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The Consumer Electronics Industry: Markets, Models, and Meta-Value

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George Bailey is a leading IBM expert on the Electronics Industry, in addition to being the global leader for IBM’s consultants to the Electronics Industry. George is co-author of the newly published book titled, *Irresistible! Markets, Models, and Meta-Value in Consumer Electronics*.

In this podcast, George explains the current state of the consumer electronics industry, and how the 3 M’s—Meta Value, Models, and Markets—are the key to being a successful consumer electronics company. George also explains what consumer electronics companies need to do to improve their businesses and to deliver higher value products to consumers.

Lafferty:

Hi I’m Sean Lafferty, strategy and thought leader for IBM’s Electronics team.

Consumer electronics are irresistible. There’s nothing quite so fascinating as seeing someone use a gadget for the first time. You can’t help but wonder how that gadget might improve your own life, whether it’s music on the go, or uninterrupted access to your friends and family, or more lifelike entertainment in the home.

There’s no question that new consumer technology sparks the imagination like nothing else.

With me today is George Bailey, an expert on the Electronics Industry and the managing partner for IBM’s Electronics industry team.

George is the co-editor of a fascinating new book called *Irresistible! Markets, Models, and Meta-Value in Consumer Electronics*.

Let’s get right to it, George. What inspired you to make a book on the consumer electronics industry?

Bailey: Well, the consumer electronics industry is probably the most dynamic, most fast-changing industry in the world today. In addition, it’s one that has direct impact on every life in the world. In fact, if you look just at the U.S. for a second—more people will spend more money on consumer electronics than any other category of gift. It is the industry that is changing our lives.
Lafferty: How would you describe the consumer electronics industry today?

Bailey: There’s a real paradox here. On the one hand, it’s an industry with incredible growth. People are buying electronics devices every day.

On the other hand, it’s an environment where nobody’s making any money. In fact, profits on average for most companies in this industry are just two-to-four percent.

So on the one hand, you have an irresistible item that people want. On the other hand, competition is so, so, so tough that companies can eke out only a two-to-four percent earnings number from this huge amount of business.

Lafferty: What reasons do you see keeping industry profits so low?

Bailey: Here are some reasons.

One is that retailers, the Best Buys, the Wal-Marts, are really squeezing electronics companies. They are setting the price that the supplier has to meet. So who’s making money in electronics? It’s not the Sonys and the Panasonics and the Sharps. It’s really the Best Buys and the Wal-Marts.

And that’s not all. Product commoditization really affects almost every product that comes out. The latest and greatest thing today is a commodity tomorrow. So when somebody commoditizes, margins become nonexistent.

There’s another reason that people don’t talk about as much, but that I think is worth mentioning. Profit growth comes from adding value. And for the most part, electronics companies are solid organizations that push technology from the inside out and aren’t really consumer focused. So consumers will pay for a gadget, but they’re not paying for the value. They’re paying the lowest price they can possibly pay for the device that they need.

Lafferty: What are some of the key challenges today for the companies in the consumer electronics industry?

Bailey: Consumer electronics companies need to do things very, very differently than they have in the past. In fact, than they’re doing now.

When we looked at this and we analyzed the whole range of electronics companies, really around the world, and we analyzed their financial performance and we looked at the issues and we looked at the challenges and the trends, we came up with three things that are the keys to success. We call them the three M’s: Markets, Models, and Meta-Value.

If you approach the new industry in this new way, if you pay attention to these three Ms, you will succeed. And by the way, you’ll create more value for your consumers.
Lafferty: Let’s take a look at each of those three M’s, one at a time. Let’s start with meta-value. What do you mean when you talk about the odd-sounding term meta-value in consumer electronics?

Bailey: Meta-value is kind of a funny name, but meta means a higher order of value.

We all know the story of synergy. Everybody knows that synergy is one plus one equals three. That has nothing to do with meta-value. That means you have to wire together your VCR plus your toaster, and have music for breakfast while you’re eating your jelly toast.

What meta-value is all about is, well—if you remember your high school chemistry class, you remember that if you take two atoms of hydrogen plus one of oxygen, do you remember what you get? You get wet.

H\textsubscript{2}O has this emergent quality called wet. It’s far different from anything that exits in either H or O, right? Hydrogen is not wet; neither is oxygen. But when you put them together in the right combination, you create that water molecule; you get what we would call an emergent quality, wet.

Well, that’s the kind of thing that you have to think about in electronics. How can you create a higher order of value?

And there are some real examples of how that might work today. Meta-value is bringing together a lot of different elements that might create a whole new category of value.

The most clichéd example, of course, is the Apple iPod. Everyone knows that when Apple took a fairly routine device and added some other things to it, the result became a market maker. Apple stock price is up nine or ten times, since that device was introduced. So what was that about? Well, it wasn’t a very technology-driven product, in fact. There are mp3 players on the market today that have more memory, or faster speed, or better menus, and so forth.

But what it brought together was several elements. One, it brought a cool factor. The design, and the marketing of the brand name that brought together this idea that people who had iPods were somehow cool and in touch, was combined with a good device, and combined with content, with the idea of iTunes, that you could have music from anywhere, from any artist, on your mp3 player. And when that was all put together in one package, it changed the way that people listen to music.

Lafferty: How does meta-value get created? What are the steps that a consumer electronics company has to take?

Bailey: Good question. Here’s the interesting thing. When it comes to creating meta-value, it is not necessarily the electronics companies that will do that.

