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The end of the world…or a world of opportunity?

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The future of the Consumer Products industry

The end of the world…or a world of opportunity?

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In the midst of explosive population growth, increased urbanization, an evolving, demanding customer base and global climate and natural resource issues, the Consumer Products (CP) industry faces shifting market dynamics, channel challenges and renewed pressures for business model innovation. An emerging class of empowered consumer, steadily increasing consumption and aggressive competition from private labels will require CP companies to execute flawlessly in connecting with consumers, managing supply chain efficiencies and collaborating with channel partners.

The world is changing...rapidly.

Consumer products companies have traditionally focused their efforts and resources on serving a relatively narrow, affluent segment of the world's population. These coveted consumers are likely to live in a developed market, make regular trips to the supermarket and chemist, with less frequent trips to a hypermarket or supercenter. To grow their business with these consumers, CP companies leverage heavy doses of trade and consumer promotion, while seeking to improve collaboration with retail customers to help deliver operating efficiencies.

While this marketing and operating model remains prevalent today, it is not an engine geared to drive long-term, sustained growth.

Dramatic population growth and income gains in regions such as Asia, Latin America and Africa, coupled with rapid urbanization and global macroeconomic shifts, are challenging notions about how and where to grow. For CP companies, these shifts are creating historic opportunities that will require new thinking, decisive action and flawless execution.

Consider, for example, that the global population, 6.75 billion at the end of 2008, will reach 8 billion by 2025 and 9 billion by 2050.[1] In 2008, for the first time, more than half of the developing world's population was middle class or above, and more than half of the world's total population lived in urban areas.[2] Urbanization is expected to continue unabated for the foreseeable future. Indeed, by 2020, 16 cities are projected to have populations exceeding 20 million, many of which will be in emerging markets.[3] These cities will represent tremendous concentrations of wealth. In fact, by 2020, 20 out of the top 50 richest cities in the world are expected to be in emerging markets.[4]

Mass urbanization brings a host of significant infrastructure challenges. But it also presents city dwellers with expanded opportunity for employment, education and information, as well as improved access to basic services, such as water, sanitation and electricity. Perhaps most important, individuals living in cities have greater opportunities to move up the income ladder.

Simultaneously, though, expanding population, consumption and climate change will exacerbate pressures on resources, creating an increasingly volatile environment with challenges in product sourcing, manufacturing, packaging, distribution — and even disposal. In their quest to develop the next generation of loyal consumers, CP companies and their suppliers must consider the environmental, social and economic impact of their operations. Concerns about underlying issues such as carbon and water footprints will drive the industry to develop and invest in smart environmental solutions. Industry leaders will integrate broad-based corporate responsibility into their organizations and brands to build awareness and create value.

Clearly, the world is changing in profound ways and is ripe with opportunities. But it is also increasingly unpredictable and unfamiliar. CP companies need to take action now to position themselves for future profitable growth. Critical areas of focus will include:

- Becoming intimately familiar with new markets and finding new ways to connect with consumers
- Understanding and sustaining consumers in the lower income tiers with appropriate services and products
- Mastering diversified distribution channels, collaborating with retail customers and, at the same time, forging direct relationships with consumers
- Grasping where direct involvement in the value chain adds value and creates sustainable differentiation.

Regardless of their area of focus, winning CP companies in the 21st century will be those that can effectively address markets, channels and model, while executing flawlessly against six enabling capabilities:

- *Glocalization* – Balancing market demands for localization with global/standard operating efficiencies
- *Differentiation* – Deploying assets and processes to create sustainable differentiation
- *Integrated information* – Integrating information to drive the business through insight
- *Innovation* – Create and deliver offerings that go beyond consumer expectations
- *Consumer-centricity* – Finding new ways to connect with consumers
- *Corporate responsibility* – Integrating corporate responsibility into the organization’s DNA.

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Population growth and increased urbanization will present CP companies with a mix of opportunties and challenges.

What on Earth?

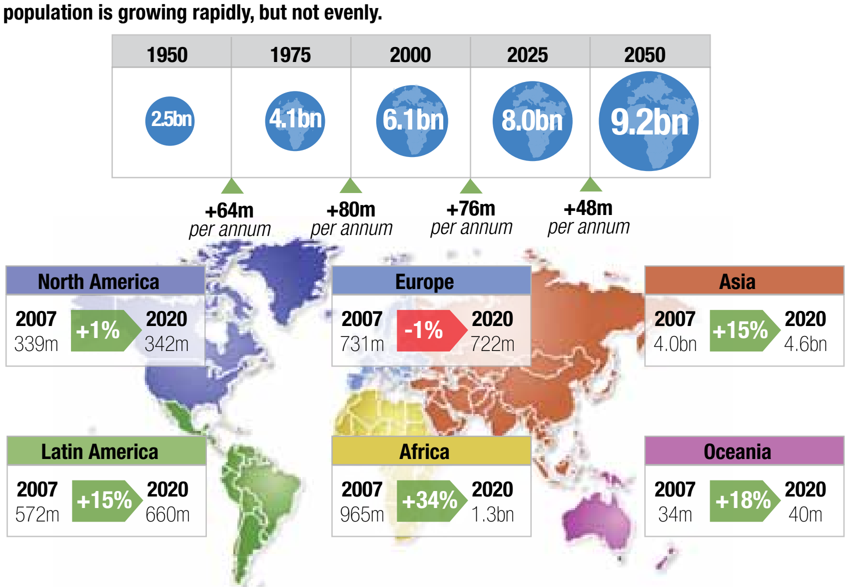
More people + more money = more opportunity

Over the next 10 years, the world's population is expected to grow by almost 20 percent, primarily in emerging market regions (see Figure 1).[5] China and India, as well documented, will be among those with substantial increases, but so will nations such as Pakistan, Nigeria, Democratic Republic of the Congo and Ethiopia.[6] Meanwhile countries such as Russia, Japan and Germany will be among the biggest population losers.[7] Clearly big changes are happening.

