

Consumer Products at a Crossroads: Major Changes Ahead as Consumer Products Manufacturers Reach Tipping Points

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By Jim Tompkins
CEO, Tompkins International

Bruce Tompkins
Partner, Tompkins International

www.tompkinsinc.com

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Consumer products manufacturing just reached its biggest crossroads in recent history.

Consumer Products Manufacturing (CPM) companies are no longer simply providers of goods for retailers to sell. The upsurge of online sales is opening a door to consumers that many manufacturers are using to engage in direct online sales for themselves.

At times, this direct sales approach puts manufacturers in competition with retailers, as well as clearly exposing manufacturers to a whole new world of technology, omnichannel, multichannel and social media. As e-retailers go, so do the manufacturers who are selling direct online either through their own websites or through others.

CPM companies are left with several choices – sell direct online, sell online through a provider such as Amazon, sell at outlet malls, open retail stores or continue to sell through retailers.

To understand the dilemma facing CPM companies, it's important to recognize that retailers have reached a critical crossroads. Retailers must have the capability to sell their products through any channel to any customer at any time. CPM companies support retailers, and therefore they feel the same impacts as retailers and are directly influenced in their own online sales efforts. Consumer expectations that are helping to create the crossroads for

retailers require CPM companies to change with the times. A greater focus will be placed on product cost, rapid response to demand changes, and agility in the supply chain.



This paper provides the first complete view of CPM companies at a crossroads and explains how to flourish in this quickly evolving environment.

As the 2012 holiday shopping season demonstrated, the consumer is now in the driver's seat. Online companies such as Amazon are leading the pack by a wide margin, whether all retailers and CPM companies realize it or not. The number of CPM companies selling through Amazon continues to grow exponentially. CPM companies need to decide if Amazon is their sales partner or their enemy.

Amazon recently reported its best holiday season ever in 2012, selling 26.5 million products around the world at a record-setting pace of 306 items per second.

At this CPM crossroads, business questions that were once heavily debated no longer matter as much. Where to locate distribution centers (DCs) and how to minimize the cost of the distribution network are structure considerations that revolve around the all-encompassing business strategy. And it is at these crossroads that it is imperative to address business strategy before tackling structure issues like DC locations.

The traditional thinking around distribution networks and distribution operations is obsolete, given the current crossroads.

With social media, technology and consumer sophistication booming, retail and CPM companies find themselves at a very similar crossroads. Between now and holiday season 2014, major decisions will be reached by both retailers and CPM companies that will result in a flood of bankruptcies not seen since the dotcom bubble burst of 2000.

This paper provides the first complete view of *CPM Companies at a Crossroads* and explains how to flourish in this quickly evolving environment. Multichannel Operations Excellence (MOE), teamed with a keen understanding of the Four Pillars of Success explained here, bring clarity to this crossroads.

SIGNS POINT TO CPM CROSSROADS

Consumer expectations are leading the way.

Through social media, increased customization, and same-day or next-day delivery,

consumers are signaling that success and failure rests on companies' continuing high expectations of price, selection, convenience and experience. This requires an improvement in their product costs and supply chains to keep pace with the demands of online consumers.

A clear pattern foretelling the twin retail/CPM crossroads has emerged based on recent business developments. Consider these reports from such diverse sources as *The Wall Street Journal*, *Harvard Business Review*, *Fortune*, and retail and consumer products publications:

- The era of big box retail dominance is coming to an end as nearly every major retailer is seeking to match Amazon's prices and delivery options.



- Online sales in the US currently represent 9% of total retail sales (up 5% from five years ago). The online sales ratio is 10% in the UK, 3% in Asia- Pacific and 2% in Latin America.
- As Europe struggled with the recent financial crisis, online retail sales grew 18.2% in 2011 even as total retail sales were flat. Amazon in Europe grew 37.2% in 2011.
- China's online retail sales are on track to triple to \$360 billion by 2015, making it the largest global online sales market.
- Sixty percent of consumer goods manufacturers are selling direct to consumers, and one of the fastest growing segments of web commerce is the manufacturing direct-to-consumer segment.
- This approach does not work anymore: "Here's some product and here's some advertising, hope you like it!"
- In 2011, Amazon experienced 41% revenue growth, while Wal-Mart realized just 8% growth (less than 2% of Wal-Mart revenue was online). Wal- Mart awakened in 2012 and began taking on Amazon in online sales and shipping.

