

Consumer products 2010

Executing to lead in a world of extremes



deeper

An IBM Institute for Business Value executive brief

The IBM Institute for Business Value develops fact-based strategic insights for senior business executives around critical industry-specific and cross-industry issues. This executive brief is based on an in-depth study created by the IBM Institute for Business Value. This research is a part of an ongoing commitment by IBM Business Consulting Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to iibv@us.ibm.com for more information.

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Introduction

Slowly but surely, market forces are leading to a global consumer marketplace that will look radically different in 2010 than it does today. Traditional mass market strategies will be eclipsed by unprecedented consumer diversity, market polarization and megaretailer dominance – pushing the consumer products industry to a “world of extremes” with big winners and big losers. What will that future look like? What capabilities will consumer products companies need to remain relevant to demanding consumers and trade customers? How should firms organize themselves and begin preparing now? The fundamental challenge is the ability to execute with speed and agility to sustain market leadership in 2010’s world of extremes.

Executive summary

All around the world, the consumer marketplace is rapidly evolving and posing new challenges for consumer products companies. Unprecedented consumer diversity and market polarization are pushing the industry to a “world of extremes” that will create big winners and losers in the coming decade.

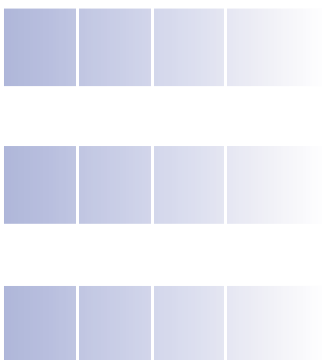
IBM Business Consulting Services has identified five deep-seated trends that will redraw the rules of competition for consumer products companies by 2010:

- *Consumer value drivers fragment.* Consumers are fragmenting into micro-segments as a result of pronounced shifts in demographics, attitudes and behaviors. Furthermore, they are “trading down” to low-cost commodity providers on one end and “trading up” to high-value, premium brands on the other.
- *Gatekeepers become more guarded.* Enabled by new technology and regulation, overwhelmed, time-strapped consumers are exerting greater control over their interactions with businesses, who must devise ways of becoming more relevant to the consumer at the point of purchase.
- *Information exposes all.* Consumers are becoming incredibly empowered through access to information however, wherever and whenever they want it.
- *Megaretailers break the boundaries.* Global megaretailers are rapidly expanding across geographies, channel formats and product/service categories, dictating the terms of trade to suppliers.
- *Partnering becomes pervasive.* Competition is no longer a solo game. Leading companies are teaming with alliance partners to create integrated, collaborative “value networks” that offer a stronger, more competitive value proposition.

In the future, “super shoppers,” armed with ubiquitous information access, will optimize their individual value equations and give their money (but not necessarily their loyalty) to whomever best satisfies their personal needs. As we move toward 2010, revenue growth will continue to flow to opposite ends of the competitive spectrum as mass-value products provide “good enough” value at low prices, and targeted products offer unique value worthy of a price premium.

Looking forward to this new reality, corporate thinking needs to rotate from “bell curves” to “well curves,” and executives must determine how to drive growth at one or both ends of the new demand curve. In this increasingly polarized marketplace, we believe industry executives must focus on four major imperatives:

- *Deliver insight-driven innovation – faster.* Traditional sources of market data are becoming less valuable. Consumer products companies need to exploit new data sources and develop more granular insights about segment and store-level consumer demand. And, equally important, they need to reduce execution cost and time-to-market for new products to drive renewed growth and profitability.
- *Sell more through superior service.* Powerful retail customers are looking for suppliers to make greater investments in retailers' success, in areas such as merchandising and promotions, order and inventory management, product innovation and consumer insights. Consumer products companies can enhance their product strengths and gain preferred supplier status by delivering account-specific value. But they need to develop the organizational capabilities necessary to shift from pushing products to partnering and providing services.
- *Build “fit-for-purpose” supply chains.* In a world of extremes, different products and retail environments demand different supply chain capabilities. Companies need to tailor their supply networks to a particular purpose – to increase responsiveness to changing consumer tastes and buying patterns (“sense and respond”) or to deliver greater efficiency and value for commodity products (“mass value”). Taking the middle road leads to inefficiency and leaves room for competitors to outperform.
- *Focus the organization on differentiators – then follow through.* To remain competitive, companies must stop driving incremental improvement in all areas of their business. Instead, they need to drive substantive, systematic change by focusing the entire enterprise on what really differentiates them in the marketplace and addressing those components of their business that ground envisioned change in reality.





Overall, the fundamental challenge for consumer products companies is to execute with sufficient speed and agility to regain and sustain market leadership in 2010. This will take more than sound planning and strategic intent. To win in a world of extremes, companies must take execution to the extreme, adopting a deep, holistic change management approach that turns their vision into real results.

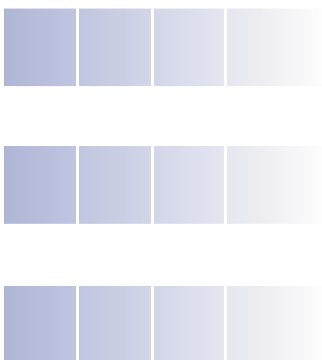
Preparedness meets opportunity

C.P. Big, president of a large, multinational consumer products manufacturer, smiles as he unrolls his electronic notepad and reviews the company's realtime performance report. From his executive information portal, he touches particular product lines, then drills down from corporate to region and even to store-level results. As he analyzes the company's current performance, he muses...

It's amazing how fast revenues from our new convenience meals have grown. I still remember the initial product pitch from R&D sprinkled with quotes from actual shoppers' smart cart entries: "Why does every prepared meal have broccoli?" and "More beans please." That flow of innovative ideas straight from the consumers' keypad eventually led to our "Big idea" consumer contest, cosponsored with MegaMart. What great press for us both! Chalk up another reason for MegaMart to stick with Big.

Looking at this category, it's clear that we've really redefined "convenience." Through our alliances with retailers and local restaurants, busy consumers can order dinner while shopping, pay for it with their groceries and have the meal delivered to their doorstep. With everyone's systems linked, every part of the transaction is handled electronically. Just the kind of innovation consumers want and MegaMart expects.

It looks like sales across the entire health food category are trending up in stores where retailers are activating our electronic nutrition labels. Information emitted by the product's RFID tag allows health-conscious consumers to obtain the exact nutritional makeup of the product (well beyond mandatory labeling requirements), while providing socially-conscious consumers with information on where the ingredients were grown, how the surrounding environment is being protected and whether the farm laborers earn a "living" wage. And sales show how much shoppers care about these details.



Getting our new flavored oils featured in this season's hottest TV cooking shows has made a tremendous difference. Less push, more pull; no hard sell; our target market is self-identifying by opting in for more information, reaching us with their interactive media devices from the comfort of their living rooms. This is so much more effective than spending millions on untargeted ads that no one pays attention to. I'm flagging these results as must-reads for all category managers.

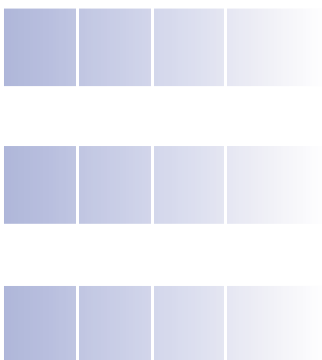
I see our ethnic foods group is gaining share against MidMarketMerchant's brand. Those infomediaries that everyone seemed so afraid of have actually turned out to be our best sales "people", influencing consumers toward our products. We didn't fight the tide – we rode it. We gave them more info, showed up in more searches and found ways to add more value to infomediary services like holiday and "meal solutions" planners.

The paper goods pilot with our top-tier retailers is showing positive signs too. With every transaction, our ability to discern between replenishment buyers and special occasion shoppers becomes more accurate. Both of the customized offers electronically presented at the point of purchase – a volume discount coupon for replenishers and reduced prices on matching plastic ware for party-givers – are each being redeemed over 75 percent of the time. Through continuous in-market campaign analysis, we've been able to advise our retail partners on discount amounts that increase sales and profits for both of us.

Although the team warned me, I still hate to see sales flattening for our household cleaners division. It's a good thing costs are falling faster. Looks like they're still above the profit threshold we set for the quarter. Let's see which manufacturing partners we're using most. It still fascinates me how this automatic rebalancing happens – mix together regional demand signals, production capacity and locations, current distribution costs and more factors than my mind can absorb, and out comes an optimized sourcing plan.

Pushing back from his desk, C.P. catches a glimpse of the 2010 calendar on his wall and thinks...

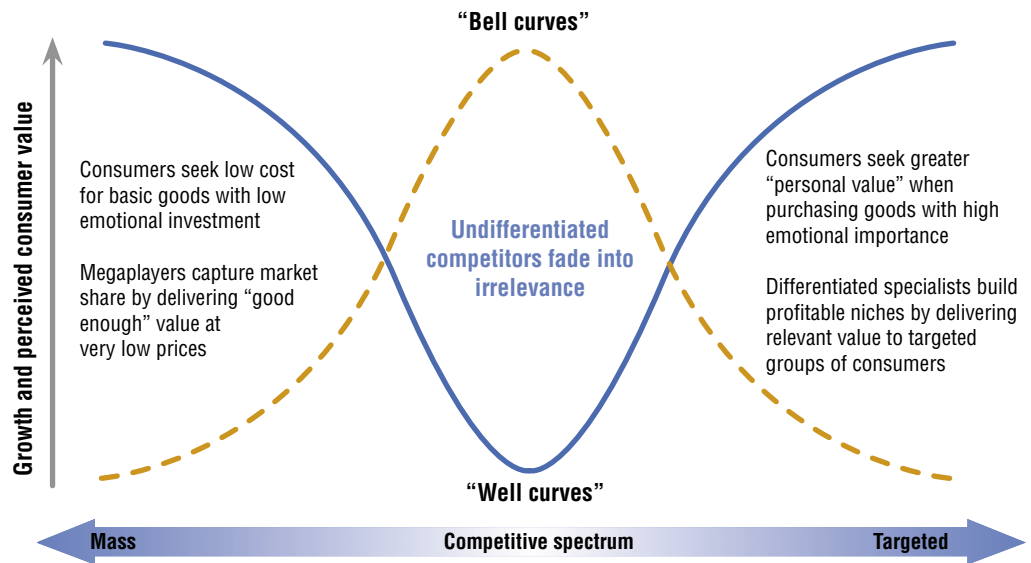
During most of my career, our company focused on making incremental operational improvements year after year; but our fundamental business didn't really change much. In fact, the entire industry operated in pretty much the same manner for more than 100 years. But what a difference now – it's like we're in an entirely different industry! These last five years have revolutionized the marketplace – and dramatically altered our operating model. Fortunately, we were ready for this new world.



