

The Future Of Consumer Goods: Moving From Analog To Digital.

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Disrupt With Digital. Growth In The Future of Consumer Goods Will Require It.

Digital is blurring the boundaries between consumers, stores and consumer brands. This holds major opportunities for consumer packaged goods (CPG) companies prepared to radically reshape for the digital world—and clear risks for those who fail to.

From Nairobi to Nanjing to New York, consumers across the globe have clearly embraced the digital world. They have rapidly adapted to shopping for groceries during the daily commute; downloading books, music or films on the move; or tweeting, pinning and sharing their purchasing decisions on social networks. This expectation of 'anytime, anywhere' consumption has grown exponentially, bolstered by the rise of a mobile, social, cloud-based era of computing.

The rise of digital technology is empowering consumers, shifting power from corporate to the individual. Consumers and shoppers have access to a wider range of products and services—and they

use them. Consumers can, and increasingly do, compare prices, while seeking and sharing opinions digitally. Great products are rapidly amplified across a social media network, causing spikes in demand. So too are dreadful reviews, which can wipe out a new product launch.

The pace of change has surpassed all prior shifts in the nature of an industry: it took just seven years from the launch of the internet in the US for it to become a mass medium, faster than any prior innovation. Today, digital is ubiquitous. It crosses all boundaries: age, geography and stage of economic development. Kenya, for example, leads the world in mobile banking uptake, and Korea has the world's fastest broadband network, while six in ten Japanese consumers go online with their phones today.²

The Digital Consumer:¹

- Online sales are growing rapidly **by 18%**.
- Online grocery shopping is growing and **most prevalent in Asia**.
- 19% of brand purchase decisions are made in store. While **81% are made from home**.
- **5 billion apps** were downloaded within **6 months** of iPhone's launch.
- eBay® generated over **\$400M in sales** from its iPhone app in the first full year.

CPG Companies Struggling With Digital Disruption

While CPG companies are usually adept at exploiting new trends, and although we are seeing some exciting innovations in the digital space, we fundamentally believe that the CPG industry has not yet grasped the scale of the change ahead.

Most CPG companies' experiments so far are tactical rather than strategic responses to the challenge of the digital revolution: digital add-ons to an existing, analog business. They are still primarily focused on digital marketing, and happen in pockets of the organization, limiting return on investment. Of course, as the lines between manufacturer, distributor, retailer and consumer blur, there has been much experimentation with digital, from both consumer goods companies and retailers. Nespresso, for example, has successfully introduced its own brand boutiques to showcase their coffee machines and capsules, while closely integrating these with their online ordering and fulfillment services for consumers. Supermarket giant Tesco has created a virtual store in Korea's subway system where consumers shop by scanning QR codes. And Brazil's Magazine Luiza has invited consumers to create social media 'stores' on Facebook, with the company providing fulfillment and paying 'storeowners' a commission. Over 33,000 consumers opened Facebook stores in one month.³