Much of the world's increased population will live in a city, and, as a result cities are getting bigger... much bigger. Consider that in 1975, only three cities – Tokyo, New York and Mexico City – had populations in excess of 10 million.[8] By 2020, 16 cities will have populations in excess of 20 million.[9] More than 70 will boast populations greater than 5 million, roughly the population of Denmark.[10]

Many of the new "mega-cities," such as Mumbai, São Paulo, Dhaka, Cairo and Lagos, will be in developing nations and will present a mixed set of opportunities and challenges. Availability of transportation, sanitation and healthcare are not likely to keep pace with population growth, resulting in issues with logistics, hygiene and illness. Already, in 2007, more than 1 billion people – or 30 percent of the world's urban population lived in slums.[11]

FIGURE 1.
The World's population is growing rapidly, but not evenly.



Source: IBM Institute for Business Value analysis, "The World at Six Billion," United Nations, 2004; The World UN Population Assessment 2006; "Unsustainable World," BBC, April 15, 2008.

In India, of the more than 1 million kilometers of roads, only 10,000 kilometers were paved.[12] The underdeveloped infrastructure, crowded living conditions and unfamiliar consumers will challenge even the most innovative CP company. However, these *favelas, barrios* and *colonias*, and slums will be the destination for dynamic growth in the future.

To analyze these market opportunities, we coupled individual consumption power with population growth and urbanization. The result is a population diamond consisting of four broad population facets (see Figure 2). Historically, most CP companies have focused on selling to the top two facets of the diamond (The Cosmopolitan Elite and Growing Middle Class) via familiar channels. But, as more and more of the Affluent Potentials gain access to employment, education, healthcare and basic services, they are exposed to modern retail establishments and new technologies, such as 3G cell phones and the Internet. Having recently elevated themselves from a rural subsistence lifestyle, many of these individuals will represent a new energized class of empowered consumer, hungry for upward mobility and demanding of the products and services they see afforded by their more affluent neighbors.

Significant opportunities exist for the innovative CP company within this consumer category. Largely underserved in the past, this mass of individuals and consumption power is positioned to drive sweeping economic, social and political changes across all facets of the diamond and regions of the globe.

FIGURE 2.
The World's population is growing rapidly, but not evenly.

Facets *(annual consumption power)*	**2020 population** *(change vs. 2008)*	**2020 aggregate consumption power*** *(change vs. 2008)*
Cosmopolitan Elite *> $20,000*	**0.5**	**$11.5T** *($0.5T)*
Growing Middle Class *>$3,000 - $20,000*	**2.1** *(+0.1)*	**$13.1T** *($0.6T)*
Affluent Potentials *>$300 - $3,000*	**3.4** *(+0.4)*	**$4.1T** *($0.5T)*
Rural Poor *<= $300*	**1.5** *(+0.5)*	**$1.3T** *($0.4T)*

Are these the next 5 billion for you?

- Cosmopolitan Elite: unbounded affluence
- Growing Middle Class: mass affluent
- Affluent Potentials: upwardly mobile "under-classes" living in rural or urban setting
- Rural Poor: subsistence living in rural areas

**Consumer goods only (excluding consumer durables and electronics).*
Source: IBM Institute for Business Value analysis; World Bank, "Bottom Billion;" World Resources Institute; United Nations.

Affluent Potentials are likely to move up the income ladder and become members of the middle class.

The rural poor will constitute US$1.3 trillion in purchasing power by 2020.[13] They represent one of the fastest growing facets in some key markets. Between 2006 and 2008, for example, the rural market for fast-moving consumer goods (FMCG) in India doubled, to $US4 billion, and now comprises 17 percent of the total FMCG market.[14] The lifestyle of this population segment may be one of subsistence, but basic hygiene, sanitation and food represent a strong and growing market. Combined, the purchasing power of the bottom two classes is expected to increase by almost US$1 trillion by 2020, roughly equivalent to the increase anticipated from the top two classes.[15]

On the surface, each facet of the diamond appears to offer similar growth potential. However, when serviced through innovative approaches and models, the Affluent Potentials and Rural Poor have the potential to deliver greater value than the two more affluent facets of the diamond. Factors beyond purchasing power increase the relative attractiveness and potential profitability of these lower categories:

- The majority of the world's population growth will occur in the lower facets of the diamond.
- Many of these consumers are Affluent Potentials who will move further up the diamond during their lifespan – with increasing wealth comes greater spend and a broader span of consumption.
- Today's enlightened and empowered middle class or affluent consumers are demanding more functionality and value from products, as well as much greater information about their source, handling, ingredients and impact.[16]
- Marketing and selling to upper facets of the diamond through modern trade has also become more difficult and costly. Slotting fees can cost thousands of dollars per product, and trade promotions can account for upwards of 14 percent of gross revenue.[17]
- Modern retailers are also demanding differentiated or customized products and more services from their suppliers, including more complete, accurate and timely shipment and forecast data.