- In the last quarter of 2012 Amazon stock hit an all-time high. It is predicted that the global e-commerce market will hit \$1 trillion by 2016, (\$280 billion from the U.S.) with Amazon poised to capture nearly a quarter of that.
- The number of people who turned to social media as a source to learn about new products more than doubled in less than a year – from 24% in 2010 to 49% in 2011. This trend is expected to increase.

SEVEN TIPPING POINTS

It is not really one tipping point that has put us at this crucial crossroads, but seven.

How CPM companies respond to these tipping points will determine their future successes.

1. ADAPTING TO RETAILER NEEDS

As retailers move to a greater percentage of their sales coming from online purchases, challenges are created for CPM companies to support them. Gone are the days of measuring lead-time in weeks with slow response to actual product demand. CPM companies must be responsive and agile / demand driven in order to meet the changing needs of retailers and their customers.

Retailers will also require more and better information from CPM companies to satisfy immediate consumer demand. Collaboration will be necessary in order to optimize the supply chain to everyone's benefit.

A number of retailers have recently = shifted = to private label products, and this has also pressured some CPM companies toward online sales.

2. RETAIL CONSOLIDATION

Consolidations are occurring across most retail segments and will accelerate as time passes. CPM companies will be required to work with fewer yet larger retailers. In turn, this places tremendous pressure on CPM companies to perform better than ever before. The focus is on meeting more demanding consumer requirements for low prices, broad selection, convenience and personalized experience. As retailers deal with these consolidation challenges, so too will the CPM companies who support them.

3. AMAZON

Amazon is the standard for retail excellence, not only for online, but for all of retail, because it is the model for being customer- centric. Amazon has created a new way to connect customers with solutions and continues to innovate quickly.

By providing content about product features, a community of opinions about the product, and finally the commerce (price and availability) of the product, it really understands how to grow both the top line and bottom line. This makes them everyone's competition. Amazon is excellent on price, selection, convenience and experience.

It is no wonder that retailers and CPM companies across all categories have begun studying Amazon in an effort to uncover their "secret sauce."



Gone are the days of measuring lead - time in weeks with slow response to actual product demand.

CPM companies need to fear Amazon, and at the same time, need to seriously consider developing a relationship with them. With the birth of AmazonSupply in late April of 2012, Amazon expanded into new business markets for industrial, scientific and commercial items. Jeff Bezos, CEO of Amazon, was named National Retail Foundation's (NRF's) Gold Award winner for 2012 - a groundbreaking accomplishment because the award was previously reserved for only brick-and- mortar retailers.

There is every reason to think that the giant e-retailer will continue to expand its customer base and offer even more attractive delivery options.

4. ONLINE SUCCESS

CPM companies are realizing substantial growth from online sales of their products. As companies reach the 7-10% level of total revenue originating from online sales, they are taking note and beginning to consider what happens if this becomes 15-20% of total revenue. How will their supply chains support this kind of channel growth?

CPM companies are searching for answers and trying to understand multichannel, omnichannel, social networks, technology, global offerings and the "endless aisle." Showcasing products online and at self- service kiosks gives CPM companies an endless aisle to offer a wide range of SKUs and models that retailers cannot afford to stock in their stores. Therefore, CPM companies are not only in competition with Amazon and other online retailers, but also with other manufacturers who are going

directly to online consumers.

5. TECHNOLOGY

The smartphone, the tablet, and web technology are all enhancing the experience of online shopping. More than 10% of all online transactions are now completed on a mobile phone. Barcode scanning and mobile coupons are emerging as a top activity on Smartphone's. Flash sales and geofencing are all the rage for bargain hunters. Consumers today crave frictionless shopping, and this typically means using technology.

