

Better Consumer Electronics Value from Better Consumer Relationships

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Sean Lafferty is an IBM consultant to the Electronics Industry, and he is an expert on the changing relationships with consumers in the consumer electronics industry. Sean is also the co-author of the chapter on consumer relationships in the newly published book titled *Irresistible! Markets, Models, and Meta-Value in Consumer Electronics*.

In this podcast, Sean describes the relationship between consumers and manufacturers of electronics products. He explains how that relationship is changing and how product manufacturers are getting closer to their customers and are providing more value to the end consumer.

HENDERSON: Hi. I'm AI Henderson.

All of us today are avid consumers of electronics products. And we're all interested in how we're going to be getting even better consumer electronics products in the future.

With me today is Sean Lafferty, who is an IBM consultant to the Electronics Industry and an expert on the changing relationships between consumers and the makers of products in the Electronics Industry. And he knows how that changing relationship will be resulting in better value for us the consumers.

Sean, I'm glad you're here with us today.

Lafferty: Thanks, Allan. Glad to be a part of this.

HENDERSON: Can you tell us about the relationship between consumers and the companies that make consumer electronics products?

Lafferty: Well you know Allan, it's interesting because most of the consumer electronics companies that we deal with don't even think of the end consumer as their customer.

You know, when you say customer, a lot of times they're thinking of the retailer as their customer. Traditionally they've sold through the retailer, through the retail channels, and they focus on meeting their customer demands. When they talk about that they are really talking about the retailer. We're seeing a big shift as a lot of the consumer electronics companies are really starting to focus on the end consumer more than they have in the past.

A great example is what we've seen with the Apple iPod. They are offering a more complete solution. You have the product, you have the service, you have compelling design, you have

compelling price points and marketing campaigns that are tailored to Apple's consumer segments and for the most part they also sell direct so you're bringing all of these things together and you see a more complete solution, more focused on the end consumer. I think that a lot of the traditional consumer electronics manufacturers are really surprised by Apple coming into this marketplace and taking it by storm. They are starting to react a little bit and trying to get a little bit closer to that end consumer.

Another company we have seen making a lot of progress in the consumer electronics space is Samsung. Samsung also has focused very heavily on the end consumer, picking out some segments, focusing on the younger generations. Accordingly, they have set their design processes and have hired a lot of young engineers to help with the design process. There is a lot more focus on what the end consumer wants as opposed to innovating from the inside out and coming up with new technologies and then trying to find a market for those.

HENDERSON: It sounds as though there is a two-level relationship going on.

Lafferty: Yes, and when we say there is a two-tier relationship between the consumer electronics manufacturer and the end consumer, we mean that we have the retailer in the middle of that.

So the end consumer buys from a retailer—in the U.S. it's Circuit City and Best Buy, and in other geographies it's different retailers—but typically, most electronics sales take place through a retailer. The end consumer usually isn't directly connected to the manufacturer.

Over the last couple of years we have seen a small shift in the marketplace. We have seen a lot more direct sales in consumer electronics—consumer electronics companies going direct to the consumer. But still, the overwhelming majority of transactions happen with the retailer in the middle.

HENDERSON: Can you tell us about the companies that make consumer electronics products? What are the challenges they face?

Lafferty: Yes. Manufacturers today are experiencing rapidly increasing revenues. We are seeing revenue growth at historic rates in the consumer electronics space. In the U.S. revenue growth was better than 10% last year. We are hitting revenue levels of \$125 billion in the U.S. Globally, we're over \$250 billion.

There really is lots of excitement and movement in the marketplace, but the profits are staying pretty flat, to negative, in a lot of cases. A lot of this is because of the consolidation of retailer buying power.

We're seeing Wal-Mart move in. We're seeing Best Buy and Circuit City get bigger and stronger. In China we see the same thing. We are seeing really big retailers in China as well as

Lafferty, continued: in Europe and Japan. Maybe to a slightly lesser extent, but still the strong presence of these mega-retailers is putting the squeeze on the manufacturers and really pushing the margins down.

The other trend that we're seeing is product commoditization. The lifecycle of these new products coming out is getting shorter and shorter. Going back to the iPod example again, they moved 15 million units. They hit their 15 millionth unit earlier this year. This, just a little more than two years after they introduced the product at the end of 2002.

In contrast, DVDs took the market by storm five years or 10 years ago and it took five years, twice as long, to sell 15 million units. We're seeing projections on HD, DVDs coming out or Blu-ray, depending on which one wins. LCD panels, they're going even faster.

So with this new lifecycle shrinking so rapidly, what we're finding is the profit cycle for the manufacturers is also shrinking. It's becoming much more critical for them to come out with hit products and be first to market with new technologies and really command the market quickly.

HENDERSON: What can the manufacturers do to overcome those challenges?