These same demanding retail customers are also increasingly formidable competitors – aggressively marketing and selling broad portfolios of private-label products. In short, it can be both expensive and challenging selling to consumers in the upper facets of the diamond.

Summary

There will be significantly more consumers, many of them city residents who will call a developing nation home.

A class of affluent potentials will create an attractive, upwardly mobile market for consumer products.

Consumers the world over, particularly in the developed markets, are increasingly demanding of the products they use and consume, and are less brand loyal, further increasing the attractiveness of emerging markets.

Consumption, climate and shortages impact sourcing, production and prices

While increases in population, urbanization and affluence create compelling growth opportunities, they also place massive strains on agricultural, mineral and other natural resources, as well as energy, water and land. In light of the high profile of their products and impact of their operations, CP companies must be especially innovative in understanding and mitigating the economic, social and environmental impact of their actions.

Changes in consumption pressure resources

Greater affluence increases consumption of protein in the form of meat, fish and dairy – which typically require more land, energy and other resources (i.e., feed) to produce than grains and pulses. Indeed as income's rose, between 1980 and 2005, Chinese *per capita* pork consumption effectively doubled.[18] More affluent consumers are also more likely to buy packaged products that require more tin, aluminum, steel, paper, cardboard and plastic.

And all of these items require more energy to grow, manufacture and distribute. Across all CP categories, these dynamics are increasing pressure on crops such as wheat, rice, cocoa, palm oil, cotton, fish and other resources, especially water. The industry's impact extends further, however, with its use of fertilizers, hormones and other chemicals also exacting a toll. It is estimated that although just 2.4 percent of the world's crop land is dedicated to growing cotton, it accounts for 24 percent of global insecticide sales and 11 percent of pesticides.[19]

Water stressors

While carbon footprints are an intense area of scrutiny, an acute global shortage of water is of particular concern to the CP industry. Agriculture is the largest human use of water, comprising some 70 percent of total consumption (see Figure 3).[20] And it is estimated that the current water utilization of just five large CP companies could meet the daily needs of everyone on the planet.[21] Yet, inefficiencies and spoilage in the food supply chain result in a massive waste of water and other resources.

FIGURE 3.
Water consumption for the manufacture of selected products.

4,800 liters of water to make one kilogram of PORK	**10,855 liters** of water to make one pair of JEANS	**10 liters** of water to make one sheet of PAPER	**40 liters** of water to make one slice of BREAD
15,500 liters of water to make one kilogram of BEEF	**16,600 liters** of water to make one kilogram of LEATHER	**70 liters** of water to make one APPLE	**80 liters** of water per dollar of INDUSTRIAL PRODUCT
140 liters of water to make one cup of COFFEE	**1,300 liters** of water to make one kilogram of WHEAT	**91 liters** of water to make one pound of PLASTIC	**120 liters** of water to make one glass of WINE

Source: "Water. A Global Innovation Outlook Report." IBM. http://www.ibm.com/ibm/gio/media/pdf/ibm_gio_water_report.pdf

Climate changes and resource shortages continue to drive up the cost of commodities.

Such spoilage and losses may already equal 50 percent of total production.[22] Product recalls also contribute significantly. The 2008 recall of 65 million kilograms of beef in the United States represented 650 billion liters of water – roughly equivalent to the annual water requirements of the U.S. city of Las Vegas.[23] As incomes grow, increasing consumption of meats, fruits and vegetables will increase pressures on water, as well as create more waste and spoilage.

Climate and energy issues

In addition to consumption and natural resource issues, many of the food-producing areas of the world have been adversely affected by volatile weather. Australia is in its tenth year of drought and has experienced a 98 percent decline in rice production.[24] Food producing regions in China, Argentina (700,000 cattle deaths), California, Texas and Brazil are also experiencing extended and unprecedented drought conditions. Famine induced by worldwide climate change may displace as many as 250 million people by 2050.[25]

Energy shortages also drive up the cost and availability of commodities. Oil reserves are forecast to fall short of demand, and prices are expected to maintain an upward long-term trend, despite short-term fluctuations. As global demand for biofuels expands, commodity food supplies are coming under increasing pressure, aggravating shortages and driving up prices. Worldwide use of cereals for ethanol production expanded more than 30 percent in 2008 and is projected to grow another 30-plus percent in 2009.[26] The impact of these issues on food prices is already quite apparent.

Summary

The sheer number and consumptive power of more affluent consumers will put pressure on a wide range of resources, forcing new trade-offs, new ways of working and some difficult decisions.

Prices of many commodity inputs, as well as the energy required for their growth, conversion and transportation, will become increasingly volatile – and, in a growing number of cases, their very availability is in question.

CP companies and their suppliers will have to consider the environmental, societal and economic impact that their operations have around the globe.

The dimensions of change

The seismic shifts in income, consumption and resource utilization are rapidly shaping a new landscape for the CP industry. This will continue, and even accelerate, as markets open further and infrastructure issues are addressed. Innovative CP companies will act with purpose and vigor to seize the opportunities created, reinventing themselves and redefining their interactions with customers, consumers, suppliers and stakeholders in the process.