Cloud-based platforms are becoming more commonplace as companies seek demand-driven technologies that deliver quicker responses with measureable results.

If CPM companies are going to thrive in this environment, then they must become as adept at using technology as the retailers or outsource this capability to others. We are not seeing CPM companies respond to this need as quickly as retailers.

6. SOCIAL COMMERCE

Due to social networking, consumers are not actually shopping "alone." They are backed up by a whole team of trusted people who know their tastes and habits. The digital realm has taken the process of word-of-mouth communication to a whole new level, often 140 characters at a time with Twitter.

Today, 68% of all people trust other people "like themselves" - this is up from 22% in 2003. Now, social commerce is exploding and both online and in-store. As consumers become better oriented to using social media and smartphones, so too must CPM companies, if they wish to grow in the highly competitive marketplace.

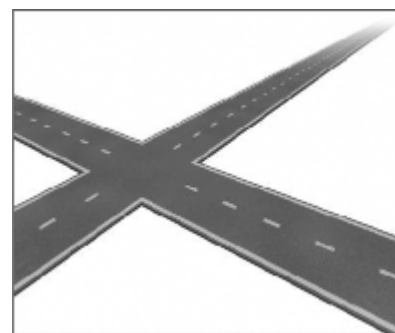
7. YOUTH CULTURE

Younger consumers are leading a shift to online sales, and as they grow older, they are buying more. The youth culture "always-on" wireless connectivity psyche is at their core and increasingly drives online growth. Greater comfort with both technology and social networks is bringing about major changes in consumer acceptance and even preference for online shopping.



For CPM companies, cloud -based platforms are becoming more commonplace as companies seek demand -driven technologies that deliver quicker responses with measureable results.

Consider that 98% of all 18-24 year-olds have a social network account and they spend almost twice as much time online as they do watching TV. It has also been reported that the average 18-24 year-old sends 1,300 texts per month; and, the average 13-17 year-old sends more than double that amount.



HOW DID WE GET HERE?

Online retailing launched in 1995 when Amazon and eBay began filling consumer requirements via the Internet.

In the 1990s, an online sale was focused mainly on books and computers; however, this has evolved to an endless list of products that is growing daily. Online sales will continue to take away sales from stores, but by 2015, online sales in the most progressive markets will only hit 20% of total retail spending. In 2025, online sales are projected to be only 25% of all sales globally. Therefore, although online sales are expected to be a prominent growth area, physical stores are still very, very important. CPM companies will also see significant gains in online sales over the next 10 years, but at the core of *The Crossroads* is the dilemma of maintaining balance and achieving synergy amongst online versus in- store sales.

It is clear Amazon is flourishing, with a five-year average ROI of 17% versus 6.5% ROI for discount and department stores. But even more important than ROI is the Return on Invested Capital (ROIC), since online holds an unapproachable advantage over in- store on ROIC.

FOUR PILLARS OF SUCCESS FOR CONSUMER PRODUCTS MANUFACTURERS

What do consumers really want?



Independent of channel, customers seek:

- 1. Great Prices**
- 2. Awesome Selection**
- 3. Best-in-class Convenience**
- 4. Personalized Experience**

A great deal of time and money has been spent on this very question, but it really boils down to these four pillars – a required stop on the road to online sales success for both retailers and CPM companies.

Great Prices

Today's consumers expect good value for the money and have a strong awareness of the total price (item price + shipping cost + sales tax) of the items they want to buy.

The consumer's ability to have total price transparency presents a clear expectation for price competitiveness. The expectation today is that on orders over \$25, shipping will be free on "normal" delivery time frames. By holiday 2013, the expectation is that all shipping will be free.

Awesome Selection

Today's consumers want what they want. Consumers want a broad assortment and expect their item to be available. They may desire customization and are surprised if it is not available.

Consumers desire help in finding related items ("What shoes would look good with this dress?") and in receiving recommendations ("Here are some ties that look great with your new suit"). Examples of great selection include Walmart.com, which has almost six times as many SKUs online as they do in-store. Also, Amazon has more than 200,000 shoe SKUs available and close to 3,000 denim SKUs.