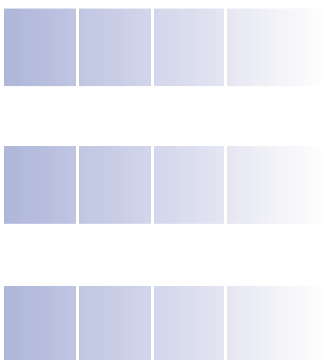
A world of extremes

In 2010, consumer products companies will face an environment defined by divergence and complexity. We call our view of the future the “world of extremes.” In this environment, consumer diversity and individualism pervade buying behavior, rendering traditional segmentation inadequate. Consumers demand low prices for basic goods but pay premiums for products that matter more to them personally. Consequently, huge megaretailers and megabrands on one end of the spectrum and targeted brands and retailers on the other expand, while undifferentiated companies lost in the middle fade into irrelevance. As the marketplace bifurcates across a variety of dimensions, corporate thinking needs to switch from “bell curves,” where firms are designed to serve the mass market in the middle, to “well curves,” where companies drive growth by applying one of two distinct business models – mass or targeted – to appropriate parts of their business to deliver the greatest value to the consumer (see Figure 1).

Figure 1. The consumer marketplace is polarizing.



Source: IBM Institute for Business Value analysis, 2004.



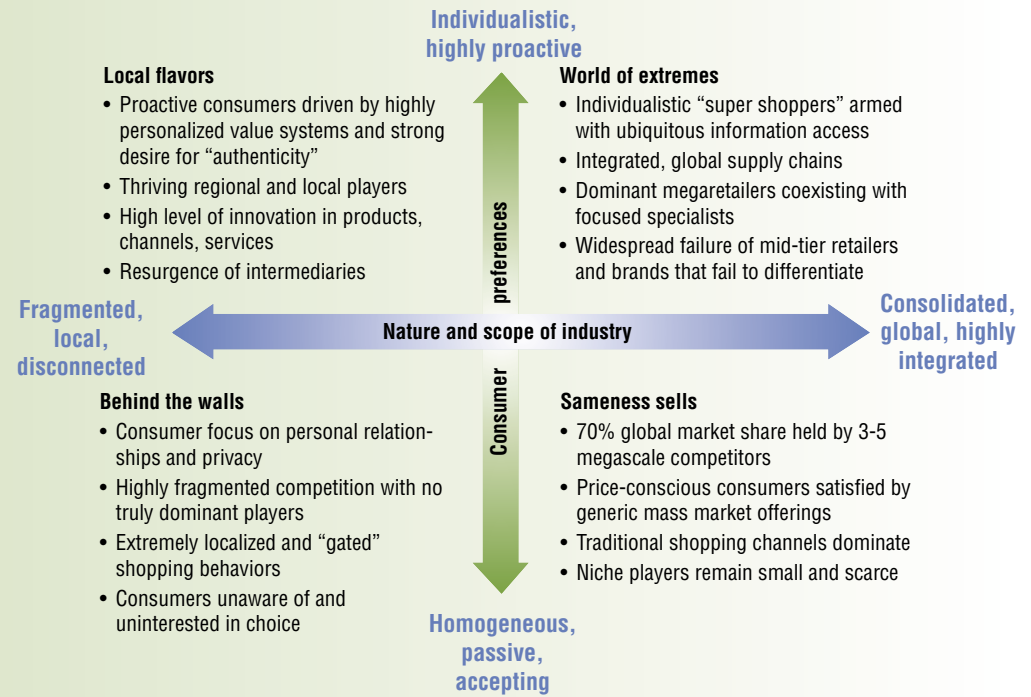
Envisioning the future

In building this vision of the consumer marketplace, we considered two critical dimensions – consumer preferences and the nature of the consumer products/retail industry ecosystem.

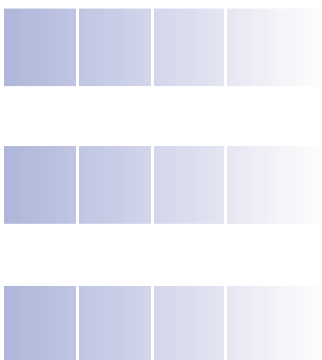
- Will consumer behavior trend toward an individualistic, highly proactive extreme or be more homogenous, passive and accepting? To what degree will consumers embrace new ways of shopping and expend effort to optimize their personal value?
- Will the industry be fragmented and locally focused or become increasingly consolidated, integrated and global? How large will the “megaplayers” actually get, and will they be capable of organizing themselves globally?

While we believe our world of extremes vision to be the most likely scenario, there are other, very plausible possibilities (see Figure 2). What if societies reject “consumerism” and accept a simpler lifestyle where materialistic consumption is unimportant? What if geopolitical shocks turn countries into walled fortresses, both in economic and social terms? With uncertainty and sudden change becoming a fact of life in the 21st century, industry executives must evaluate their preparedness for a variety of future states and build sufficient flexibility to adapt as the future unfolds.

Figure 2. Alternative future scenarios.



Source: IBM Institute for Business Value analysis, 2004.



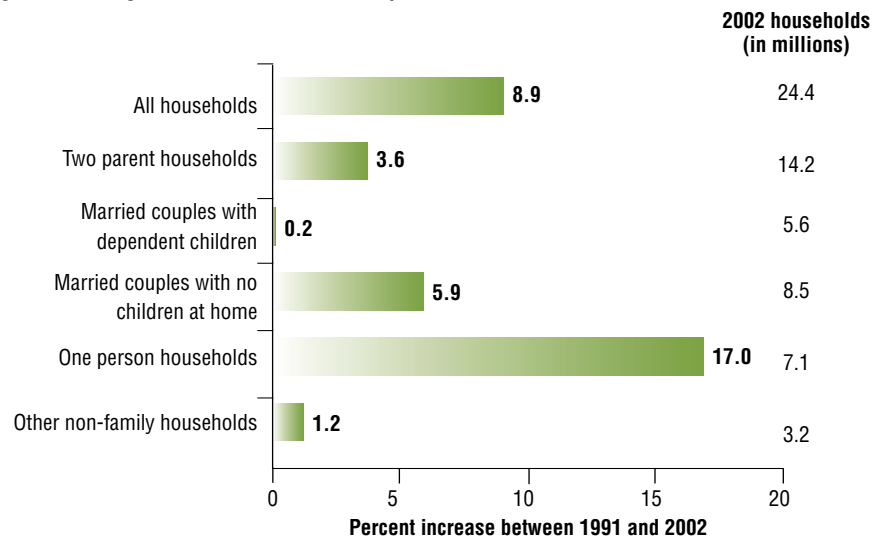
Based on research at the IBM Institute for Business Value and our work with clients worldwide, we have identified five megatrends that are redefining the rules of competition in developed markets. These fundamental drivers are pushing retailers and their suppliers into a world of extremes and altering how consumer products companies will need to compete in 2010.

Consumer value drivers fragment

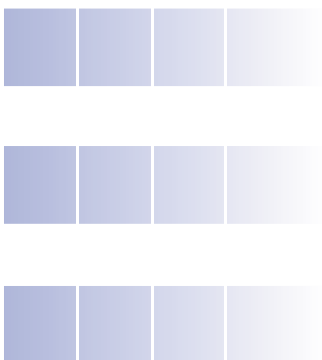
Aging baby boomers are carrying population growth to the tailend of traditional consumer age groups. By 2010, for example, nearly 40 percent of the European population will be over the age of 50, and 22 percent of Japanese consumers will be age 65 and older.^{1, 2} These older consumers tend to be more skeptical – perhaps even jaded – and are less likely to try new brands, creating a burgeoning marketing dilemma for consumer products companies.

Across all age groups, long-standing life stage patterns are becoming more unpredictable. People are marrying later, divorcing more, having second families, starting second or third careers and even raising their grandchildren. These changes are causing unprecedented diversity in household composition. For example, between 1991 and 2002, single-person households in the United Kingdom grew twice as fast as the overall average and currently outnumber married couples with dependent children (see Figure 3).³

Figure 3. Changes in U.K. household composition between 1991 and 2002.



Source: "Social Trends, 33." U.K. Office of National Statistics, 2003.

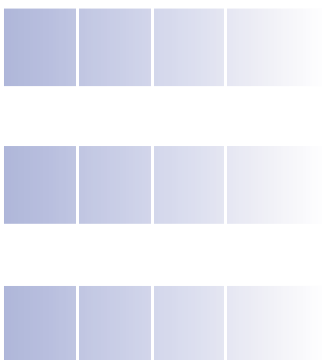


Ethnic diversity is permeating more nations at a more rapid pace. Between 1990 and 2010, the Hispanic population in the U.S. is projected to grow by over 80 percent and reach nearly 14 percent of the overall population.⁴ In Germany, the Netherlands, Sweden and many other European countries, nonindigenous populations continue to grow, and ethnic minorities will comprise from 8 to 11 percent of the population by 2005.⁵ Their growth is especially being felt in major urban markets – for example, in Rotterdam, the Netherlands, ethnic minorities already account for more than 45 percent of the population.⁶ As each new state is added to the European Union, diversity will only increase.

Shoppers' decision patterns are also growing more complex. Value-oriented buying, based on the price-quality dynamic, is increasingly sharing the stage with a values orientation, where buying is based on personal ethical beliefs or self-expression. Already, over 45 percent of Swedes are characterized as ethically-minded,⁷ with consumers in other countries following their lead. The traditional value equation comprised of price, quality, features and convenience will become exponentially more complex by 2010 as consumers factor in personal opinions about corporate and social ethics, health, privacy, politics, world trade, the environment and much, much more.

With an increased focus on what matters to them personally, individuals are spending more of their money on “meaningful” products and services (such as media and entertainment, home or personal aesthetics, electronics or vehicles) and less on things they eat or use around the house, leaving traditional “consumer packaged goods” with less and less wallet share. From 1970 to 2003, U.S. personal consumption patterns shifted substantially, with the share of consumer spending on services rising by nearly 15 percent and declining by a similar amount for nondurable goods.⁸

This personal tug-of-war is causing different consumers to trade up and down within the same category. In areas where a particular shopper perceives no unique value, the individual is trading down to mass-value providers that offer “good enough” quality for rock-bottom prices. In categories that matter more to them personally, consumers are trading up to “new luxury” providers, paying significant premiums for offerings that satisfy specific wants and needs.⁹ Meanwhile, companies caught in the middle with insufficient differentiation for either audience are experiencing major growth challenges (see Figure 4).