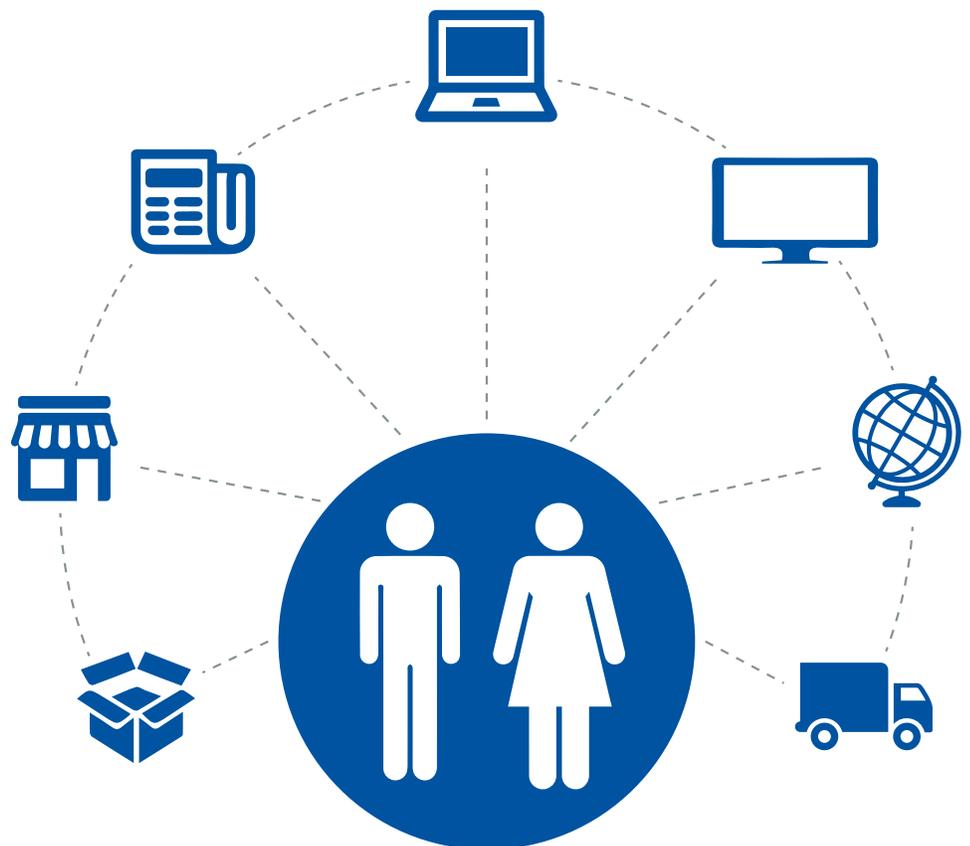
But if CPG companies are going to enjoy sustained growth into the future, they need to take a far more holistic approach that places the consumer at the center.

We are on the threshold of a dramatic digital disintermediation. It will literally re-write the rules of doing business. It will disrupt existing CPG relationships, whether they are with suppliers, retailers, or consumers. It will affect all aspects of CPG businesses—how they are structured internally; how they train employees; how they engage with their supply chain and retailers; how they create and market their products; and how they interact with consumers and shoppers.

Digital Revolution:

We've seen this happen in other industries: a decade ago, the shift to digital allowed low cost airlines to steal a mark from more expensive rivals by making passengers print their own boarding passes and check themselves in. Today, digital travel has become the norm.

It's time to stop dabbling with digital.
It's time to disrupt with digital!



Globalization Amplifying The Need For Digital Capabilities In CPG

Digital strategies are doubly important when considering the impact of globalization on CPG companies. First, the dismantling of political and trade barriers around the world brought new workers, consumers and shoppers into the global economy. Combined with rapid falls in transport and communications costs, this provided huge opportunities for businesses of all types to prosper in a globalized world.

The second factor is the rise of the emerging market middle-class consumer (by 2015, there will be at least one billion), which is opening up a vast new potential market. But here many consumers

are in rural areas or communities lacking modern infrastructure. An estimated 15 million new retail outlets would be required to reach these new consumers, which would be a significant cost for retailers (construction, staff and operations), additional supply chain costs for all, and many new consumers who will likely require their localized tastes are met and very competitive pricing.

Meanwhile, consumers in developed markets are aging and looking to live longer, healthier lives, but they are also cash-strapped, due to the stagnant economy, and seeking value. Quite simply, leveraging digital technology will be the only economically viable way for CPG companies to deliver on the

diverse tastes around the world and profitably compete. Digital technology is able to bring products and services to communities that it would be economically unfeasible to reach with a physical store, whether that's due to the price of real estate, or a lack of infrastructure and time.

To sustain the business they have and capitalize on the opportunities for growth in this digital age, CPG companies should evolve to a digital operating model. Leveraging digital technologies alone will not be enough. The entire CPG enterprise needs to have shared digital strategies and technologies to enable the necessary agility required of a true consumer-centric approach.

Dramatic Disintermediation



Geography is no longer the basis for management and organization

The justification for truly digital operations

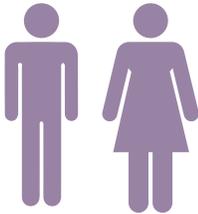
Over the last two decades, consumer goods companies have skillfully aligned their businesses to a changing world. This has led them on a journey from their predominantly local roots, to boldly reshape their operating models and become first regional, and then global, giants. Their vision has been rewarded: every stage of the journey has been accompanied by significant growth.

