electronics consumer products and all different types of major and multi-national electronics companies. And they're both here today to talk a little bit with you about, Not business as usual, changing channels. And we're not talking television channels right now.

So, I'm going to dive into some questions here. First, I want to thank you both for joining me today. Hey Christian, how is today's consumer electronics marketplace different than ten years ago?

**Christian Seider:** I think what has happened in the last ten years in the consumers electronics market is absolutely remarkable. On the demand side, sales of consumer electronics products have risen steadily, and especially in the last five years even more so.

In the global market last year was about 160 billion U.S. dollar, and it's predicted to grow to more than 200 billion in 2010. Just to put these figures into context, Finland, for example, had a gross domestic product last year of around 170 billion U.S. dollar, so this really emphasizes that consumer electronics is a major marketplace.

Let me also talk a little bit about the recent trends in the market and how it compares to ten years ago. Our changing channels study has shown that the industry is just entering the next wave in its evolution which we call the wave of customer centricity where it becomes more and more important for the OEMs to really understand what their end customer's true wants and needs are. Ten years ago, most of the OEMs have been pretty focused on product development and in optimizing their supply





chain. And, when I mean product development, it was more around developing what the companies believed that their customers could need.

Today is – this is really different, the voice of the customer has become much more important, much more critical, and will be and has to be an integral part of the OEMs product development efforts. While the revenues for the OEMs have risen similar to the total market, the unit prices for that products and just look at the prices for – or price decreases in mp3 players of that have decreased. So this drop in unit prices, of course, has significant impact on the profitability of the OEMs which is on a low level of around two to three percent.

Let me also talk a little bit about, you know, who the leaders are in this marketplace. If we look at the sheer size of the business, we've got the usual electronic OEMs like Sony, Panasonic, Phillips or LG Electronics and this is really just to name a few. But many of the large OEMs have a significant profitability problem. If we want to pick out a couple of companies with healthy revenues and profits, we have to mention, of course, Apple, or Bang & Olufsen. Both of them have managed to create turnaround in the recent years by moving closer to their customers and by controlling debt based channel in a more direct way.

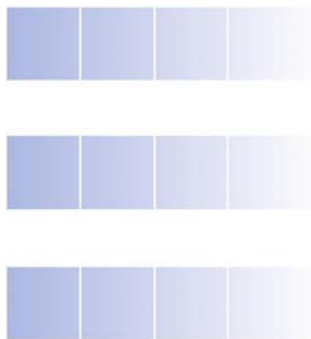
**Christa Fritz:** Really interesting and it's so different than ten years ago. I know these consumer electronic OEMs are under quite some pressure. What kind of pressure and what are some ways they deal with it?

**Christian Seider:** That's also – it's a very good point. I think first of all the OEMs, the consumer electronic OEMs are operating in a highly competitive marketplace. I've talked about the increases in sales, but the lower unit prices resulting in the low margin business. It's very short innovation in product life cycles there as the decreasing the customer's want, new products every couple of months in the shelf.

So, this is really a major pressure on the OEMs development and design capabilities. You find commoditization of products, you find also that the OEMs need to better understand their target audience, and also understand better their consumer micro-segments which are evolving. If we look a little bit into the sales channel, of course, the sales channel are also putting pressure on the OEMs.

So, if we look at the retailers like Best Buy or Circuit City or Wal-Mart for example, we see a major consolidation of the retailers which leads to an increase in the buying power and strengthens the position of the retailer towards the OEMs. And furthermore, we also see an expansion within and across geography of the retailers and Best Buy, I think they have just announced recently that they are opening stores also in China, so which substantiates the point of geographical expansion.

And, of course, then the consumers also putting pressure on the OEMs because the consumer has really information on the fingertip, he can easily go onto the internet





and compare different products where in the past this was a little bit a clumsy process for the consumer. He can log into certain Web sites, can compare different product features and prices and this is a really something new which is definitely putting pressure also on the OEMs.

**Christa Fritz:** It's interesting that companies like Apple really have done well despite the pressure. For example, Apple and iPod go together just like wine and cheese. What can IBM tell our listeners about this type of company Apple and its products and services? It's definitely evolved into something new, hasn't it?

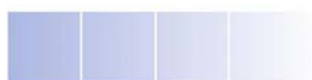
**Sean Lafferty:** Yes, for sure Christa, I mean I think you hit on a great point. Christian laid out the scenario and some of the dynamics in the marketplace, particularly the difficulty that a lot of the OEMs are having with retailers. But, if you look at Apple over the last couple of years actually, their stock prices appreciated 700 percent over the last three years, I mean that's amazing. And, a major part of that is that they've been able to sustain about a 16 percent net margin in their retail channel.