This phenomenon is not confined to particular products or geographies – it is occurring worldwide in virtually every category. For example, in Japan, it is quite common to see a teenager wearing a pair of inexpensive jeans along with high-priced designer shoes – or vice versa. Some retailers are even witnessing this bifurcation within their own lines of business. For example, from 1999 to 2003, revenues at Gap, Inc.'s value-priced Old Navy division posted a compound annual growth rate of over 13 percent, while its higher-end Banana Republic brand grew at nearly 9 percent annually. But its flagship, mid-tier Gap (U.S.) division only achieved 2 percent average annual growth during this period.¹⁰

Figure 4. Within many categories, growth is greater at both ends of the pricing spectrum.

Sales CAGR, 1999 - 2002

Retailers

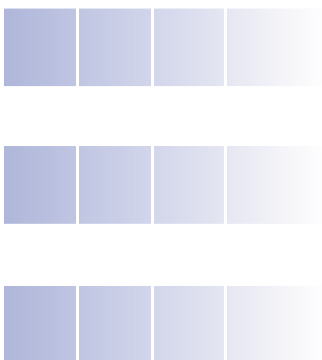
Grocery (U.S.)	Costco: 12.2%	Albertson's: -1.7%	Whole Foods: 21.7%
Grocery (U.K.)	Tesco: 9.9%	Sainsbury: 0.9%	Waitrose: 6.9%
Dept. Stores (U.S.)	Target: 9.2%	Federated: -1.3%	Nordstrom: 5.1%
Dept. Stores (Japan)*	Ito Yokado: 1.6%	Tokyu: -2.1%	Takashimaya: 0.2%

Brands

Cosmetics (US)	Cover Girl: 4.3%	Revlon: -5.2%	Clinique: 7.6%
Laundry Detergent (US)	Purex: 8.1%	Era: 0.0%	Tide: 8.4%
Vodka (US)**	McCormick: 7.2%	Smirnoff: 1.6%	Ketel One: 20.6%
Autos (Germany)***	Hyundai: 20.6%	Volkswagen: -0.7%	Porsche: 16.7%
Shoes (WW)	Candies: 18.7%	Guess: -9.0%	Kenneth Cole: 11.6%



*Notes: *CAGR for Japanese dept. stores based on 1998-2002; **CAGR for Vodka brands based on 1999-2001; ***Figures represent unit sales growth in Germany for 2003 over 2002.
Source: IBM Institute for Business Value analysis.*



By 2010, we can expect to see the downfall of companies that provide “reasonable value” at “reasonable prices”. Success will come to either lowest-cost, mass value products or premium-margin products with which consumers have strong emotional attachment. The challenge for marketers is to accurately assess which specific consumers are likely to trade up or down in their particular area. With norms becoming increasingly rare, consumer products companies must delve deeper to understand the wants, needs and purchasing drivers associated with ever-increasing numbers of consumer segments. Even where demographic profiles are similar, consumers can be driven by very different motivations. By 2010, consumer products companies will need to achieve a deeper level of consumer insight.



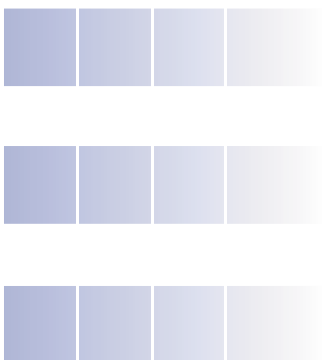
Tackling the trend

- How can you develop better insights about consumers’ true value drivers in an environment where consumer segments are fragmenting?
- How do you balance category-specific segmentation requirements against a companywide view of the consumer?
- How do you build an operating model that functions effectively in a world of “well curves”?

Gatekeepers become more guarded

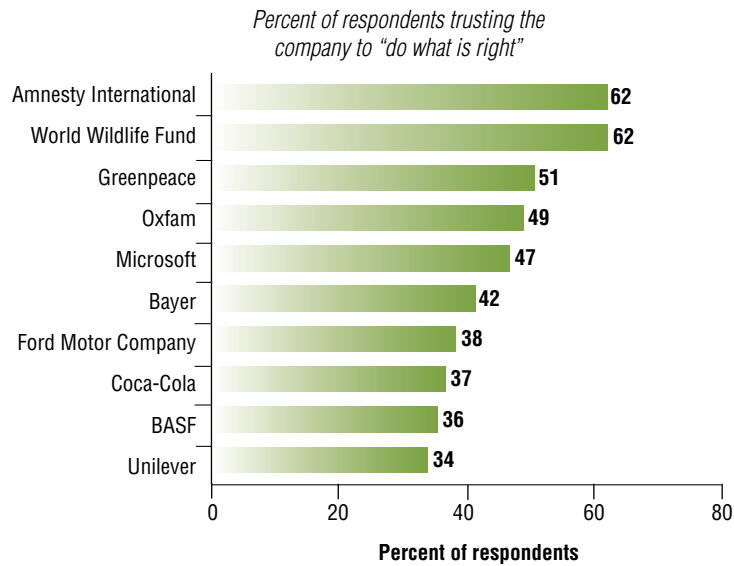
Individual consumers are currently bombarded with an estimated 5,000 marketing messages each day, up from 3,000 in 1990 and only 1,500 in 1960.¹¹ Consumers are overwhelmed – and increasingly annoyed. Enabled by technology and regulation, time-strapped consumers are blocking out communications that are not demonstrably relevant to their particular needs and interests. New technological tools for phones, Web browsers and televisions are already impacting the volume of marketing messages that make it through; for example, among TiVo users (currently 1.3 million strong and growing fast), as many as 77 percent of people watching recorded prime-time TV programs are skipping past the advertisements.^{12, 13} Around the world, public dissent is leading to legislation prohibiting or heavily regulating unsolicited contact whether by phone, fax or e-mail.

With many traditional mass marketing avenues blocked or becoming less effective, marketing tactics will need to focus increasingly on influencing behavior at the point of purchase. As 2010 approaches, more purchasing decisions will be made during “moments of truth” while the customer is in the store, at the bar or in the restaurant. Already, 40 to 50 percent of grocery shoppers “almost always” or “frequently” deviate from their shopping lists and make unplanned purchases.¹⁴



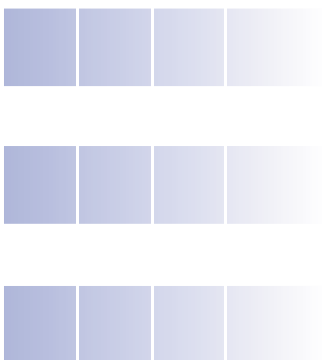
As access to consumers narrows, brand strength becomes more important than ever. Consumer products companies will need to step up their efforts to communicate and consistently deliver on their core brand values. Based on recent survey findings, consumer trust is shaky, even among top brands (see Figure 5). Forward-looking companies are starting to appoint Chief Privacy Officers or Chief Security Officers – a position that may well be commonplace by 2010.

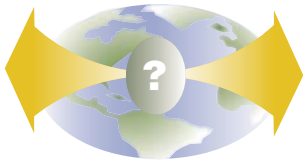
Figure 5. Consumer trust in top brands, 2003 (Europe).



Source: Edelman International Survey of Trust, January 2003.

And yet, trust is only the ante. Wary of fraud and misuse, consumers are also exercising greater control over how their personal information is used by companies. To better their hand, companies must develop more innovative and relevant ways of "compensating" consumers for access to their information. As volume-based promotions and loyalty programs become ubiquitous, mere discounts may prove insufficient motivation for consumers to provide personal data to yet another company. As the gated environment of 2010 emerges, consumer data-gathering may have to happen unobtrusively as part of the normal course of business, and analytical techniques will need to become more sophisticated to derive inferred insights.





Tackling the trend

- What core values are you trying to project with your brand, and how will they help you gain entrance to a more guarded consumer?
- How should your marketing mix evolve as consumer media consumption changes?
- What new marketing techniques will help you exert greater influence over decisions made at the point of purchase?

Information exposes all

Consumers are becoming incredibly empowered through the ability to access information how, where and when they want it. Over the next decade, rapid, wide-spread adoption of advanced wireless devices and networking will flood the marketplace with ubiquitous information access. By the end of 2004, the number of Wi-Fi “hotspots” in the United States is expected to double to 20,000.¹⁵ When next-generation Internet services and “infomediaries” are available from devices sitting in the palm of their hands, consumers – while standing in the aisle of a store – can compare the price on the shelf with that of the store across the mall or down the street. They could even pull up a personalized report telling them which supermarket has the best overall price on their entire shopping list based on the particular promotions offered by each store that week.

Indeed, the Internet is fast becoming a standard part of the global shopping experience. As people go online, experience shows that the Net becomes a vital source of information about brands, products and retailers, influencing a growing breadth of buying decisions (see Figure 6). By 2010, the online population is projected to reach over 1 billion globally.^{16, 17} Rather than fight this trend, consumer products companies need to find ways to turn this trend to their advantage – providing even more information, but in a relevant context and manner that is digestible and valuable to the consumer.

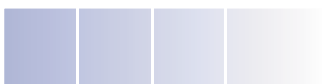
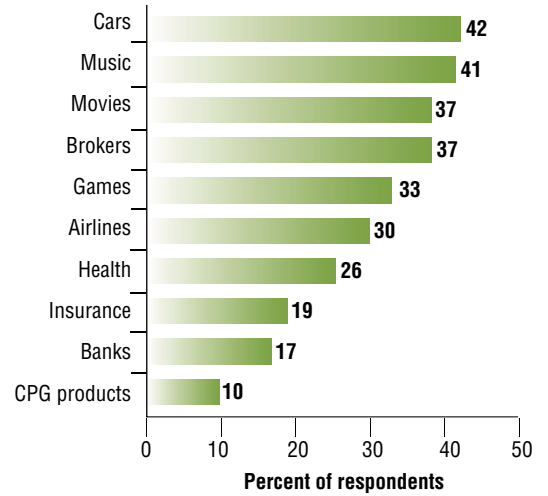


Figure 6. Online shopping behavior in Europe and the United States.