The first stage of the journey saw companies extend their operations regionally and win new consumer segments in countries adjacent to, or with similar characteristics to, their home market. They began to segment consumers by type as well as geography, to introduce shared services and outsourcing, and to consolidate their manufacturing and supply chains regionally. All these measure dramatically reduced costs and improved margins. The majority of the industry now runs a regional operating model.

A few companies have moved to the next stage, and 'gone global'. They focused on global consumer segments, and developed priority global brands with target segments stretching from Tokyo to Turin to Toronto. They introduced global operating models, supported by ERP systems, regional management and supply hubs, and shared services. They standardized operations, processes, supply chains, products and marketing, thus cutting costs and substantially increasing revenue and profitability.



One billion new consumers by 2015



Newly affluent emerging market middle class



The 15 million new outlets needed to reach them

The next stage of the journey combined the best of the regional and global models together to create "Super Global-Super Local" companies. The sophistication of consumer segmentation increased, and consumer and shopper archetypes were created to drive product development and engagement. At the same time, unique local products supplemented global propositions. Only a handful of companies operate like this today.

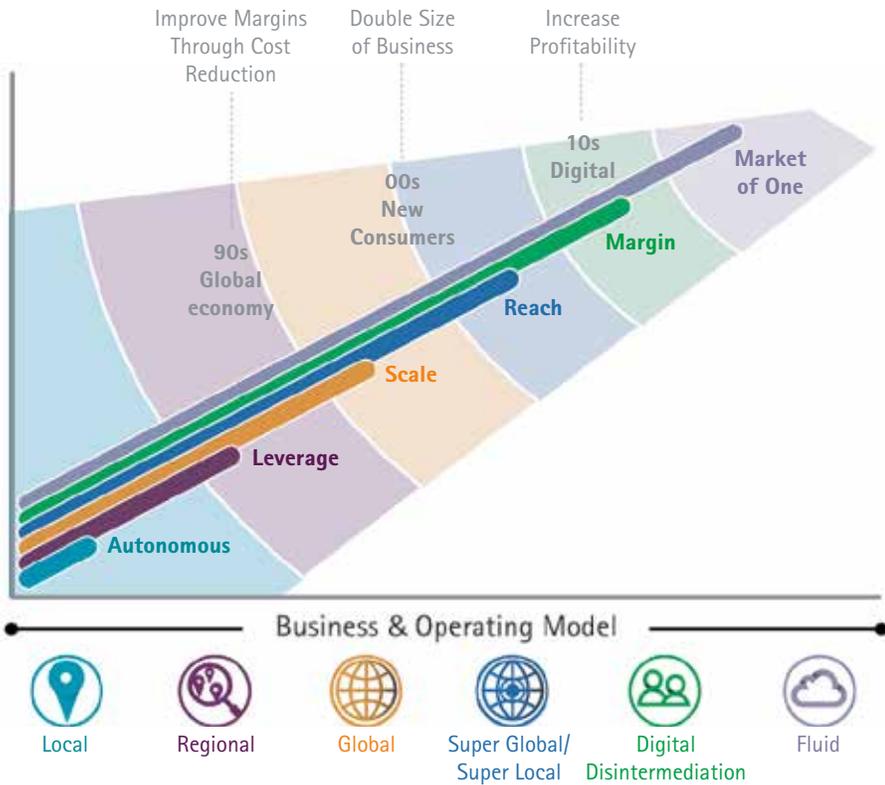
This transformational journey is associated with increased earnings and profitability in the CPG industry. Global consumer goods companies have achieved more than double digit growth in earnings before interest and tax in every year since 1995⁴; and earnings have outpaced sales growth in all but the last two years. But, by



capturing the hearts, and wallets, of emerging consumers and shoppers with desirable snacks and drinks, cosmetics, toiletries and household goods, CPG companies have grown revenues by almost 7 percent CAGR⁵ in the last two years, despite depressed global economic growth.