CPM companies beyond the crossroads pass through "virtual retail," "non-stock retail" or "endless aisle retail" to offer all SKUs in which customers may have an interest in purchasing. Therefore, limiting selection is not a strategy that will work in the future. Unlimited selection will become the norm very soon.

Best-in-class Convenience

Today's savvy consumers, in addition to being concerned about price and selection, are worried about their time. They want shopping to be quick and easy, or they want it to be entertaining.

Online consumers seek same-day or next-day delivery, but for now they will accept three- to four-day delivery. Going forward, same-day or next-day delivery will be the norm for most items sold online.

Consider that today in China, the delivery is not measured in same-day or next-day terms, but in hours. The goal for delivery in major cities in China is four to six hours.

Consumers also want returns to be quick, easy and hassle free. They prefer online returns to be free.

By holiday 2013, they will demand that online returns be free. Consumers want shopping to be done on their terms and when, where and how they want to do it. They expect to easily obtain feedback and responses to their questions and interact freely via their mobile devices.

Consumers expect clear, transparent communications that enable them to make informed choices. Amazon has developed many innovations in regard to online convenience, including one-click check-out and advanced search and recommendation functionality, as well as Amazon Prime.

Similarly, Wal-Mart recently determined that a segment of their customers do not have credit cards, or do not want to use credit cards online, and are precluded from shopping online.

To solve this issue, Wal-Mart now has a "Pay with cash" button on its website so that customers can order online and choose the store where they can go to pay for their orders with cash.

Wal-Mart and other big box stores began a strong and deliberate push to gain a share of Amazon's online orders and match their prices over holiday season 2012 – setting off a "delivery and convenience war" that promises to escalate over the next few years.



Consumers also want returns to be quick, easy and hassle free. By holiday 2013, they will demand that online returns be free.

Personalized Experience

Today's consumers demand that sales channels work in unison. They want the same stellar level of treatment regardless of channel.

This may take the form of an intimate, personal dialogue, or an engagement as per customers' specifications.

It may be in person or via a social element (Consumers who bought this also bought...Consumers who viewed this also viewed...Frequently bought together... consumer reviews, etc). They expect order accuracy, reliable descriptions and zero surprises.

As Zappos says: "Customers want online sales to deliver 'WOW' through service," whatever the customer's definition of service may be.

Zappos defines 'WOW' on service as "Free shipping, free returns, free 365-day return policy, 24/7 customer service and happiness."

So, for this successful online retailer, it is beyond convenience – the shopping experience must bring happiness. They strive to make the shopping experience fun, exciting, entertaining, emotionally engaging, efficient and educating.

Increasingly, consumers are saying, "Remember me when I want to be remembered; contact me when and how I want to be contacted; reward me for my loyalty when and how I want to be rewarded; and positively surprise me when and how I want to be surprised never negatively surprise me."

Consumers are also allowing information gathering at each point of contact and want retailers and CPM companies to use this information to enhance their shopping experience.

THE FUTURE IS IN 'MOE': MULTICHANNEL OPERATIONS EXCELLENCE

As retail and CPM companies continue to evolve, it is clear that neither the Amazon 2011- 12 model nor the Apple Store 2011-12 model will be where the world is headed in the near future.

A major transformation is poised to propel retailers and CPM companies to a whole new place – one that allows immediate response to consumer expectations and rapid adoption of new innovations in the marketplace.



MOE demands that every aspect of online sales be entertaining, interactive, educational, exciting, fun, engaging and personalized.

Some have taken hold of the word “omnichannel” to represent the correct path leading from *CPM at a Crossroads*. But, since omnichannel is a relatively new word, move forward with caution.

The thinking behind omnichannel is that online sellers need to interact with consumers in an integrated, consistent way (think channel -continuity, or sometimes termed “enterprise selling”) via many channels (websites, stores, catalogs, kiosks, direct mail, social media, mobile devices, television, etc.) that provide consumers with endless value and satisfaction.



The first step in reaching any new position of performance is to develop the right strategy for the specific business.