Online penetration and behavior in Europe, Q2 2003

Country	Population online	Research online*	Shop online*
Sweden	73%	93%	48%
The Netherlands	71%	94%	40%
Germany	55%	90%	55%
UK	57%	89%	62%
Italy	45%	76%	17%
France	40%	82%	33%
Spain	28%	89%	16%
Europe	49%	86%	42%

U.S. consumers changing opinion due to online information, 2002



**Figures shown are percent of the online population.*

Source: "Online Retail Europe January 2004 Data Overview." Forrester Research; American Interactive Consumer Survey, 2002, Dieringer Research Group.

Furthermore, connectivity does not have to be a one-way thoroughfare; these "super shoppers" – through their own personal devices or in-store technology – can provide a wealth of information to help consumer products companies enhance their offerings and competitive position. In fact, as information abundance pushes products toward commoditization, product development needs to change. Shrinking windows of exclusivity and proprietary advantage will compel companies to innovate more rapidly and frequently, focusing on products that are more difficult to copy.

Tackling the trend

- How can you flip this trend to your advantage? What part will broader consumer information access play in your marketing mix?
- How can information received from consumers become a more integral part of your R&D efforts?
- Where will tomorrow's sources of proprietary advantage come from? What will make your products and brands more defensible?



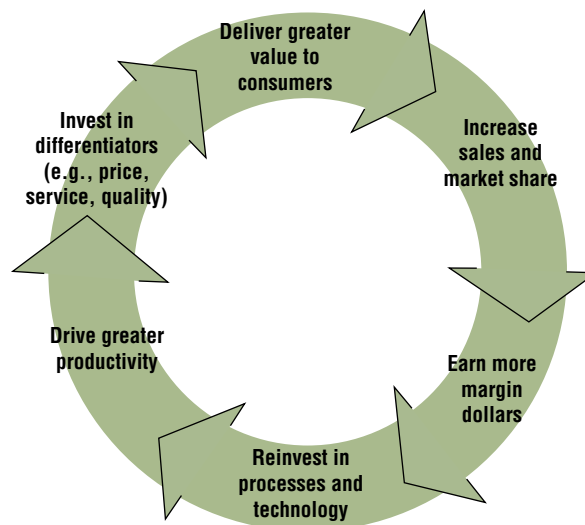
Megaretailers break the boundaries

In general, consumer products companies' customers are becoming more powerful. But a select few of these companies are becoming "megaretailers" by exploiting a virtuous cycle that fuels continued growth in market share and profitability (see Figure 7). Dominant players are aggressively expanding across stores, formats and categories, blurring the boundaries between traditional retail segments. Consider the following:

- *Wal-Mart* is making strategic acquisitions in Latin America and Asia, aims to operate 1,000 gasoline pumping stations in 2004 and is beginning to enter categories such as home sales, auto sales, financial services, online music and DVD rental.^{18, 19}
- *Carrefour*, which operates a variety of formats from giant hypermarkets to convenience stores, is planning to have 500 stores open in China by 2007.^{20, 21}
- *Metro*, operator of cash and carry, hypermarket, department and specialty stores, opened nearly 100 new stores in 2003 and continues to expand into new markets; it is now present in 28 different countries across Europe, Asia and North Africa.^{22, 23}
- *Tesco* now measures its market share in terms of the total U.K. retail industry, not just grocery. It is also offering telephony, gas and electricity, and financial services.^{24, 25}

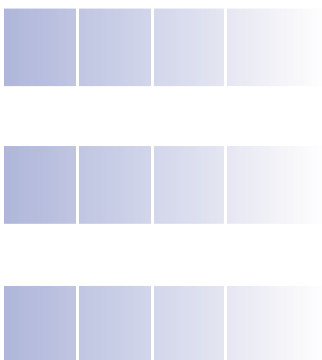
Mass merchants like Wal-Mart and Carrefour – as well as "category killer" specialists like Staples and Home Depot – are posting double-digit revenue and profit gains year after year.²⁶ As they continue this torrid rate of growth, these giants are driving rapid consolidation of the retail industry. By 2010, it's quite possible that just a handful of global retailers could have aggregate sales over US\$1 trillion.

Figure 7. Megaretailers employ a virtuous value creation cycle to continuously increase efficiency and market share.



Source: IBM Business Consulting Services analysis, 2004.

In some countries and segments, retail consolidation has already reached extreme levels. In Germany, for example, the top five food retailers control 70 percent of the market, and in the United Kingdom and France, their market share tops 60 percent.²⁷



With undeniable market dominance, megaretailers will increasingly dictate the terms of trade and usurp supplier pricing power. With low or even negative inflation holding down consumer prices, and with retailers driving down wholesale prices, consumer products companies will find their margins continually under pressure. Brands must battle for shelf space as retailers rationalize product assortment and expand private brands in certain categories – and this at a time when the point of purchase is becoming increasingly important to motivating consumer behavior. Furthermore, new retailer “mandates” – regarding data standards, radio frequency identification (RFID), product packaging or other future issues – may raise the cost to serve. But winning consumer products companies will not simply comply with the growing list of customer requirements; instead they will proactively seek out opportunities to assist their retail partners and, in the process, help themselves.

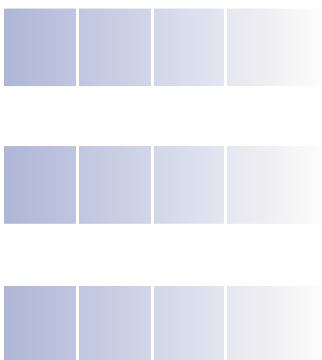


Tackling the trend

- How do you increase your importance to both consumers and trade customers to preserve your place “on the shelf”?
- How can you turn future customer requirements into opportunities for yourself to capture greater market share?
- How much will your organization need to change to effectively serve a global retail customer with diverse formats in multiple geographies?

Partnering becomes pervasive

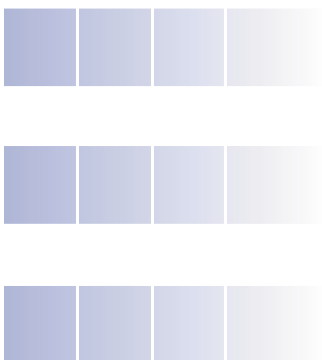
In addition to the external pressures from consumers and retailers, leading companies from within the consumer products industry will increase the heat on their less-innovative competitors by transforming their business models to become more agile, responsive and efficient. They are morphing their traditional, vertically-integrated value chains into more flexible “value networks” that allow them to deliver greater value to the end consumer, with each company in the network contributing its own unique capabilities. Retailers too are reevaluating how their value networks are assembled and will search out suppliers that can deliver best-in-class results in areas such as category management or consumer analytics. For all companies in the ecosystem, how quickly and efficiently their value networks can respond to shifting consumer demand will determine market leadership in 2010. As the decade unfolds, industry relationships will only grow more diverse and complex, making effective alliance management a strategically important competency.



Although massive structural change has already reshaped other industries such as electronics and financial services, this transformation is just now underway in more traditional industries like retailing and consumer products. Behind this restructuring are several critical enablers which are simultaneously reaching functional maturity and adoption “tipping points”:

- *Universal connectivity:* Increased bandwidth, Internet access, wireless networking and RFID adoption create a pervasive computing environment where everyone (and everything) is connected.
- *Data and systems integration:* Middleware, Web services, application integration software, workflow management software, portals and user “workbenches” facilitate continuous, often realtime, information sharing and interaction.
- *Open industry standards:* Global data standards such as global trade item number (GTIN), global location number (GLN) and electronic product code (EPC), along with extensible markup language (XML) and Linux create a common parlance and basis for integration across the increasingly digital consumer marketplace.
- *Process outsourcing to business specialists:* Process specialists are proliferating in both horizontal (e.g., HR, indirect procurement) and vertical (e.g., food manufacturing, customer data analytics) competency areas. As these providers mature, consumer products companies can obtain more efficient and effective external capabilities in a growing range of business areas.

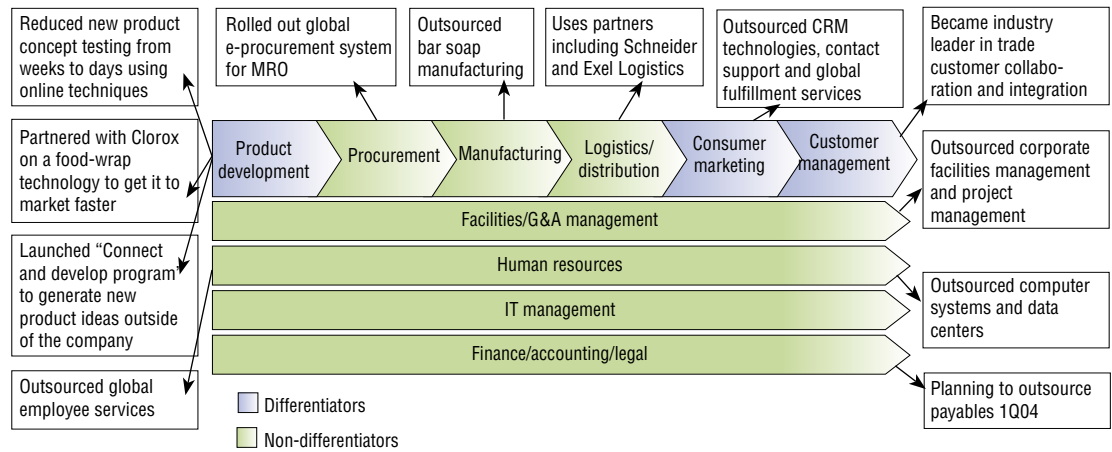
By effectively leveraging these new capabilities, industry leaders such as Procter & Gamble are executing on this new model today. The company is examining entire business functions and even activities within particular business functions, searching out what it does best and, more importantly, what it doesn't (see Figure 8). The company is steadily turning over key parts of its business to external partners, helping it focus more on consumer and customer needs and win in the marketplace.



Tackling the trend

- What are your unique capabilities and what roles can you best play in the evolving industry ecosystem?
- What new organizational capabilities are required to effectively manage a more complex business operating model?

Figure 8. Procter & Gamble's network of business partners.

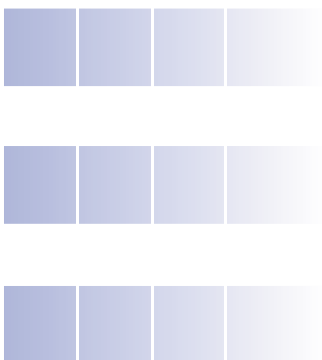


Source: "Sykes Enterprises, Inc. selected by Procter & Gamble for 5-year, \$70M global customer care pact." Dow Jones News Service. June 30, 2003; Berner, Robert. "P&G: New and Improved." Business Week. July 7, 2003; "DJ. Jones Lang/P&G." Oster Dow Jones Select. June 17, 2003; "Jones Lang LaSalle and Procter & Gamble finalize real estate outsourcing agreement." PR Newswire. June 17, 2003; Breen, Bill. "The Big Score." Fast Company. September 1, 2003; Company web sites.