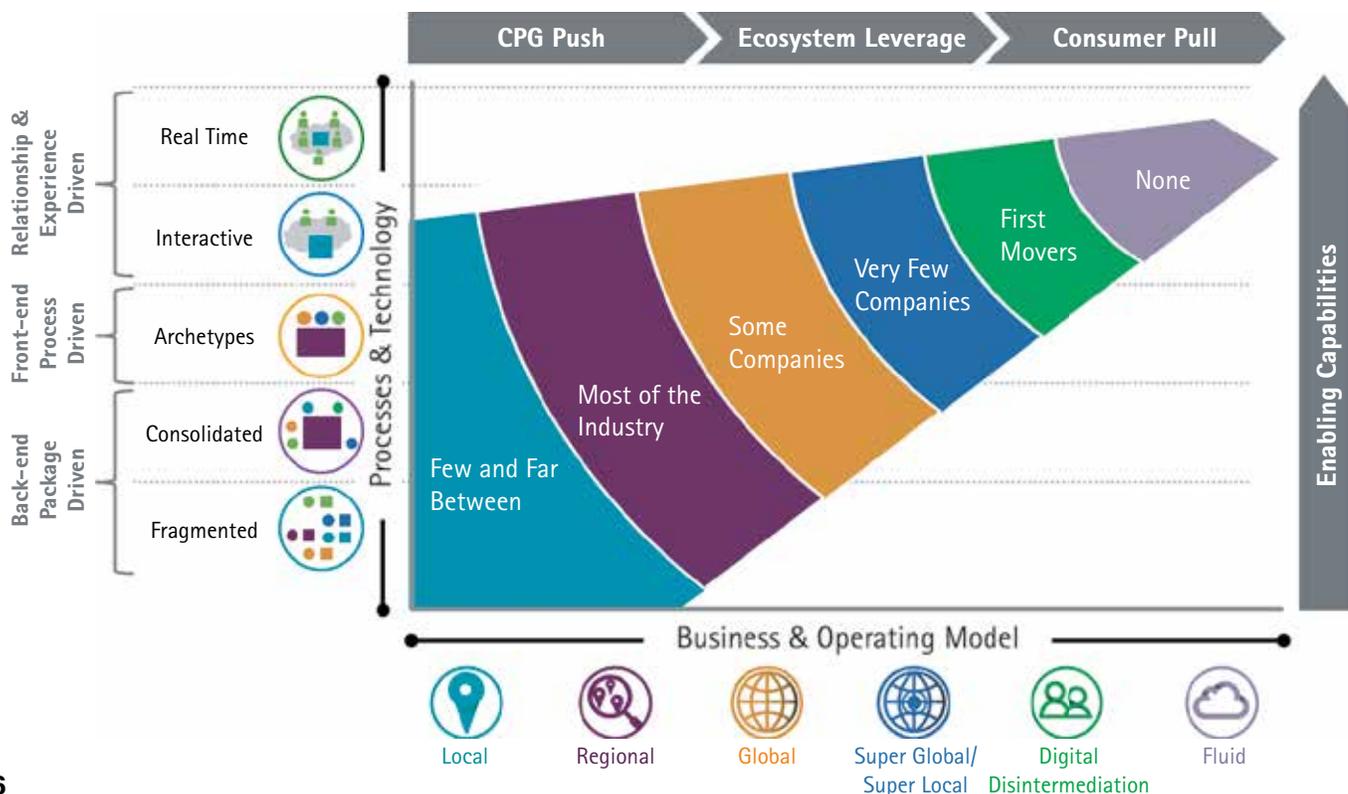
However, many firms are likely to find that, as globalization continues and consumer growth increases, their margins and business growth will come under challenge. It is time for them to radically reshape their existing business models and strategies to benefit from the digital world. Importantly, this isn't about some kind of digital façade; it's a far more transformational change requiring new processes and technology.

Figure 1: Digital is a fundamental change for CPG companies and is equivalent to previous macroeconomic changes



Wherever each company is on its journey, the digital world will affect the future of its business profoundly. The path ahead is challenging. But it also offers the prospect of stronger revenues and profitability for those companies that can successfully enfranchise new emerging market consumers and digitize their businesses.