Based on our research and experience, we believe action is needed across four dimensions:

1. Markets that will continue to change from the familiar and predictable – to the increasingly unfamiliar and unpredictable
2. Channels that will offer dynamic new opportunities for simultaneously collaborating and competing with retail customers, while forging new connections with consumers

3. Business models that will be reinvented based on a mastery of where value is created and destroyed across the entire value chain
4. Capabilities that will be developed, nurtured and acquired to create lasting differentiation and competitive advantage.

1. Market: Connecting with the unfamiliar and the unpredictable

For most of the 20th century, the CP industry grew largely by improving its ability to develop and sell products to a relatively affluent, homogenous market of shoppers, who responded in familiar and predictable ways to the traditional 4 P's of price, product, place(ment) and promotion. The fading relevance of this marketing construct is accelerating with the emergence of new economic powers and the adoption of technologies that enable greater transparency and connectivity. Indeed, across all facets of our population diamond, in the both the developed and developing world, conventional market thinking is rapidly being replaced by a new set of realities (see Figure 4).

CP companies looking to prosper in the 21st century will need to explore segments and regions beyond their traditional market(s). Much of the growth opportunity will be with lower income consumers, the Affluent Potentials and Rural Poor, who bring unique values, perceptions, constraints and drivers to their CP purchases. CP companies must, therefore, build a deep understanding of the motivations and influencers of both perceptions and purchasing decisions in order to rapidly "connect" with consumers in these markets. Many of these consumers have yet to form the brand associations that will persist as both their income and consumption rise. However, they will demand products that communicate and deliver a clear and relevant value proposition. Those with limited disposable income can ill afford products that fail to deliver value. Companies with unfocused marketing messages that try to sell stripped-down versions of existing products are unlikely to succeed.

FIGURE 4.

Across all facets of the diamond, conventional market thinking will increasingly be challenged by emerging realities.

Conventional thinking	*Emerging realities*
Price is primary driver of purchasing behavior	Low prices perceived to be of inferior quality
Global brands prized over local brands	Local brands increasingly trusted by consumers
High income consumers not overly price sensitive	High earners equating thrift and responsibility
Consumers will buy more if more discounts offered	Many consumers cannot afford to buy in bulk
Growth market learnings have limited applicability	Products and learnings can be applied directly
Private label products are low price and quality option	Three-tiered private label offerings with top quality

Source: IBM Institute for Business Value Analysis; Menzel, Peter and Faith D'Alusio,"Hungry Planet: What the World Eats," Tricycle Press; "Rise of Domestic Brands."AlixPartners press release, October 21, 2008; "Tightening the Beltway, the Elite Shop Costco," The New York Times, Novmber 25, 2007.

Empowered consumers are demanding ever more information about the products they consume and are increasingly turning to private labels to meet their needs.

Innovation, persistence and partnerships will be differentiators in developing insights into these markets. Indeed, Chinese retailers and FMCG respondents to the 2008 IBM Collaboration Study both listed "complicated and diversified consumer needs" as their top challenge.[27] Recognizing the burgeoning need for insights about consumers such as these, McCann Worldgroup, a global advertising agency, created a new division, Barrio, specifically tasked with marketing products to lower-income consumers in Latin America.[28]

Consumers in both developed and developing markets are empowered with more knowledge about products and alternatives, and are demanding the combination of message, product and service that best meets their individual needs (See sidebar, Indulgences and essentials in every facet of the diamond). The majority of them crave detailed information about product contents, ingredient sources and environmental and social impact.[29] Indeed, savvy consumers are increasingly willing to purchase private-label alternatives when branded products disappoint, don't connect and/or fail to justify their price premium. And they will trade up, down and across categories in a quest for greater value. For example, consumers seeking a personalized, premium cup of coffee have embraced the Nestlé *Nespresso* machine, sales of which doubled between 2006 and 2008, at least partially at the expense of established coffee retailers.[30]

Indulgences and essentials in every facet of the diamond

Opportunities exist for CP companies within each facet of the population diamond as the concept of occasional luxury or indulgence differs:

- *Cosmopolitan Elite:* Super premium liquor, "scarce" ingredients, frivolous essentials, designer fashion, premium hair dye, organic pet food, nutraceutical foods delivering health and/or beauty benefits
- *Growing Middle Class:* Organic foods, tooth whitener, skin whitener/ tanner, premium chocolate, imported beer, logo fashion, ultra-convenient "home-cooked" meals
- *Affluent Potentials:* Small tubes of toothpaste, deodorant, bottled drinks, packaged bread, packaged broth, low rinse detergent, noodles formulated to address region-specific nutritional deficiencies
- *Rural Poor:* Individual sachet of shampoo, single cigarette, candy bar, individual tea bags, shampoo formulated to treat lice, nutritional fortified powdered milk sachets.