In fact, I would say the electronics companies have to, absolutely have to, innovate in a collaborative way with non-electronics companies to create this meta-value.
Bailey, continued: I’ll give you another example, which may surprise some of our listeners. ESPN is, of course, the market leader in sports. They are—they have a dominant share in sports broadcasting, and have a trademark that’s associated with sports 100%. They know the sports consumer tremendously well.

Well, imagine if ESPN decided to enter the cell phone market. Imagine if they created a phone that allowed you to access sports information 24/7. There is a subscription service that sports nuts would pay for, probably at higher margins than the traditional wireless carriers are currently getting. Well, I think that ESPN might do something like that very soon.

If you really understand the consumer need and you adopt the technology to meet that need, you might just get out of that commodity space and into a space where you’re adding this kind of meta-value, 25-hour-a-day sports for the sports addict. And creating this feeling of connectivity with the sports world that people would actually pay for.

So goodbye to the two-to-four percent and start looking at healthy margins for a change.

Lafferty: Let’s move on to the next M—Models. In your new book, you talk about the importance of models. What do you mean by that?

Bailey: Most consumer electronics companies today work with a business model that is incapable of sustaining profitability.

I’ll give you a couple of examples.

Most of them have a fixed-cost structure that is way out of line with the variability of their revenue stream. If you’re a company whose revenue can vary as much as 20% up or down quarter-to-quarter, and your costs vary only eight percent up or down, you have a real problem. You have a recipe for missing earnings. And that always results in a share price decline. And that’s exactly what we’ve seen in consumer electronics companies.

I feel sorry for the people who invested in electronics companies four or five years ago, because they haven’t done very well. Partly that is because the business model isn’t correct.

So we really think that in the future companies who are in this industry are going to have to have highly variable costs. They are going to have to focus on only what they’re good at. They are going to have to partner or outsource for the rest.

And they’re going to have to be much more competitive.

Not based on technology alone, but also based on their business model. For example, how do they go to market? How much of the Internet channel do they use? What do they do to steer consumers to highly profitable solutions, as opposed to pointing to products?

All those things in the business model have to be figured out and drastically changed.
Lafferty: And let’s look at the final M you talk about in the book—Markets. What do you mean by markets?

Bailey: The third thing electronics companies need to do to be successful is find some additional markets that can promise growth and profit improvement.

And actually, one of the biggest markets out there today that everybody’s talking about of course is China. Now there are other countries. There are the BRIC countries, right? There are Brazil, Russia, India, China.

But the biggest and probably the most important one is China. I’ll give you some statistics here. They are somewhere between 1.3 and 1.5 billion consumers. Nobody actually has an exact number. Let’s assume 1.3 billion. And GDP growth is averaging eight to ten percent a year since 1995. That’s something like three times, maybe four times world GDP growth. So, a very fast-expanding economy.

And so there are a lot of business plans being written today by electronics companies saying, “Gee if I could just sell my product in China and make $1 for each person in China, I’d make $1.3 billion.”

Well, I suggest that you need to think more carefully about that because in fact, it’s a very tough competitive market and you’re not going to make it just by taking whatever you’re doing somewhere else in the world and landing it there with the same distribution system, the same pricing, and the same market approach.

It’s an attractive market. You need to get in there and do something, but you have to be very, very thoughtful about how you do it. There are some people who have thought very well.

In fact, I’ll give you a little story here that probably is not widely known about the richest people in China. The richest man in China, number one, is Huang Guangyu, who founded GoMe Appliances, which is China’s largest electronics retailer. Not somebody who makes electronics, but somebody who sells them. Incredible person. His personal net worth is estimated at $1.3 billion. So maybe he did get $1 for every person in China. But anyway, that’s a big number.

The third richest person in China is the founder of Shanghai-based Shanda Interactive Entertainment, which is an online gaming business. They estimate that something like 200 million Chinese participate in online gaming. It’s a huge market. And the fourth richest person is also an online gaming/systems managed storage market person.

Can you imagine that of the top four richest people in China, three of them are involved in electronics in one way or another?

But guess what? The competition is so tough now that it’s driving margins down. And right now, the average earnings-before-interest-and-taxes (EBIT) margin for electronics companies in China is, guess what—something around two to four percent, just what it is in the North American marketplace.
Bailey, continued: So what does this mean?

It means that China is forced to go global. They have to find some ways to continue to grow their business. China is very tough. They are thinking about entering the U.S. They are thinking about entering Europe. And they are going global.

There are some examples of that. The most famous one of course, in our industry, is the Lenovo example: the company Lenovo bought IBM’s PC division. Very, very big change in the global marketplace.

And now Lenovo is the number three computer company in the world. Can you imagine? It’s Dell, it’s HP, and then it’s Lenovo. And I wouldn’t be surprised to see Lenovo bypass, not only HP, but also Dell, to become the biggest.

So there’s an example of a China company turning into a global company and becoming the largest in the industry.

So if you want to pay attention to what’s going to happen to the industry, watch China.

Lafferty: Can you summarize for us the message of the three M’s?

Bailey: Okay. Key message is you have to change, to transform, to grow. So here’s what they mean, the three M’s.

Meta-value—create meta-value for consumers and you will realize higher margins and make more money.

Second, business models—you need a new business model to deliver that value and to pass it to your shareholders.

And third, markets—you have to play the emerging markets if you’re going to be successful.

Lafferty: Thank you, George, for your insights about the consumer electronics industry, and for taking time to be with us today.

That was George Bailey, editor of the new book, Irresistible! Markets, Models, and Meta-Value in Consumer Electronics.