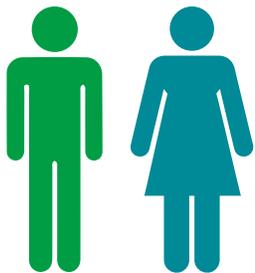
Figure 2: Processes and Technology have to evolve to support the journey in each step







Evolving To A Digital Operating Model



1 Organize by consumer and market archetype rather than geography.

For CPG companies, structuring their business operations geographically made sense in a world of high transport and communications costs, and limited globalization. In today's era, companies will need to structure their businesses in socially and economically coherent groups, such as types of consumer and route to market, to be successful. For **Consumer Archetypes**, this might include groupings of culturally similar markets—so Australia grouped with the UK (similar language and customs), rather than nearby Indonesia, for example. More radically, they should structure themselves and their propositions around distinct consumer groups, such as working mothers, or the recently retired.

When it comes to delivering the capabilities required to win in the local market, there is no one size fits all and not every market requires the most advanced capabilities in order

Moving to a digital operating model will involve a fundamental rethink of corporate structures, customer and consumer engagement, product development, supply chain, marketing and sales.

to succeed. Given the sheer number of different markets, it is necessary to understand where groups of markets share the same commercial success model and organize by these **Market Archetypes**.

CPG companies can determine the commercial success model required to win in each market or market-type, typically through evaluating capability, channel, and KPIs. Markets can be grouped according to their attractiveness (size and growth) and the complexity inherent in their route to market structure and general maturity and stability.

Similar markets and consumer segments are not always geographically contiguous. Both these routes will require fundamental organizational change. Companies will need to organize their systems and processes, supply chains, distribution, sales, branding and marketing activities around these archetypes.

Defining Commercial Success Models:

- **Capability assessment:** Assesses the importance of key commercial capabilities—route to market, pricing, portfolio, trade promotion, distributor management, and marketing investment—in each market
- **Channel assessment:** maps out the route to market in each country
- **KPI assessment:** Highlights the core KPIs that are applicable to measuring performance in specific markets



2 Expand into online sales—through eRetailers and/or directly through eCommerce.

Much of the growth in retail today is in convenience or impulse shopping and non-store business—including online, via mail order, and TV. For example, Asia has been progressive in selling outside traditional bricks and mortar retail—being the first to accept mobile payments. Although online sales are still a relatively small part of the market, their compound annual growth rates of 18 percent are far outstripping that of urban retail sectors and shopping malls.⁶ With lower costs and greater flexibility, so-called etailing will lead the way. But in turn, this will disrupt the traditional structure of the industry, as CPG companies discover new opportunities to sell direct to consumers, and build relationships with them, more than ever before.

In the past, CPG companies have relied on bricks and mortar retailers to sell their products. But in the digital world, digital retailers will be king. Urban retail sectors and malls have been among the first to feel the sharp end of digital disruption. Etailers have come into their market. They operate without the overhead costs of physical stores. They carry extensive

product ranges beyond the capacity of a physical store. And they have cut costs and passed some of the savings on to the shopper in reduced prices.

As a result, they have taken a bite out of the profits of traditional retailers. This is why, despite the rising profits in the CPG industry over the last decade, profits at bricks and mortar retailers have stagnated.

This **retail revolution** is not so much the disintermediation of retailers, but the disintermediation of the physical store. Tesco, for example, has halted construction on new stores. Retailers are developing their own online and virtual offerings, and integrating them with their stores to drive traffic and interest across channels. If retailers can't insulate themselves from digital disintermediation; nor can CPG companies. What is happening today in retail will happen tomorrow in consumer goods. CPG companies need to act now to adapt their business model.



3 Ensure integration throughout the value chain to enable a seamless shopping experience.

The integration of physical and virtual shopping experiences, across the lifecycle of a product, continues to develop rapidly. This is making the previously intangible aspects of how consumers discover and value goods far more valuable—from how they are paid for, delivered, used, and disposed of. This demands that these fragmented aspects of the value chain can no longer be arm's length processes: they need to be integrated with the manufacturer's brand. Nespresso's market strength is partly wrapped up in its tight integration of all these aspects, ensuring a seamless consumer experience from its concept stores, to its online fulfillment channels, to its dedicated support lines.

In a survey⁷ Accenture undertook last year into consumer expectations and habits, 8 out of 10 consumers said that the ability to pay for their goods anytime-anywhere-anyhow, and the ability to arrange delivery at their convenience, was important to them. This means that tangential capabilities—such as payments processing, and customer order management and delivery—become core to the delivery of brands.