Russian CP company Wimm-Bill-Dann is one firm exploiting these dynamics with products and messages targeted to specific consumer facets and is rapidly growing both revenue and share.[31] Its *Beauty* dairy drink delivers functional benefits centered around hair, nail and skin health to premium consumers – those, according to the company, with "enough money to buy major household appliances, monthly income above $500 per family member."[32] Its *Zavetny Bidonchik* product is aimed at the economy facet – individuals with "enough money for food only".[33]

In addition to rethinking the "where" dimension of new markets, technology advances and changing consumer preferences are impacting "how" companies connect. Two main drivers are the consumer's ability to access a wealth of unfiltered information about products and the companies that make them, and acceptance of word-of-mouth as a trusted source of information. The Internet and interactive tools of Web 2.0 – such as social networks, blogs, wikis, and mashups – can help CP companies generate "buzz" and capture mind and market share. However the ability of companies to exert control over these connections and resulting perceptions is limited. In Japan, young women looking for trusted recommendations on cosmetics frequently turn to the online *Cosme* community, where they can access over 6.6 million individual, unfiltered product reviews.[34] Individuals looking for information and a connection with the spread *Nutella* can join the more than 2 million fans of the product on Facebook.[35]

While shoppers in Mexico currently are more likely to turn to their local shopkeeper for recommendations and insights, the widespread and broad-based global ownership of mobile phones is driving the relevance of this medium in connecting with consumers in the future.[36] Worldwide mobile phone subscriptions are forecast to reach 5.3 billion by 2013, up from approximately 3 billion currently.[37] Globally, the mobile phone penetration rate was 47 percent in 2007, with rates in many emerging markets growing by double digits.[38]

Leading CP companies are rapidly navigating the knowledge curve in developing mobile applications. Kraft launched an application for the iPhone, *iFood Assistant*, that accesses recipes, builds shopping lists and finds nearby stores.[39] Nestlé's Purina brand has launched its *go2 Pets* mobile phone service that delivers location-specific information to travelling pet owners about pet-friendly playgrounds, beaches and hotels, as well as local emergency numbers.[40]

In this era of new media, CP executives may often find themselves at the mercy of unfettered and open consumer-controlled social communication regarding their companies, operations, impact, branding and marketing. While there will be unprecedented opportunity to create connections, and even dialogs, it is the consumer who will decide when, where and on what terms these connections occur.

Successful CP companies will be those that identify and leverage information, insights and capabilities across all facets of the population diamond. For example, responsible interactions with consumers in the bottom facets of the diamond – the Affluent Potentials and Rural Poor – will influence perceptions among more upscale audiences. News of recalls, examples of social or environmental irresponsibility and/or poor product quality will get exposed and change perceptions across the diamond. Conversely, products marketed at the top of the diamond will create aspirations among other facets. Savvy CP companies will craft

CP companies need to balance improved service and collaboration with retail partners while developing direct connections with consumers.

marketing messages and brand hierarchies that create and feed a virtuous cycle of brand associations. Another critical element will be leveraging insights across different markets. For example, Nestlé is leveraging expertise gained selling its *Popularly Positioned Products* in emerging markets to introduce smaller pack sizes in its mature markets.[41] In the United Kingdom the company is selling 100 gram packs of instant coffee, which reduces consumer outlay.[42]

Summary

CP companies will need to:

1. Identify the key influencers and drivers of purchasing behavior for each consumer micro-segment
2. Connect with consumers via the development and delivery of highly targeted product and service offerings for all facets of the population diamond
3. Use existing and new technologies to tap consumer insight and influence buyer behavior (e.g., social networks, gaming, mobile phones, kiosks, etc…)
4. Rapidly apply key learnings across and within markets and segments
5. Work with partners to rapidly gain local market knowledge, distribution and other key competencies.

2. Channel: Managing complexity, collaboration and competition

For the foreseeable future, consumers in much of the developed world and some of the developing world will continue to purchase their soap, soup, socks and soda though modern chain retailers. However, for literally billions of other consumers – in both developed and developing economies – primary channels include kiosks, pavilions, open markets and single-unit retailers. At the same time, alternative channels for distributing products and disseminating information are also growing in relevance. Global channel choices include: traditional Indian *haats, kiranas* and *Paanwallas;* Web grocers such as Ocado in the United Kingdom and Fresh Direct in the U.S.; online category or lifestyle-centered communities of interest; and individually driven distribution models, such as Amway, Mary Kay and Shakti.

The venerable vending channel is also carving out new niches, with machines now assessing individual skin type and dispensing Elizabeth Arden cosmetics in malls and airports, baking custom, “from scratch” pizzas in three minutes and crafting fresh, custom ice cream in machines that use wireless Internet connectivity to report when supplies or maintenance are needed.[43] The challenge for CP companies is to balance the need for improved service and collaboration with traditional retailers, while simultaneously developing alternative sales and influence channels.

As CP companies expand their reach and push into new markets, the channel choices multiply, as do the complexities. In Brazil, there are 850,000 outlets for groceries, while in India 95 percent of retail sales flow through independent, family-run *kiranas*, general stores and chemists.[44] In Russia, modern trade penetration is only 21 percent, and the top three retailers comprise only 6 percent of the market.[45] Further complicating the channel picture in many markets – including China, India and Japan – multi-tiered distribution remains a fixture, creating significant challenges tracking product, measuring inventories, calculating sales and forecasting demand.

Given the relative immaturity of traditional retailers in many markets, CP companies will need to choose how to invest in training and development of channel participants. CP companies are well aware that the creation of a viable modern trade also creates the potential for formidable competitors. Indian health and beauty giant Dabur has deployed *Astra*, a retailer training module, in five languages.[46] Meanwhile, Coca-Cola is training more than 6,000 traditional retailers via its *Parivartan* program, imparting the necessary skills, tools and techniques to succeed.[47] These initiatives – aimed at building and leveraging the traditional trade – are reflective of the strength and growth possible in markets served by this channel. Between 2006 and 2008, the rural market segment in India for CP products grew from 13 percent of the total market to 17 percent.[48]

At the same time mega-retailers still account for a heavy percentage of sales at many CP companies – and a growing number of these retailers provide access to point-of-sale, operational and shopper data. CP companies need to determine the best option for capturing, harmonizing and transforming the various streams of demand signal, operational and shopper behavior data. Some are already integrating this data into their category management, trade promotion management, supply chain forecasting and planning, sales and operations planning, and retail store operations applications in order to improve store operations, better target shoppers, and create new in-store experiences.