The view from Asia Pacific

Though we expect the 2010 world of extremes to emerge in many regions of the world, the influence of particular megatrends varies in some markets. To be sure, the Asia Pacific region is one of great diversity and high importance to the future of the global consumer marketplace. To better understand how our future vision might apply to this dynamic region, we took a closer look at three of the key markets: Japan, India and China.

The retail industry in Japan remains highly fragmented, and economic stagnation has become an ongoing feature of the business environment for many companies. Historical trading practices create further complexity and reduce visibility and flexibility across the supply chain. Consumer products companies have not yet been subjected to megaretailer demands, but they do remain reliant on powerful wholesalers. Meanwhile, Japanese consumers exhibit perhaps some of the most "extreme" shopping behaviors in the world. Despite the poor economic environment, shoppers are spending selectively on luxury items that matter to them individually, creating the familiar well-curve effect. For example, between 1996 and 2003, sales of Jaguar automobiles rose by 9.7 percent and "light car"²⁸ sales grew by 4.4 percent, while standard domestic car sales fell by 1.9 percent (all annualized figures).^{29, 30, 31} Information access is critical to Japanese consumers, and their communications technology adoption rates are among the highest of any industrialized nation. But while consumer



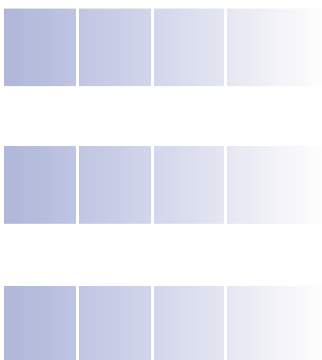
values are shifting in extreme ways – witness the heightened concerns over food safety and freshness – structural constraints in the industry and the stalled economy may result in Japan looking much the same in 2010 as it does today. The potential emergence of megaretailers remains an uncertainty and will prove pivotal in Japan.

In Asia's two giant emerging markets, India and China, things are, of course, changing a great deal – but at different rates. The rapid growth of the urban middle class across India – coupled with a favorable economy – creates fertile ground for 2010's rising consumerism. However, in India (as well as in China), where technology and Internet use is still rapidly expanding, enthusiastic consumers have not yet been inundated with media, and the flow of information to consumers is relatively unrestricted. But this situation could change quickly. India's regulatory environment has made it difficult for multinationals to enter the market, but regulations are now relaxing somewhat, and determined companies have found footholds through foreign equity participation, wholesale trading operations and franchise-based retail outlets. Consumer products companies in a variety of categories – food, personal care and apparel, for example – are exploring direct-to-consumer strategies. India might, in fact, represent the best opportunity for branded products to build and maintain that strong consumer relationship that has eroded in so many other markets.

China looks poised to move steadily into a world of extremes environment, at least in the major urban markets. Demand for consumer products is rapidly growing, but the megatrends will likely not fully materialize by 2010 due to the sheer scale of the population and the degree of change involved. Nonetheless, middle-class consumers are already exhibiting extreme behaviors, with shoppers buying based on personal values and the younger generation guarding their personal information more closely. Although multinational retailers are not (yet) commonplace in China, the increasingly open economic environment seems amenable to dominance by major players. Both domestic and foreign retail chains are rapidly opening new stores and expanding their reach. China is developing faster than most other large Asian markets and, by 2010, could be on the way to becoming the largest single market in the world of extremes.

Given their large emerging middle classes, China and India clearly represent enormous growth opportunities for global consumer products companies. However, to succeed, multinationals will need to understand and cater to regional differences, build required local relationships and leverage their global brand power effectively. A key challenge will be managing supply chains and retail customers that extend across different markets, each with its own rate of change.

For their part, local companies may enjoy the advantage of a better understanding of how to compete in huge consumer markets. By capturing more than their fair share of domestic market growth, they have the opportunity to build a powerful base from which to expand globally. Building scale on the backs (or the mouths) of 300 million or more domestic consumers with rapidly rising disposable income could elevate some local players to the global playing field by 2010.

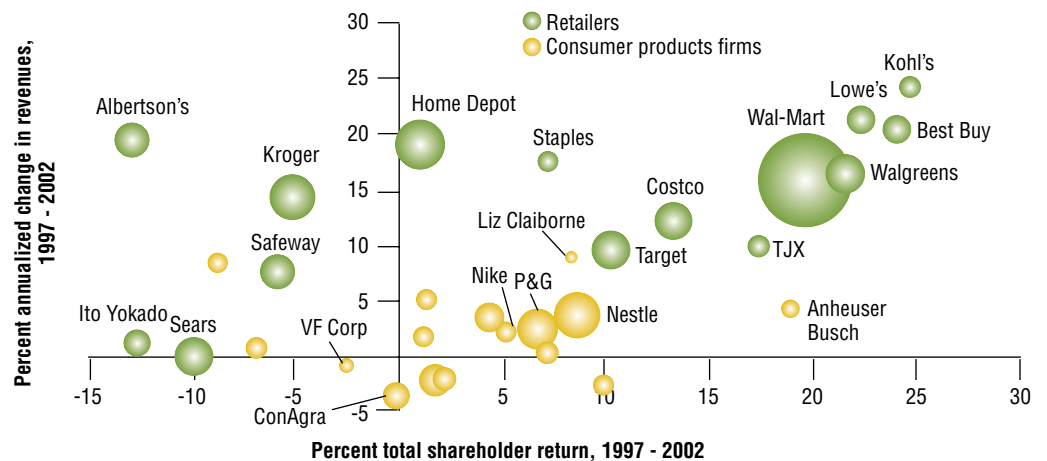


Big winners, big losers

Together, these megatrends are driving us toward the world of extremes – a marketplace of tremendous complexity, with big winners and losers. Here, super shoppers, armed with ubiquitous information access and equipped to fend off unsolicited contact, make purchases that provide them with the most overall value – both financial and personal. Dominant megaretailers and megabrands coexist with focused specialists – while both witness the widespread failure of undifferentiated, mid-tier competitors. In this world, ultra-efficient, globally-integrated value networks dominate, and insular enterprises disappear. The winners of 2010 will clearly understand where they play in the marketplace and what capabilities are required to excel, and they will align their operating models accordingly.

Some consumer products companies recognize the looming challenges, and some even have a vision for how to respond. Others remain stuck in traditional ways of doing business, making small improvements but continually falling further behind. Few are effectively executing on the organizational changes required to lead in 2010's world of extremes. Even today, while they continue to do business as usual, consumer products companies are gradually ceding economic value to retailers. Recent profit gains in the industry have largely come from cost-cutting, not revenue growth. In contrast, leading retailers are consolidating demand and responding to what really matters to consumers – and thus are achieving faster growth in revenues and market capitalization (see Figure 9).

Figure 9. Leading retailers are devising strategies that deliver faster growth.³²



Source: IBM Institute for Business Value analysis based on data from Standard & Poor's Research InsightSM.

To survive, let alone thrive, in this world, consumer products executives need to address several critical challenges: maintaining relevance to highly informed, value-optimizing consumers; responding to powerful megaretailers that have changed the rules of the game and breaking through today's constraints to execute with speed and agility on the critical imperatives for 2010.

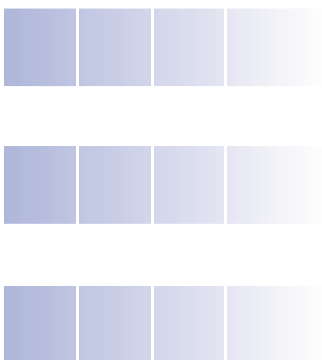
Strategic imperatives for the new world

With these challenges in mind, we see four strategic imperatives for consumer products companies:

- *Deliver insight-driven innovation – faster.* Systematically analyze new data sources to develop better insights on segment and store-level demand, and accelerate new product development.
- *Sell more through superior service.* Enhance product strengths and gain preferred supplier status by providing customized, value-added services to major retail customers.
- *Build “fit-for-purpose” supply chains.* Achieve radical improvements in performance by tailoring supply networks to particular product and channel requirements.
- *Focus your organization on differentiators, then follow through.* Drive substantive, systematic change by focusing the entire enterprise on what really matters and addressing the key operating model pieces that ground envisioned change in reality.

Deliver insight-driven innovation – faster

As the industry's information requirements become more sophisticated (thanks to rising consumer complexity), traditional sources of insights, like syndicated data, with their basic, consolidated views of the marketplace, are no longer sufficient. Consumer products companies need more granular information – at the store level, for example – and more advanced analytical capabilities to look at that data in innovative ways. As consumers fragment and their attention and loyalty become more difficult to maintain, innovation must meet a higher bar; it must be based on a deep, factual understanding of consumer decision-making and greater proprietary advantage for the company and its products.



“Great marketers build great brands without technological breakthroughs.”

– James Stengel, Global Marketing Officer, Procter & Gamble.³³

Doing more with more data

Increased integration and digitization will significantly expand the volume, quality and currency of insights available to consumer products companies. In addition to point-of-sale data, companies will be able to tap into retailers' loyalty program and other shopper data, as well as information expressed by consumers themselves on the Web, combining it all with their own market research to provide a much more comprehensive view of the consumer and shopper. Furthermore, by 2010, companies can expect to have access to large volumes of RFID data, whether at the product or store shelf level. This source will provide a window of visibility into how shoppers make selections at the point of purchase and possibly even where a product is consumed (assuming privacy concerns are sufficiently addressed).

What will consumer products companies do with all this new information? For a start, they can uncover how shopping and purchasing patterns vary by occasion for a particular consumer micro-segment. They might find, for example, that middle-aged suburban mothers with a specific profile typically exhibit some number of distinct buying patterns (see Figure 10). Having the ability to analyze information at this level can lead to more granular insights and more focused innovation. For example, how does price sensitivity differ between consumers shopping for convenience and those shopping for self-expression? What kinds of experiences entice discovery shoppers to spend more time in a store and purchase more items? Which value drivers are most critical to generating product trial among this group of consumers, and how do they vary by local market?

Improved innovation is not only needed in the development of new products. A deeper understanding of the consumer also allows companies to innovate how they market or package existing products, applying them to new needs and new segments and promoting them in brand new ways. Both forms of innovation are crucial to driving revenue growth, and both are founded on deeper consumer insights.