4 Build engaging, relevant and customized brand relationships with target consumers.

The **moments of truth are converging**, and to achieve the kind of seamless experience consumers and shoppers want, CPG companies will have to have a presence at every stage of the shopper's journey—from initial product discovery, to purchase, delivery, first usage, and so on. They will need to engage with and manage their **whole value chain**—outside their enterprise, as well as within it.

And the blurring of the boundaries will also encourage CPG companies to sell directly to target consumers. This is a development that lends itself primarily to upmarket brands, as consumers and shoppers will have a limited appetite for shopping for commodity items from multiple sites. Direct-to-consumer consolidation sites, such as *alice.com* in the US try to get around this issue. Other manufacturers are trialing eStores and subscription services for bulk or repeat purchases.

Marketing departments have long been expert in the art of monologue: endlessly highlighting a brand's merits to consumers. Now they need to **learn the art of dialogue**; they need to find the points of intersection between what they want to say and what a consumer wants to hear, through multiple channels. Content needs to be customized, timely and continuously relevant to individual consumers.

The digital world enables, and now demands, engagement through numerous interconnections between the consumer or shopper, product, brand, retailer, digital and social networks. There's a great opportunity here. CPG companies get the chance to build direct relationships with target consumers. But there are significant challenges too. In the digital world, the consumer and shopper will decide whether to engage or 'consume' any given piece of marketing. If the content isn't engaging and relevant, it will be disregarded.

Achieving a personalized digital relationship with individual consumers and shoppers will require investment in automation, technology and analytics. They can take relationships beyond transactional.

From Monologue To Dialogue:⁸

- A Brazilian department store, C&A Fashion Like, has created clothes hangers that display live data on the number of 'likes' a product receives on Facebook.
- Nestle created Marktplatz in Germany in 2011 allowing shoppers to rate their products.
- Having launched a popular Stain Solver website for its Vanish brand, Reckitt-Benckiser took the concept a stage further with a 'tip exchange' Facebook page where users share their top stain removing tips.

Together, they have the power to create personalized engagement, based on a 360° view of consumers' digital interactions that will allow companies to anticipate shoppers' tastes, habits and expectations.



5 Expand product ranges as the constraints set by physical space decrease.

The size of stores, competition among CPGs for shelf space, and supply chain costs has limited product ranges. This physical constraint will decrease with the digital revolution. We foresee an exponential expansion of product ranges to meet consumers' diverse needs and tastes around the world. Advances in technology will turbo-boost this trend by making mass-customization of products a reality.



6 Enable consumer co-creation, allowing individuals to customize their chosen products.

Companies used to exploiting the mass market, will have to learn to exploit the market of ONE. **Focus on the individual** consumer, influencer, and shopper—they are all digital and expect specific attention. This could be highly profitable: we already know that the more specific a product is to an individual, the more value they assign to it, and the more they are willing to pay for it. As advances in technology make the mass-customization of products an economical reality, allow consumers to specify products to suit their individual tastes, such as fragrance, flavor, pack size and color.



Making Sense Of A New Landscape

These trends are blurring the boundaries in the consumer goods industry. Product manufacturers are becoming retailers, distributors and media operators. On the demand-side, consumers are no longer just passive shoppers: they are critics, product co-creators, and, in some instances, even digital storeowners.

Although CPG companies are talking about the need to digitize their businesses, they are still a long way from understanding the scale of the revolution that is coming. Right now, too many companies are simply seeing the digital revolution as a technology issue: adding another channel to reach consumers. It is far more. It is a commercial revolution that must be addressed strategically across the enterprise, rather than

being led tactically by the IT function. Internal boundaries between functions need to come down, blurring the lines between sales, marketing, R&D, the supply chain and consumer service – enabling a holistic view of consumers, the capabilities to deliver customized messages and offers, and the agility to adjust quickly as consumer needs change.

It's time to disrupt with a digital operating model.