Improving retail collaboration remains a critical concern for the CP industry. Although significant advances have been made, through initiatives such as Collaborative Planning Forecasting & Replenishment, Vendor Managed Inventory and the Global Commerce Initiative's New Ways of Working Together, effective collaboration remains elusive.[49] For many, the focus remains on expanded data sharing which – while necessary – is by no means a sufficient condition for collaboration. Even when data is shared, it is often unusable or not acted upon. As a result, inaccurate and/or out-of-date forecasts persist. Even when forecasts are accurate, such issues as out of stocks, poor promotions, ineffective product launches and excessive inventory levels often remain. The growing presence of Demand Signal Repositories (DSR) – 36 percent of CP companies reported having a DSR at the end of 2007 – that enhances visibility all the way through to the retail shelf is also no guarantee

CP companies can build brand equity by initiating and nurturing new direct-to-consumer channels.

of success.[50] Core change management issues surrounding store, field sales, and third-party merchandiser staffing, timeliness of information sharing and supply chain flexibility (i.e., ability to redirect shipments and produce/ship to demand) continue to pose challenges. CP companies must adopt a holistic and pragmatic approach to collaboration, converting pilots and proofs of concepts with forward-thinking retailers into everyday ways of working.

While retailers continue to serve as the primary sales channel, they are also increasingly fierce competitors. Supermarkets throughout the world now offer high-quality, aggressively promoted private-label brands. These products are positioned at multiple price points (e.g., budget, volume and premium) and are benefiting from sophisticated management and marketing techniques applied by recently acquired former CP company executives. While private-label share varies widely by retailer (Tesco at 48 percent, Kroger at 27 percent) and geography (United States at 22 percent unit share and Switzerland at 53 percent of total retail products) sales are big . . . and growing.[51] It is telling that two of the world's largest and faster growing retailers – Aldi and Lidl – are hard discounters with robust private label volume, 61 percent and 94 percent of sales, respectively.[52] Increasingly retailers are delivering both innovation and value to consumers, such as the expansion of mobile coupon initiatives by supermarket chains Sainsbury's and Kroger and the delivery of mobile phone alerts for product recalls by Costco.[53]

Going forward, CP companies can expect retailers to:

- Continue to consolidate and expand in emerging markets
- Make inroads at the expense of traditional trade
- Focus on increasing their understanding of shopper and consumer behaviors and shaping offers and communication to win their trust
- Continue private label as a key growth strategy for boosting revenues, gaining control over the cost of goods and pressuring manufacturers.

To combat this, it is critical for CP companies to connect and build equity directly with consumers – at least in part by initiating and nurturing new channels. Already, P&G is experimenting with *Tide*-branded dry cleaners, and *Mr. Clean*-branded car wash franchises. Plus, the company sells directly to consumers via its *The Essentials* website.[54] P&G has also invested UK£5 million for a 1 percent stake in online grocer Ocado.[55] As they continue to refine their direct-to-consumer offerings, however, CP companies will have to balance the benefits gained with increased tensions with retailers.

Hindustan Unilever Limited's Project Shakti: Connecting with the Rural Poor

Recognizing the specific needs, as well as huge potential, of the rural poor market segment in India – estimated at US$4 billion for FMCG in 2008 – Hindustan Unilever Limited ("HUL") launched Project Shakti in 2000-2001 as a pilot in 50 villages.[56]

The project represents an innovative model for connecting with an underserved facet of the market in a deep and meaningful way, improving individual awareness of health and hygiene issues, creating income-generating opportunities for an underprivileged segment of the population and fostering the growth of market for its products.[57] Shakti empowers women in small rural villages across India to become direct-to-consumer distributors, Shakti ammas, of a diverse range of Unilever products, including Lux and Lifebuoy soap, Wheel detergent, Lakme color cosmetics and Brooke Bond tea.[58]

In addition to providing the women with micro-credit for inventory purchases, HUL also provides sales training and, perhaps most important, self-esteem and status. Distributors typically earn between 700-1,000 rupees a month through a combination of a discount on inventory purchases plus a trade margin.[59] This income is a meaningful amount in a country where the majority earns less than 20 rupees per day and live in "abject poverty."[60] The project has grown to reach more than 3 million households in more than 135,000 Indian villages via the network of 45,000 entrepreneurs.[61] The scope of the project has also expanded to include additional services such as i-Shakti, an Internet-based rural information service network providing information on topics such as animal husbandry, hygiene, education, women's empowerment and Shakti Vani, a health education initiative.[62] A mobile phone partnership is also under consideration.

The success of Shakti has prompted Unilever to export core elements into other markets such as Vietnam, Bangladesh and Sri Lanka.[63] Projects Joyeeta and Saubaghya in Bangladesh and Sri Lanka, respectively, are now empowering Unilever to connect with consumers in rural areas not accessible by traditional mass media or distribution channels.[64]

Summary

CP companies must:

1. Hedge their bets between expanded collaboration with multi-national retailers (to achieve captaincy) and more assertive, efficiency-driven relationships with national and regional independents (to maintain margins)
2. Deploy multi-channel retailing strategies that reduce reliance on modern retail where feasible.