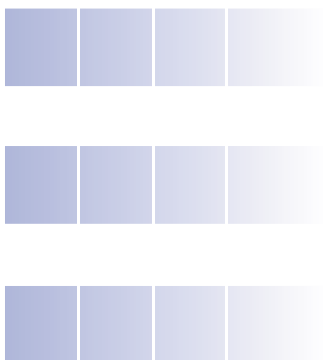
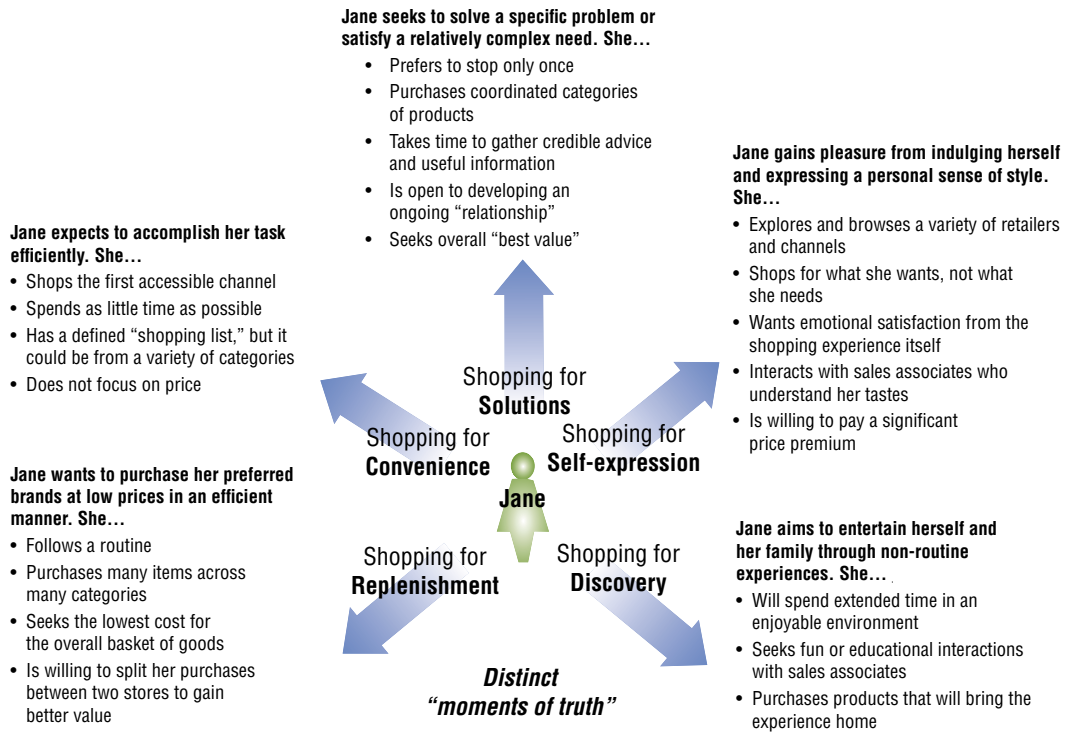


Figure 10. Companies need to develop insights on the distinct drivers and characteristics of specific consumer shopping occasions.



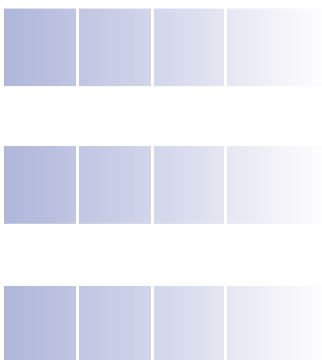
Source: IBM Institute for Business Value, 2004, adapted from Retail Forward, Inc.

"The science behind LC1 (a 'probiotic' yogurt product launched in the late 1990s and then withdrawn) was perfect. We realized that what we needed was more understanding of the consumer."

– Werner Bauer, EVP Research & Development, Nestle³⁴

Buried in the abundance of available information are the next major consumer trends. As consumer products companies equip themselves to "listen" better, innovation can finally become driven by consumer-pull in addition to technology-push. Furthermore, companies will gain greater insight about what products or product characteristics still excite consumers and which ones are fading toward commoditization. By knowing which direction the market is moving, executives can prepare alternative strategies and operating practices for brands where the nature of competition is changing.

The flood of data that will be available by 2010 – from new in-store technology, consumer devices and product tagging – will require consumer products companies to become more proficient at managing and manipulating these new data inflows. Because they will be acquired from multiple sources, the data must be "cleansed", and differences in format and categorization (e.g., by product, channel, time period, consumer segment) must be realigned to make the information useful. Investments in tools and infrastructure to manage and analyze this wealth of information will be required.



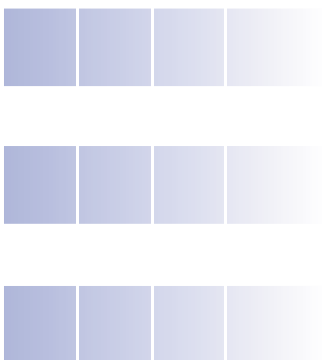
But to truly capitalize on these newfound insights, the people and culture within an organization must become more insight-driven. Valuable insights are created by a balance of analytical and creative muscle. They require careful screening, hiring and training of employees to develop the initial ideas as well as involvement of senior staff with enough experience to dig deeper for even greater insights. Consumer products companies will need a top-down commitment to apply the insights uncovered and to foster creativity as a critical means of converting insights into innovation.

Accelerating the innovation process

How quickly and profitably companies can turn insights into innovation depends on the sophistication of their new product development and introduction processes and the degree of integration they establish with retailers and other partners. Revenue growth is clearly linked to innovation, as demonstrated by many studies, including one conducted by IBM of over 250 companies; this study found that companies with a larger proportion of turnover from new products also tend to grow revenues faster.³⁵

To keep the new product pipeline flowing, companies need to renovate how they innovate. There are four key areas to focus on:

- *Reengineer processes with a focus on time to market.* Build R&D and supply chain capabilities that enable new products to reach the shelf faster than competitors' products (including retailer private brands). The goals should be earlier revenue generation and first-to-market advantage, in terms of both time to "first market" and time to "full market."
- *Integrate internally to increase efficiency.* Achieve tighter integration and earlier involvement of key functions such as procurement, manufacturing, logistics, marketing and customer service. Cut through the red tape that inhibits creativity and innovation. The ability to capture, distribute and reuse knowledge, information and content enterprisewide is invaluable.
- *Partner externally to improve execution and differentiation.* Work closely with partners to improve process execution, market responsiveness and sheer development speed. Consumer products companies need to draw on the expertise of suppliers, creative partners and each other (through joint ventures, for example) for both idea generation and product commercialization. Retailers should be involved early in the process; their cooperation and advice on timing can determine the success of a new product introduction.



- *Drive the new product development and introduction process through IT enablement.* Automate standard parts of the process, and facilitate greater internal and external collaboration. Leading innovators are using project portals, optimized stage-gate processes and collaborative tools to enable high-speed development that leads to greater market differentiation and commercial impact.

Kick-starting new product development: Boots Healthcare International³⁶

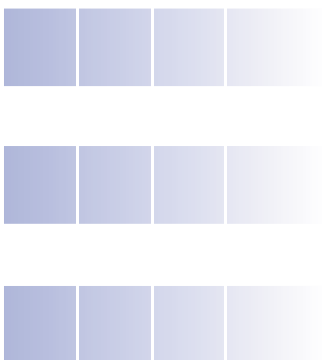
With products sold in over 130 countries, U.K.-based Boots Healthcare International (BHI) is one of the fastest growing over-the-counter healthcare companies in the world. In particular, BHI strives for leadership in three core categories – analgesics, cough and cold, and skincare – with its power brands Nurofen, Strepsils and Clearasil. To meet ambitious organic growth targets, the company needed to accelerate time-to-market. In the short term, the company also needed to hit a fixed window of opportunity for a key brand renovation.

Under its “Oxygen” change program, the company embarked on a fast-track reengineering project to improve its new product development and introduction process. As part of the effort, BHI adopted best practice stage-gate processes from the consumer goods industry (versus healthcare peers). The company also implemented organizational changes to clarify accountability at every stage – from initial insight to product withdrawal. Its updated processes included earlier involvement of supply chain and channels and a new approach for addressing regulatory requirements. To better support these revamped processes, BHI implemented a new product lifecycle management system that allowed the company to collaboratively plan and execute on a global basis.

Within 16 weeks, the program identified ways to cut development time by 25 percent for an upcoming product introduction. This type of acceleration is expected to yield multiple millions of U.S. dollars in additional revenue during the initial five years of each new product release.

Sell more through superior service

Relationships with retailers undeniably influence consumer product success. Unfortunately, trade relations across the industry continue to be less than optimal. According to Progressive Grocer’s annual report, for example, over 60 percent of surveyed retailers and wholesalers felt that trade relations had not improved during the past five years. As a whole, grocery manufacturers received poor marks from surveyed retail customers, scoring less than 50 (on a 100-point scale) in each of the top eight service areas.³⁷



“[VF Corp.] has enabled our stores to provide excellent customer service...and we are pleased with the increase in profitable sales.”

– J.C. Penney executive.³⁹

“[VF Corp.] is the best at doing category management in soft lines.”

– ShopKo executive.³⁹

“We believe technology will differentiate the winners from the losers in a highly competitive and consolidating industry.”

– Mackey McDonald, Chairman and CEO, VF Corp.⁴⁰

As megaretailers seek to extend their dominance, and their competitors strive to carve out sustainable market niches, they will look for suppliers that are willing to make investments in the retailer’s success in areas such as:

- *Account management:* One global face to the customer; a single invoice across all touchpoints in a customer-specified format
- *Product innovation:* Account-specific products or packaging; realtime changes to product launch support programs (refining promotions, displays or advertising based on insights uncovered during launch, for example)
- *Merchandising and promotions:* Vendor-led category management; merchandise and space planning; dynamic in-store displays and marketing; realtime adjustment of promotions at the store level
- *Order and inventory management:* Data-driven order generation that incorporates store-level requirements; monitoring and managing on-shelf availability
- *Consumer insights:* Consumer segmentation and needs analysis at a local level.

By helping their key retail customers differentiate, grow revenue and cut costs, consumer products companies increase value delivered. In return, they can gain greater control over the marketing and merchandising of their products and access to more valuable information, such as point-of-sale, promotion redemption and consumer loyalty data.