Lafferty: Well, we're seeing a big push among our clients where the manufacturers, the consumer electronics manufacturers, are trying to get closer to the consumer. I think many of them are starting to recognize the importance of understanding their end-target segments, and in some cases they're doing that by going direct. They are increasing their presence online and selling direct to the consumer.

Not a lot of them are competing on price, but we're seeing some things like completing the value proposition for the consumer by offering some services or recommending accessories, or offering consumer financing. We are seeing some of these kinds of things.

And loyalty programs. Loyalty programs are an area where you have a consumer come to you and say, "Hey, I choose to be served by you directly." That gives you a little bit of leverage. One of the tricks to going direct is you certainly don't want to cause any ripples with the retailers. If you have a consumer electronics manufacturer starting to advertise and send emails out to the world, broadcasting a message saying, "Hey, we're trying to attract people to our Website," the retailer is going to take exception to that because that's THEIR job.

But we are seeing a segment of the population who seem to prefer to go directly to the manufacturer. We don't know if they perceive the manufacturer as providing better service or if they just want to know who to deal with when they have questions or issues.

So there is a value proposition there around service that we're seeing some of the manufacturers take advantage of. They sell direct and build that one-on-one relationship electronically online.

Some of the other things manufacturers are doing: We are seeing a lot more focus on market segmentation, doing some analysis and study on who the customer is, the consumer demographics—what are their income levels? How old are they? So the manufacturer knows

Lafferty, continued: who they are designing for. Is it a mobile lifestyle or is it a home lifestyle? These people who the manufacturer is being successful with or wants to be successful with—how does the manufacturer reach them? Some manufacturers are getting smarter about how they market to the different segments.

A lot of this can be done with in-house data. A lot of the manufacturers are looking to their internal sources. People who have called in with problems. People who are registering the products online. People who come to the Website looking for information.

The manufacturer brings all of these different data sources together—rebates, some specific manufacturers promotions, and addresses and information about the end consumers. The manufacturer gets a better picture taking all of that data and looking at who the consumer really is. Maybe the manufacturer assigns some profiles, and puts a marketing hat on and thinks in terms of being one of those people. Maybe the manufacturer runs some focus groups around those market segments.

Lately we have seen a lot more movement by the manufacturers to get closer to the end consumer.

HENDERSON: It sounds like getting close to the consumer is a critical piece of the puzzle here. Can you say more about that?

Lafferty: Yes. We talked a little bit about having in-house data, but a lot of that can be difficult to aggregate or grow. Once you've collected from those data sources you may find that you need to supplement them.

There are a couple of ways to do that. One way that we have seen in the marketplace is buying access to consumers. We have seen a number of cases where online services are provided by manufacturers—for example, Ofoto with Kodak. They have 11 million members in that online community.

Well some of the other companies we see out there, like HP, did not have access to that size and type of end-user community, but they were still active in that market. So they went out and acquired Snapfish. While Snapfish looks like a good business overall, from the outside, what is important to HP is that Snapfish brings 13 million satisfied consumer customers. Snapfish has direct access to consumers. Now HP can have a little bit of insight into the consumer market.

HENDERSON: What can companies do with the insights they gather? Can they use those insights to create better products?

Lafferty: Once the companies are able to gather those sources and, as we discussed, maybe add to them, the real key is turning that information into client value.

A big piece of that is in tailoring the offering. Manufacturers can think about what new products are going to be coming out or how to differentiate themselves in the marketplace. It's really all about understanding what the consumers expect from you and want from you and what they are

Lafferty, continued: willing to pay for. For example, that might be new product lines or it might be a service offering to offer with a product line.

You are trying to get inside the head of the consumers you are making offers to—the people who are going to be buying the products and services that you’re offering.

HENDERSON: **What does all this mean going forward for the consumer of electronics products, like you and me?**

Lafferty: What this comes down to, Allan, is that we expect the consumer electronics manufacturers to be providing a lot more value for end consumers like you and me.

The traditional focus has been around creating new technologies and coming out with new products and new offerings and then hoping that those resonate with the marketplace.

I think what we’re going to see going forward is much more of an outside-in approach where the companies think about the marketplace first—what people want and need—rather than think, “What can I sell them?”

We are going to wind up with more value created for the consumer, and solutions created to solve our problems, and solutions created to enhance our lifestyles. Consumer electronics really should be more about the consumer, and not so much about the electronics.

HENDERSON: **I’m sure that I speak for everyone listening in when I say we’re glad to hear about more value for us as consumers. Thanks for joining us today, and thanks for the insights.**

Lafferty: Thanks, Allan. It’s great to be here with you.

HENDERSON: **That was Sean Lafferty. Sean is one of the co-authors of a fascinating book called *Irresistible! Markets, Models, and Meta-Value in Consumer Electronics*.**

You can learn more about this topic, and about other topics that are important to the consumer electronics industry, in that book. The book is called *Irresistible! Markets, Models, and Meta-Value in Consumer Electronics*.