The real challenge of the current crossroads, however, looms larger. Succeeding at omnichannel is a real positive for CPM companies, but unto itself, it is inadequate. Eliminating the internal barriers created between different channels is beneficial, but it is not the answer that consumers are seeking.

To move beyond the crossroads, CPM companies need to provide excellence within several channels as well as the omnichannel. Engaging and serving customers under their own terms (how, when and where) compels CPM companies to achieve MOE. MOE demands that every aspect of online sales be entertaining, interactive, educational, exciting, fun, engaging and personalized. CPM companies who employ MOE will set the pace for the next decade as well as define online sales excellence for the next 50 years. But approaching MOE requires a major transformation.

In this age of connectivity, mobility, and social networking, the successful CPM companies will need to focus on adapting to how their customers make decisions and purchases. Thus, multichannel access may involve partnering with online competitors to broaden the brand appeal to a wider audience; or integrating online with social media such as Twitter and Facebook. Regardless, achieving MOE requires the adoption of new processes and

technologies so that effective selling techniques will continually delight consumers.

WHAT MOE IS AND IS NOT

Realizing that consumers want everything and they want it their way goes to the heart and soul of Multichannel Operations Excellence.

The transformation to MOE begins with an understanding that today's consumers ***are beyond:***

- Having an “interface” with the online seller, and instead desire an engagement (on their terms) with the CPM company.
- Listening to the online seller, and instead seek a dialogue.
- Understanding the CPM company's value proposition for consumers, but want to understand their own value proposition.
- Needing rules and barriers to customer service, but instead want a true consumer-centric view of service, performance and delight.
- Accepting CPM companies who do not get the social issues related to poor sustainability, child labor laws, and other key areas.
- Accepting bad shopping experiences and poor, impersonal service.
- Seeking a single channel experience. Different channels for different product categories are in demand. The consumer will decide that for some products they want only an online interaction, but for others, they want “try before you buy” satisfaction.
- Accepting bad surprises from their shopping. Extra fees, negative experiences, and having CPM companies tell them how they should shop are all unacceptable.
- Accepting yesterday's shopping experience, but also wanting and expecting to be constantly impressed with innovations and given services they did not even know they wanted.

TRANSFORMATIONAL PATH FORWARD



The five essential steps to achieving MOE are:

- 1. Strategy**
- 2. Network Plan**
- 3. Processes and Organization**
- 4. Technologies**
- 5. Continuous Innovation**

Once company leaders recognize that MOE is the right direction, how do they begin moving beyond the crossroads? By pursuing the right sales strategy, the right technology, and the right supply chain structure. **It is always strategy before structure.**

Strategy

The first step in reaching any new position of performance is to develop the right strategy for the specific business. There is no substitute, or shortcut.

The “blind spot” where many CPM companies fail is in not defining their strategy well, or not being able to communicate it to all stakeholders – investors, management, employees and customers. Basically, the strategy has three components with key questions that must be answered before moving forward:

- a. *Target Market* – Who are our targeted customers? How are they segmented? What do they need and expect?
- b. *Products, Services and Value Proposition* – What do we provide, and why should our target customers buy these from us? How do we distinguish our value proposition? How do we know how well we are doing?
- c. *The Capabilities* – What do we need to deliver? How should we do it, and is there a compelling theme that differentiates us? What are our critical success factors?

Network Plan

Once the strategy is clear, proceed to infrastructure – planning the network of, DCs, direct delivery centers, forward fulfillment centers, direct special services centers, depots, forward picking locations, cross-docks and other processing/shipping locations. The network plan is no longer a straightforward, computer-based exercise of minimizing total costs. A huge challenge that must be met with gusto is how this network contributes to the best-in-class convenience described under the “Four Pillars of Online Success.”

In addition, decisions must be made with respect to doing distribution internally or outsourcing to logistics service providers. The network plan will include the preliminary facility plan, transportation plan, inventory deployment plan, customer interfaces and endless aisle partners.

To further complicate matters, CPM companies have to consider tax rates, real estate costs, energy costs, and incentives, as well as labor availability, cost and flexibility.