So, that's really unprecedented, so you have to take a closer look and say well how can they do that when everybody else is struggling to make three percent? And so, one of the things of course, you know, everybody knows about how the product and service work in the iPod and the iTunes, you know, and the design is interesting. They really do have a great offering there, but it's more than that they really done a terrific job of managing their channels. And, when you look at it they've built a direct channel, it's very compelling, their retail stores are terrific. They're engaging and exciting, and what they really accomplish with that is they put a lot more pressure back onto the retailers that everybody wants the product, everybody has access to it.

And so, when they walk into that Circuit City or Best Buy, they want it and they're willing to pay for it. So Circuit City and Best Buy are put in a more difficult position when they're handling Apple than they are handling other branded OEMs.

**Christa Fritz:** Sean, IBM has done a great deal of work with major consumer electronics companies. Can you tell me about some recent IBM successes?

**Sean Lafferty:** Well sure, and this lines up to some of the points in our – in our point of view, I think, we've outlined a number of opportunities for our clients to be more successful in the retail channel and how to manage their channels better. And, among those are collaboration – tighter collaboration in the supply chain with the retailers. So, for example, with one of the major multi-national consumer electronics OEMs in the U.S., we've actually done quite a bit of work in helping them with their forecasting process. The consolidation of the retailers that Christian mentioned and their increased power has really enabled them to put more pressure on the OEMs and ask them to manage the inventory in the channel, right?





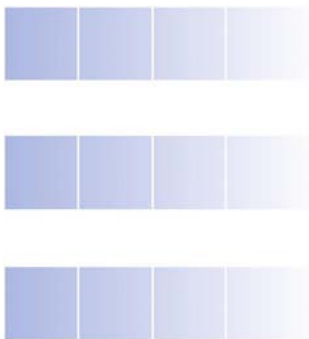
So, you're looking at vendor managed inventory and you're looking at collaborative forecasting, and a lot of these companies haven't had to do that in the past, and so what we were able to do is – with one of our clients, work very closely with them on redefining the process, help them – we provided IBM research techniques in developing algorithms. So, they're actually now getting access to the point of sale data that they didn't have before. And, this is something that they didn't know how to take advantage of. And so, what we did is we put, you know some of our guys from research on it, Ph.D.'s in mathematics and statistics, and these guys developed it – a better algorithm for turning that data into forecasts. And, we actually improved the forecast percentage of the accuracy from about 60 percent to about 75 percent which is among industry leadership.

So, I mean it's a terrific example where we worked very closely with them and we helped them through this process. We brought IBM's best capabilities and now we're also integrating that solution into their ERP system. So, we're developing some assets there and helping them formalize this structure. So, terrific example where we got great business benefits, we leveraged all that IBM brings to the table, including software development, consulting, process, redesign and our research capabilities and created a unique solution.

A second example is with another one of our clients who is working on multi-channel management. And so, what we've been able to do is help them think more about the entire purchase decision process. And so, what we're working on with them is, at this point, it's kind of a transformational consulting engagement. And we're helping them rethink how to manage all the interactions across the consumer buying decision so that customers don't get lost when they enter into the sales channel.

So, direct sales is not only about completing more transactions and getting revenue because, for the OEMs, they don't really need to worry about whether the transaction goes through the retailer or whether they handle it directly. But, what the direct channel can do for OEMs is it can help them manage that process of walking a consumer through hey, I think I might want to buy something to I want to buy this specific brand. And, this is where I'm going to get it and now I know what I want and I'm going to go and purchase that. And further, after the transaction is done, I'm happy with it.

So when I take it home and I take it out of the box, think of a plasma TV, and you're going to have to think of, the installation. Now I've got this big ugly cardboard box and I've got all these wires and I don't know what to do with it. So, when we think about multi-channel management, it's that entire process end to end, leaving the customer satisfied and happy, enabling them to recommend the product, and basically working all of the touch points from conceiving of purchasing something all the way through to buying it and then beyond that to working on enabling the experience for that consumer.





**Christa Fritz:** Fantastic. You know, it sounds like IBM is leading edge once again. If companies are ready to compete in the electronics marketplace of today and a few years down, it sounds like we've got a great number of case studies, great examples of where we've already done some pieces of thought leadership and real client work in the CE channel management space. So, I'll close it today just thanking you both for your time.

And just a note, being an end consumer myself, it makes me feel better that IBM is helping out these consumer electronics products getting ready. After all, right now I have an iPod and I know I have a PlayStation and I want the easiest setup possible so it's great to know IBM is helping us all out. To find out more about this podcast, "Not business as usual: Changing channels in consumer electronics study" visit us on the web at [www.ibm.com/services/bcs/iibv](http://www.ibm.com/services/bcs/iibv). That's a wrap for today and thanks for your time.