To accomplish this, consumer products companies will need to become much more services-oriented, with the appropriate organization, business practices, processes and infrastructure required to shift from pushing products to providing services as a key business partner (see Figure 11). Though often viewed as just a cost of doing business, customer-facing employees and the increasing range of tasks they perform are a fundamental part of the supplier’s value proposition. Their function will need to move from tactical “selling” activities to a more strategic and deliberate “customer business development” process. By 2010, leading-edge, value-added services will be a critical differentiator and a key determinant of success for consumer products companies.

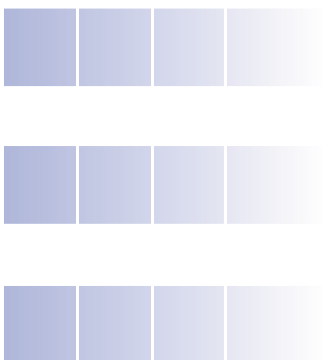


Figure 11. Key capabilities to better serve retail customers.

Organizational	Process	Infrastructure
<ul style="list-style-type: none"> • Sales and marketing teams aligned to serve global accounts as an integrated unit, with corresponding incentives • Data- and innovation-driven culture to foster greater insight and value-add by sales teams • Selling skills oriented to delivery of tailored services (versus products), with strong focus on achieving the customer's business objectives 	<ul style="list-style-type: none"> • Collaborative demand forecasting and management with global scope for multinational customers • Performance tracking and reporting at brand level via joint business plans and scorecards • Cross-functional teaming to understand and increase customer profitability 	<ul style="list-style-type: none"> • Synchronization of item, price and promotions data with customers • Ability to systematically integrate and analyze data from sales teams, retail POS and supply chain, including information obtained by RFID • Decision support tools that enable employees to make better decisions, faster • Infrastructure flexible enough to integrate processes and applications among alliances and trading partners

Source: IBM Business Consulting Services analysis, 2004.

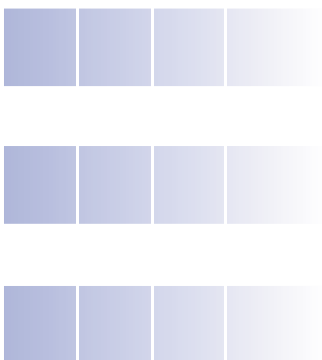
Selling more soda through better service: Pepsi Bottling Group⁴¹

The beverage battlefield is no longer just a cola war. A host of new soda flavors – as well as teas, fruit juices and bottled water – are competing for the same consumer wallet share. The Pepsi product line has multiplied into hundreds of product and packaging configurations, from less than 50 several years ago. This rapid expansion has brought complexity to Pepsi bottlers – and their retail customers. To capture more shelf space and more sales, the Pepsi Bottling Group is elevating its customer service.

Dubbed “NextGen,” the group’s mobile sales strategy aims to equip its sales force to optimize revenue at a store level by putting to realtime use a wealth of Pepsi promotional, inventory and consumer data. With their SMART handhelds (SMART stands for specific, measurable, attainable, relevant and timebound), salespeople can:

- Compare weekly and monthly sales and highlight how actual results compare to quotas
- Plan promotions to prevent out-of-stocks by linking demand forecasts for a particular product in a specific market to a variety of pricing, display and inventory scenarios
- Show retail customers color images of new products and packaging options as well as videos of upcoming ad campaigns
- Target promotions to specific accounts based on individual store sales, enabling their best customers to receive special deals.

With competition at an all-time high, Pepsi Bottling Group is bent on building customer loyalty among store managers and is backing up its intent with tangible investments in retail customer service.



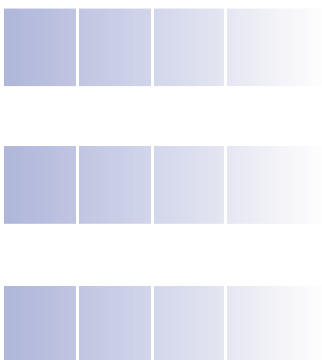
Build “fit-for-purpose” supply chains

As the marketplace polarizes, consumer products companies will need to develop “fit-for-purpose” supply chain networks that align to the needs of particular product categories or retailers at each market extreme – the “mass” end where efficiency rules and the “targeted” end where strong brands can command premiums. The same supply chain and manufacturing capabilities will not win both – mixing elements from both approaches leads to inefficiency and leaves room for competitors to outperform.

Low-margin, high-volume product categories tend to be customer-driven with stable demand and are best served by “mass value” supply chain networks. Here the retailer is the demand trigger, and the supplier’s focus is on replenishment. Because brand loyalty is lower, the consumer products company risks substitution if it cannot keep products on the shelf. Superior customer service is key; high availability, greater packing flexibility and multichannel logistics for multi-channel retailing can help suppliers meet steadily increasing retailer demands. Mass value manufacturing is characterized by long production cycles and efficient processes, with an emphasis on maintaining consistency and resiliency.

Conversely, high-margin, premium brands are driven more by consumers – how they respond to promotions and decide to make discretionary purchases. In this arena, “sense-and-respond” supply chain networks are needed to help consumer products companies meet fluctuating demand levels and keep product portfolios fresh. Manufacturing and distribution operations rely on realtime consumer triggers, demand-driven forecasts, short cycles and flexible production processes. Here the risk is shared; when these products are not on the shelf, the retailer and consumer products company both lose.

This dichotomy also has important implications for supply chain planning, for which different approaches are necessary based on product type, product lifecycle or channel to market. For low-margin, high-volume brands or mature products at the end of their lifecycle, mass-value planning mechanisms, such as continuous replenishment (CRP), vendor managed inventory (VMI) and retailer forecast-driven replenishment will often make the most sense. In contrast, high-margin, premium brands or new products early in their lifecycle require sense-and-respond planning mechanisms, such as collaborative planning, forecasting and replenishment (CPFR), demand-driven distribution resource planning (DRP) or point-of-sale demand-driven replenishment.



“The supply chain has been focused more on productivity and efficiency as opposed to an enabler of competitive advantage. We are seeing a significant change in channels that is requiring us to think of the role of the supply chain quite differently.”

– Chris Moye, VP of Strategic Planning, Global Supply Chain, Campbell Soup⁴²

To optimize manufacturing and supply chain performance, consumer products companies need to evaluate product, customer and channel sets to decide which type of capabilities are most relevant. A mass-value supply chain will focus on production volumes and maintaining quality standards, while a sense-and-respond supply chain will afford companies the flexibility they need to keep pace with changing consumer fads, buying patterns and behaviors. For any given brand or business unit, the choice is one or the other – a single model would be too expensive for mass-value products but never quite flexible enough for products that require a high degree of responsiveness to demand fluctuations.

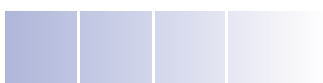
Dueling with dual strategies: Procter & Gamble⁴³

Until recently, most of the supply chain improvements at Procter & Gamble (P&G) were internally focused, using “mass value” strategies aimed at cutting costs. But competing in an increasingly demanding marketplace with a product portfolio as diverse as P&G’s soon convinced the company they needed “sense-and-respond” capabilities as well. The company is currently pursuing a vision they call “the consumer-driven supply network.”

On the mass market side of the curve, P&G pioneered continuous replenishment and vendor-managed inventory strategies. The company has also invested in collaborative planning capabilities to build a firm understanding of its retailers’ merchandising plans to ensure consistent availability of its brands on the store shelf. Now, with the help of emerging electronic product code (EPC) technology, P&G’s supply chain will be based on realtime demand information. No longer totally dependent on point-of-sale information, P&G is making realtime EPC data the linchpin of its supply network.

As consumer purchase drivers diversify and create greater demand volatility, the company is investing in other sense-and-respond capabilities such as:

- Produce-to-demand manufacturing – Though highly efficient, long runs of the same product were leaving the company with inventory gluts and no way to adjust production to avoid shortages. Two years ago, the company could produce every item once a month. Now they can produce every item each week, with the ultimate goal being the ability to produce every item every day.
- Dynamic replenishment and distribution – Here, the goal is to deliver today what was ordered yesterday, cutting replenishment time for retail customers and keeping products on the shelf for consumers.
- EPC tagging at the product level (targeted for 2008) – P&G believes that item-level tagging will provide it with realtime visibility into product demand, allowing the company to reduce both excess inventory and out-of-stocks while responding rapidly to shifts in consumer demand.



“Our core capability is to develop and commercialize. Branding is a core capability. Customer business development is a core capability. We concluded in a lot of areas that manufacturing isn’t. Therefore, I let the businesses go do more outsourcing. We concluded that running a back room wasn’t a core capability. You do what you do best and can do world-class.”

– A.G. Lafley, Chairman and CEO, Procter & Gamble.⁴⁴

Focus organization on differentiators, then follow through

Most consumer products companies recognize the need to evolve. Unfortunately, many are trying to drive incremental improvement in too many different areas, are merely reacting to outside pressures or are getting bogged down in organizational complexity. Breaking these patterns will require focus and follow through – the ability to discern what truly differentiates the company in the market and the capability to change operating models top to bottom.

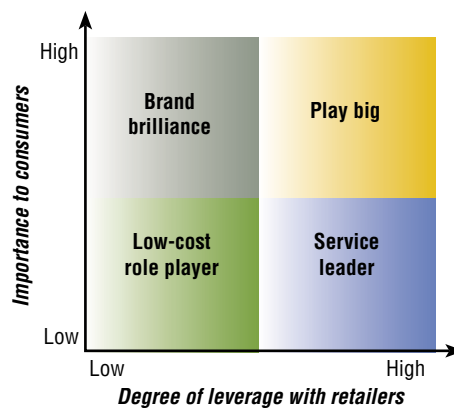
Determine what’s truly differentiating

The starting point for determining critical differentiators is to understand where the most value is created in the business. Although this seems obvious, many companies don’t (or can’t) do this because they lack the data; decisions related to strategic change initiatives must be based on facts. The objective is to pinpoint where the company can and must achieve competitive advantage and to focus resources on enhancing those capabilities. Non-differentiating areas, even if traditionally considered “core”, can be offloaded to external partners to free management attention from these less important activities. We estimate that as much as half of the operating activities (in financial terms, roughly 40 percent of sales) at a typical consumer products company are non-differentiating.

To hone in on their true differentiators, consumer products companies need to evaluate honestly their relative importance to consumers and trade customers. Even when distinctions seem clear, periodic evaluation is valuable since portfolio composition changes over time.

IBM has developed a positioning framework to help consumer products companies assess their current strategic positioning (see Figure 12). As companies map their brands, categories or business units across this grid, the key priorities for each become clear. Knowing which parts fall where allows companies to manage each part of their business differently, based on its unique competitive drivers.