3. Business model: Executing for differentiation and value

Much has been written about the business model changes CP companies must effect in response to industry and other trends. In the IBM 2008 Global CEO Study, 82 percent of CP CEOs recognized the need for "substantial change" to their organizations, and two-thirds prioritized for business model innovation as a principle driver of that change.[65] While many CP companies have embraced aspects of business model innovation, i.e., outsourcing of non-core activities such as indirect procurement and Application Development and Maintenance, only a select few have truly embraced its transformative potential to redefine their role in the value chain.

Ongoing consolidation is reshaping the industry and requiring a rethinking and repositioning of the CP role in the value chain.

The basis of competition in the CP industry is fundamentally changing. Excellence in historical roles and operations is no longer sufficient. Brand names that resonated with the generations of consumers raised in Miami, Munich or Manchester have little currency in Jakarta, Jinan or Jodhpur, and media spend on traditional TV, print and point of sale isn't effective in a G3 mobile world without supermarket retailers.

The ongoing consolidation of companies is also reshaping the CP industry. In 2000, the top 20 brewing groups controlled 57 percent of global beer sales, up from 48 percent in 1993.[66] By 2007, approximately 50 percent of the global market was controlled by just five brewers.[67] Consolidation is impacting other categories, such as Turkish confectioner Ülker acquiring Godiva from Campbell Soup Company, PepsiCo acquiring the leading Russian branded juice company JSC Lebedyansky, and Danone acquiring Dutch baby food-maker Numico. These acquisitions only deliver value when the resulting larger companies are able to effectively harness and deploy the assets and capabilities to satisfy customers and delight consumers.

What is required is a rethinking and repositioning of the CP role across the value chain, based on a deep understanding of where the company's direct involvement adds value and is differentiating. This may drive upstream integration to develop and maintain access or better manage critical inputs, as PepsiCo has done with *Merisant* for its *PureVia*™ sweetener, partnering to enter new markets, as Campbell Soup has done with Bridgetown Foods to grow its business in Russia, or innovative deal structures such as Unilever's combined sale/license of its *Bertolli* olive brand to Grupo SOS.[68]

Commodities giant Cargill readily acknowledges it applies insights gained from its upstream commodity trading activities to the other elements of their business.[69]

The primary factors influencing business model innovation include:

- Increasingly complex and extended supply chains as markets expand, channels proliferate and participants specialize. For example, Li & Fung has emerged as a new industry player, managing the financing, procurement, new product design and development, vendor relations and logistics aspects of the extended supply chain for pharmaceutical, apparel, and food and beverage companies.[70]
- The emergence of new competitors in the form of aggressive retailers, private equity-funded specialist firms and emerging market competitors with family ownership and/or alternative capital structures. Private equity fosters new business models by leveraging diverse cash flows and embracing longer investment time horizons. For example, private equity firm Vestar Capital Partners purchased Unilever North America's laundry businesses.[71]
- Companies and countries are competing for increasingly scarce resources by leveraging new approaches to maintain access to commodities and energy. Depending upon their market situation and imperatives, many companies are moving upstream and acquiring control over the commodities that go into their products. Dubai-based Abraaj Capital, a large private equity company, and Qatar Livestock Company have each been acquiring land and other agricultural assets in Pakistan for food security purposes.[72]

- Companies are vertically integrating for control access and quality. For example, PepsiCo has vertically integrated for access to and greater control over the quality of potatoes grown in China for its Frito Lay snacks.[73]
- Companies need new models and capital to pursue the breadth and depth of growth opportunities. Wealthy financier and investor Warren Buffett, via his Berkshire Hathaway company, provided critical investment capital for the US$22 billion acquisition of Wrigley by Mars, Inc.[74]
- Maturity of technology has enabled the realization of long-held visions around the globally integrated enterprise. For example, the Nestlé GLOBE project harmonizes business practices and leverages global standards, information systems and technology to drive consistent global processes and to manage complexity and create operational efficiency.[75]

Summary

CP companies must:

1. Understand at a deep level the unique or differentiated value their business model adds for each element of the business and prioritize areas where greatest value is added and differentiated
2. Identify future sources of capital and explore alternative capital structures to realize growth opportunities
3. Develop capabilities, skills and management structures to enable the business model to "execute flawlessly"
4. Assess whether the company is more likely to be acquired or acquiring, and developing strategies and models reflective of those realities.

FIGURE 5.

Macro trends are driving CP companies to embrace fundamental change to many elements of their organizations.

Trend	*Business model implication*
Slow – no growth in developed markets	Emphasis on true product innovation, and delivering new services to customers, suppliers and consumers
Extended, complex global supply chains	Redefine CP roles via developing deeper relationships with retailers, distributors and suppliers. Be clear on where you add value
Robust competition in emerging markets	Exposing CP firms to entities with substantially different ownership, funding and payback horizons
Competition from discretionary consumer income	Competitive set now includes media and entertainment, telecommunications and consumer electronics companies
Number and breadth of growth opportunities	CP companies accessing new types of capital and deploying new venture and capital structures
Constantly connected customers	Seeking new ways to interacting with brands and consumers, leveraging new tools to access information and embracing new inputs

Source: IBM Institute for Business Value.