1 eMarketer, "The Global Media Intelligence Report Asia Pacific", 2012

2 eMarketer, The Global Media Intelligence Report: Asia-Pacific, September, 2012 pgs. 38,39

3 Retail Planet, Global Trends & Forecasts, 2013:Retail Horizons – Looking Forward to 2020, December 2012, pages 25,54, 55

4 Planet Retail

5 Captial IQ, FMCG Sales and Profit 1995-2012

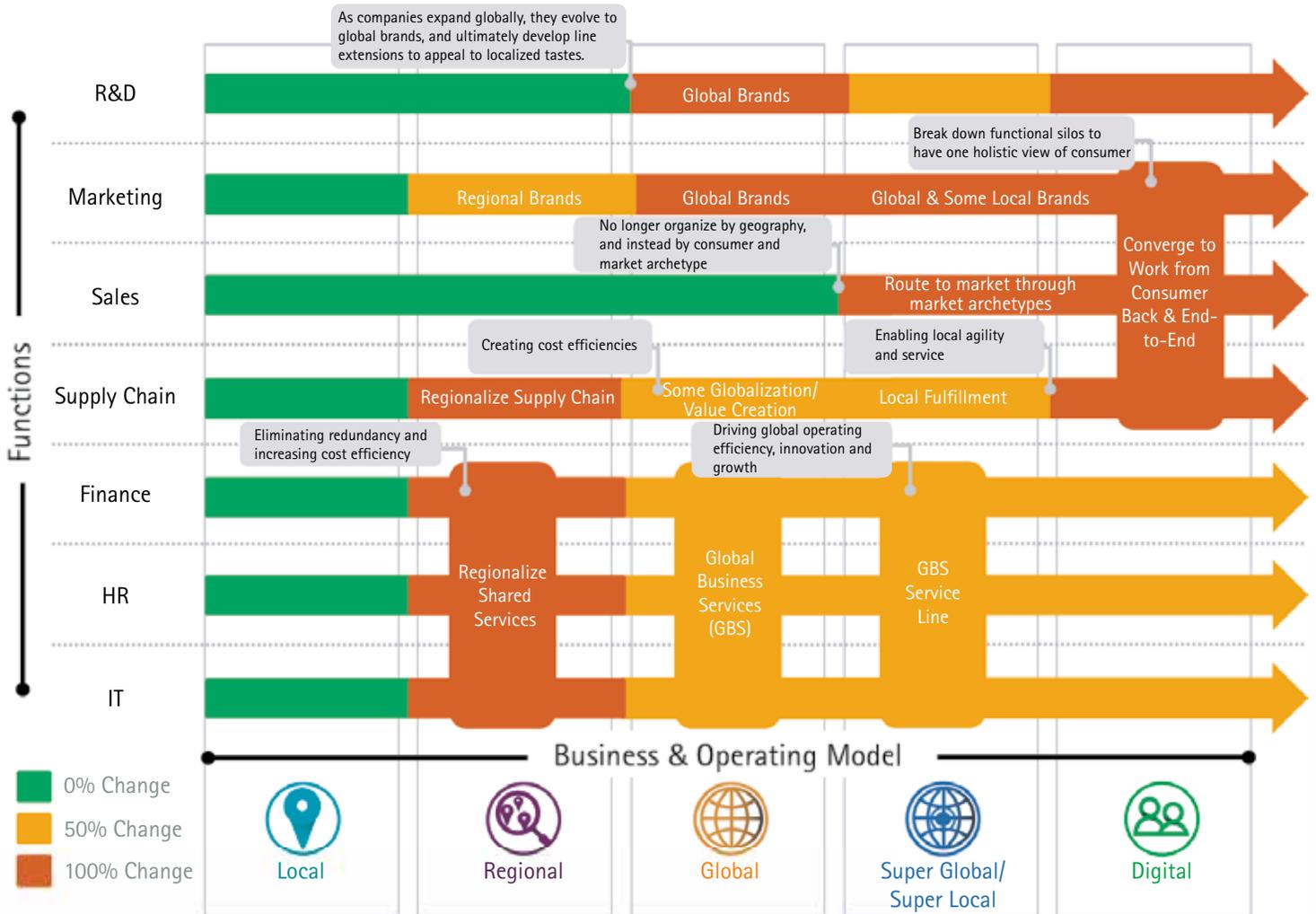
6 Planet Retail, "Global Channel Trends", May 2013

7 Accenture Seamless Retail Study

8 Retail Planet, Global Trends & Forecasts, 2013: Retail Horizons – Looking Forward to 2020, December 2012, page 34



Figure 3: The degree of functional change for CPG companies as they evolve through the stages of the journey



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