Figure 12. Consumer products strategic positioning framework.



Source: “Play big: The consumer packaged goods imperative.” IBM Business Consulting Services, 2002.

For example, businesses that fall in the Service Leader quadrant must prioritize key account management and supply chain management, while those in the Brand Brilliance quadrant need to focus on driving insight to innovation and increasing marketing effectiveness. There are some business functions that consumer products companies, regardless of their positioning, typically do not need to manage – such as finance, IT or HR.

As the required business and technology enablers mature, consumer products companies are beginning to realize the economic advantages of disassembling their vertically integrated business models and building more flexible value networks. The partnering trend – which already has substantial momentum – will become even more pronounced by 2010. Attempting to do everything yourself (and excel at everything too) makes progress difficult and slow.

This is not to say there are only two choices of how to manage particular parts of the business: to in-source or outsource. Depending on how differentiating a particular business capability is and how tailored it is to a specific organization, companies may opt to consolidate it internally as a shared service, to procure it from an external “utility” provider or to leverage strategic partnerships with focused specialists. If a capability is truly differentiating, of course, the goal is to invest to achieve competitive superiority in that area.

Component business modeling (CBM) – a new approach for assessing a company in terms of its basic activities – can help consumer products executives navigate these subtleties. Unlike traditional approaches to organizational analysis, CBM can help overcome internal biases resulting from existing practices and organizational boundaries to help companies discover and eliminate redundancy, realize unrecognized synergies and optimize the management of specific parts of their business. (See Figure 13 and the IBM executive brief “The heat is on: Increasing challenges for consumer products companies demand a new approach” for more discussion on different approaches for managing business components.)

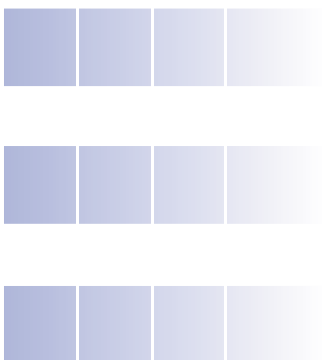


Figure 13. Business component map for a typical consumer products company.

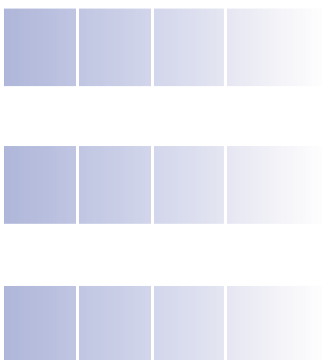
	Consumer relationship	Customer relationship	Manufacturing	Inventory and distribution	Business administration
Direct	Category/brand strategy	Customer relationship strategy	Manufacturing strategy	Supply chain strategy	Corporate strategy
	Category/brand planning	Customer relationship planning	Supplier relationship management	Inventory planning	Corporate planning
			Production/materials development and planning	Network and asset configuration	Alliance management
Control	Brand P&L management	Assessing customer satisfaction	Manufacturing oversight	Distribution oversight	Corporate governance
	Matching supply and demand	Customer insights	Supplier control	Inbound transportation	Business performance management
	Marketing development and effectiveness	Account management	Product/component manufacturing	Outbound transportation	External market analysis
Execute	Product ideation	Value-added services	Assemble/package products	Distribution center operations	Organizational and process design
	Concept/product testing	Customer account servicing	Plant inventory management	Transportation resources	Legal, tax and regulatory compliance
	Product development	Retail marketing execution	Manufacturing procurement	En route inventory management	Treasury and risk management
	Product management	In-store inventory management			Financial accounting and reporting
	Marketing execution	Customer directory			Indirect procurement
	Consumer service				Facilities and equip. management
	Product directory				Resource development
					HR administration
				IT systems and operations	

Source: IBM Business Consulting Services analysis, 2004.

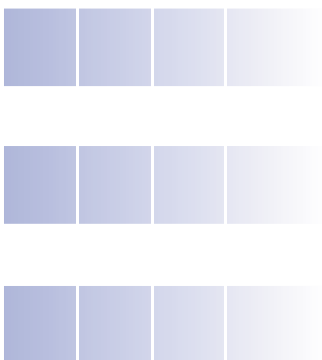
Realign all the pieces of the business operating model

After deciding on macro-level changes in the organization, senior managers need to align the entire organization with the chosen areas of focus. This is where many change initiatives falter, with “reorganization” happening only in a very superficial way. To achieve deeper transformation, companies must address the six major aspects of their business operating model:

- *Culture, climate and capabilities:* Identify specific capabilities that are key to the business strategy. What gives you unique competitive advantage (e.g., branding, innovation)? What can be done better elsewhere (e.g., IT development, transaction processing)? Determine what values, beliefs and behaviors are critical for success, and create reinforcement strategies for systematically embedding those in the organizational culture. For example, if you want an entrepreneurial style, then keep the reporting lines short; if you want to differentiate top performers, then be sure that objective is reflected in the compensation system.



- *How the company structures itself (legally and operationally):* Identify the "best fit" organizational structure, and establish appropriate roles and responsibilities. Do you want to run local, regional or global businesses? And which dimensions of the matrix are primary versus secondary (e.g., brand, customer, channel, etc.)? Evaluate whether a different legal and fiscal structure would better support the strategy. For example, should you organize as one global corporation or as several distinct units within a conglomerate? Do you manage a few tax jurisdictions globally or one in every country?
- *Assets deployed (physical and intellectual property):* Determine what levels of assets (such as people, plant, property and intellectual capital) are required to accomplish particular activities, and evaluate their optimum location. If you want a regional business with regional finance processes, for example, then you may not need a finance "factory" in each country. If you want to build "one face to the customer," then you may want to reevaluate how many sales offices you need and where they are located. Redeploy such assets as appropriate.
- *Communities the company interacts with (i.e., value network and alliances):* Identify all outside organizations with which your company interacts, and decide who should manage each of those relationships (e.g., "global" relationships can be managed either by a global department or by one region on behalf of global, depending on the circumstances). Establish a clear vision for the type of relationship desired and manage it accordingly. Do you want a supplier-customer relationship or a partnering relationship and what does this mean in terms of resources, organization, processes etc.?
- *How decisions are made and information is used:* Where will profit-and-loss responsibility be held, and which decisions should be made at which levels of the organization? Will you, for example, have P&L managed locally but try to make decisions regionally/globally? Establish the necessary information flows to provide decision-makers with the data they need, when they need it.
- *Processes and technologies:* Define the optimum level of commonality for specific processes (e.g., common buying processes across categories), and determine where they should be executed to optimize value and reduce cost (e.g., demand forecasting = local, supply planning = regional, supplier selection = global). Process follows organization, and systems follow processes, so it is critical to understand the sequence at adequate levels of detail (typically down to level 4 or 5). Clarify the technology architecture and landscape (i.e., application software, hardware and infrastructure) needed to support these processes.



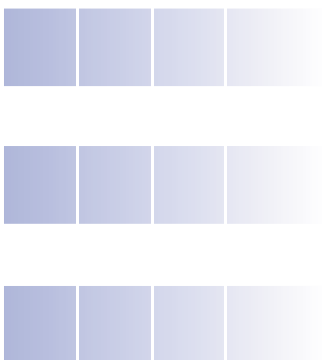
Substantive organizational change at this depth is difficult, and executives across all industries readily admit that their organizations are often ill-equipped to accomplish it. In fact, half of the CEOs recently surveyed by IBM cited “limited internal capabilities and leadership resources” as the most significant barrier to change in their organization. (See the IBM executive brief “Your Turn: the Global CEO Study 2004”). In 2010’s fast-paced and volatile world of extremes, however, effective change management will stand out as a clear differentiator.

Conclusion

2010 will present extreme challenges for consumer products companies. The marketplace will look quite different than it does today. Generic consumer norms will disappear. Products at both ends of the pricing spectrum will be popular – but to which shoppers? Technology and regulatory fences will help consumers assume greater control over their dialog with businesses. What kind of messages will make it through? Ubiquitous information access will empower consumers and expose companies’ shortcomings. Will consumer products companies be capable of turning this conduit to their advantage?

How and where these companies compete will change, too. As megaretailers transcend previous notions of what “big” means and redefine how the marketplace works, which suppliers will they favor and why? In 2010, threats will come, not just from other companies, but also from large, integrated networks of competitors. The question then becomes which value network will be flexible, integrated and responsive enough to meet a continuous stream of unpredictable marketplace demands – and do so faster and better than its rivals?

In this world of extremes, industry executives need to focus on well curves not bell curves and figure out how to drive growth at both ends of the new spectrum. As the marketplace polarizes, companies must deliver insight-driven innovation more quickly, sell more to consumers by serving their retailer customers better and build “fit-for-purpose” supply chains tailored to the market extremes where their products compete. But, most critically, the whole organization must be focused on those capabilities that truly differentiate it as a company and use the latest tools and techniques to transform its operating model from top to bottom.



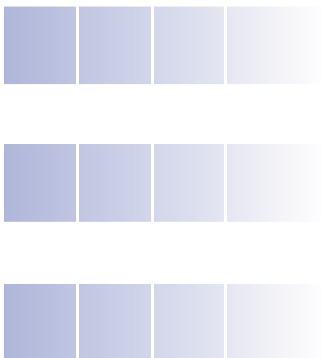
Institutionalizing these strategic imperatives will take more than intent. Even action will not be enough; consumer products companies have attempted change in these areas before, only to get trapped by traditional pitfalls. Companies that want to regain and sustain market leadership in the coming world of extremes must take execution to the extreme – trading reactive, gradual change for a focused, bold change agenda that systematically turns their strategic intent into operational results.

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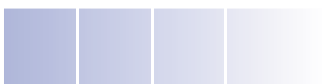
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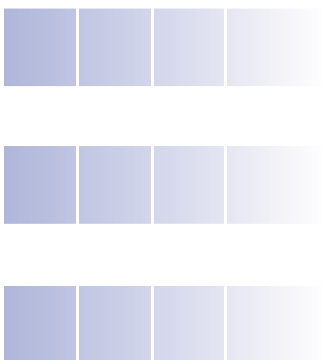
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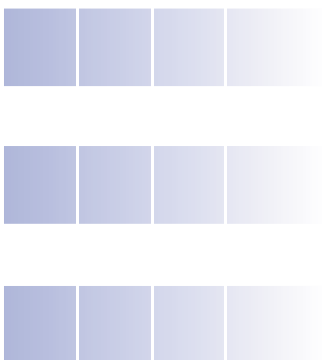


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