Flawless execution is a critical key in positioning for long-term success.

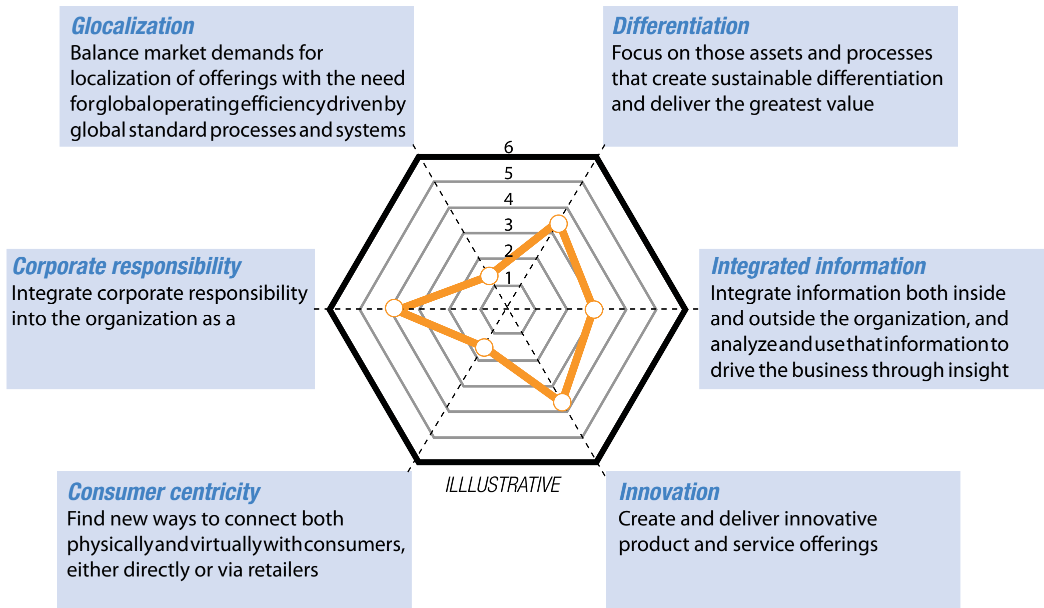
Capabilities

With the proliferation of change in markets, the environment and the global competitive posture of many CP companies, success will hinge upon successful and flawless execution against six capabilities as follows:

1. *Glocalization* – CP companies will need to put in place standard global systems and processes to deliver operating efficiencies, while simultaneously delivering localized offerings in individual markets. Getting the balance right between what is local and what is global and standard will be critical for future success.
2. *Differentiation* – CP companies must understand what processes, assets and resources really help create sustainable differentiation in the market place and then focus on adding value to these at every possible opportunity, while challenging the operating model for those that do not differentiate.
3. *Integrated information* – With the proliferation of data and information, both inside and outside the organization, CP companies must learn to capture the relevant data, integrate the relevant information, analyze this information and then convert it into insights that can be used to better deploy assets and optimize business performance.
4. *Innovation* – An open innovation model that facilitates differentiated, value-oriented product and service offerings that go beyond consumer expectations will be an essential ingredient for the successful CP company of the very near future.
5. *Consumer-centricity* – CP companies must develop channels to access information about consumers – what they are buying, what issues are important to them – and find avenues to connect with them, both directly and, where necessary, through retailers.
6. *Corporate responsibility* – Integrating corporate responsibility into the organization's DNA will be a vital factor as a source of both value and performance. Increasingly, consumers will be looking not only at products and services offered, but *how* a company conducts business.

Maturity in each of the capabilities ranges from 1-"Innocence" – in which a company does not have the necessary processes in place, to – 6-"Excellence" – in which the company is likely to assume a position of market leadership. (see page 19, for more information about capabilities maturity.)

FIGURE 6.
Success in this changing world will require execution against six capability areas.



Source: IBM Institute for Business Value.

Each capability area is important, but, as resources available for capability building are finite, each company must decide, based on its current market condition and growth strategy, on which areas to focus – either as a source of competitive advantage or to address shortcomings in the current maturity level of the capability. A large gap between existing capability and ambition is a signal for action.

Conclusion

Undoubtedly, for any consumer products company, the pace of change in nearly every facet of operations – from defining the market, to managing resources, to executing a new, differentiated operating model – presents some daunting challenges. We believe, however, that a gap will develop between the global leaders and a second tier. The global leaders will recognize that a new, largely untapped market is waiting for those companies willing to take bold, innovative steps.

The *status quo* is no longer sustainable. The future belongs to those that cater to new markets and develop operating models that consistently deliver exceptional quality and service in both the mature and emerging growth markets. The leaders will maintain a balanced approach on social and environmental issues in all markets and at every touch point along the value chain. These companies will prioritize connecting with consumers on a deep level and working to exceed their expectations. They will collaborate with channel partners and execute with excellence. They will reposition themselves to deliver value in everything they do.

The world of the Consumer Products industry has changed. Those companies that recognize the change, embrace the challenges this imposes, seek new ways of working and new markets to sell to and focus on developing their capabilities for the future will position themselves to thrive in this new world.

For more information about this study, you may e-mail the IBM Institute for Business Value at *iibv@us.ibm.com*. To view other research reports created by the Institute, please visit our Web site:

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For a detailed Maturity Model of the six capabilities mentioned in this paper, please email *iibv@us.ibm.com*.

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