Processes and Organization

To move CPM companies beyond the crossroads, major process and organizational transformations are required. The forward- thinking processes and organizational requirements that will be critical success factors for future CPM companies include:

- Market Intelligence
- Customer Centric
- Global Player
- Endless Aisle
- Demand-driven
- Supply Chain Execution
- Technology
- Flexibility

Advancing beyond the crossroads means that CPM companies will need to re-engineer their Key Performance Indicators (KPIs) and approach to compensation, along with intensifying their focus on customer-centric service and growing globally.

At the same time, CPM companies must address the transformational changes of endless aisle and become more demand-driven in their supply chains.

The very nature of MOE and its potential to drive change compels companies to pay attention to the processes and the organization.

Technology

The new MOE processes will necessitate new enabling technology. CPM companies will be required to adapt to the traditional online practices of planning, sourcing, allocating, deploying, moving, storing, distributing, delivering, selling and last mile delivery.

Moreover, CPM companies will be required to act and perform like their retail online counterparts or outsource this function to capable providers.

Needed technology applications can be bolted onto most existing ERP systems, so it will not be a four- to six-year implementation cycle. In fact, many of the technology solutions going forward can be done on a cloud and integrated on top of an existing ERP. However, it is unwise to try to achieve MOE without a clear, strong understanding of the new technology needed to achieve it.

For CPM companies, doing business online is not as simple as setting up a website for consumers to place orders.

Continuous Innovation

The final step recognizes that even the best strategies, network plans, processes and organization, and technologies will not be cost-effective or consumer-endearing forever. The world of online sales has changed rapidly, and this rate of change will only accelerate.

Consumer expectations are expanding every day, and if CPM companies cannot keep up, the shopper will follow the path of least resistance or the path that is most convenient and pleasing. Consumers have alternatives for not only products, but also where they shop, when they shop and the ways that they research, browse, compare, order, pay for, receive, unpack, use, support and/or return the products they desire.

Thus, the path beyond today's crossroads must include how changes can be accepted and embraced with the fewest cost and time delays. This evolution will require that strategies, network plans, processes and organization, and technologies be designed with changes in mind - not actually knowing what they will be in the future.

While anyone can speculate about speed, velocity and flexibility, the consumer vision of

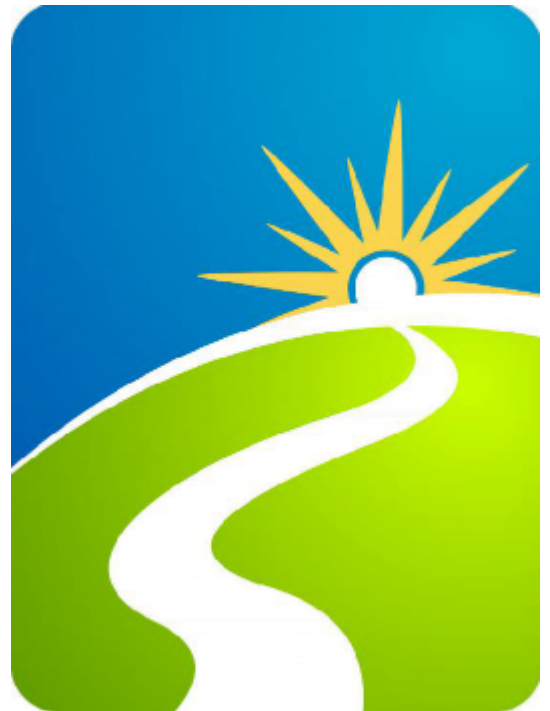
“anything, anytime, and any way I choose” will lead every CPM company to embrace change and prepare for it in order to succeed online.

MOVE BEYOND THE CROSSROADS

Retail stores are certainly not going to disappear any time soon.

There were only 3% fewer stores in 2012 in the US as compared to 2011.

In addition, more than half of retail growth across all categories results from in-store purchases. Therefore, stores will continue to be where the majority of retail sales occur in the foreseeable future.



The physical presence of retail stores is not the point, however. In a multichannel world, it is not important from which channel satisfied customers are obtained. ***The goal is to gain enough satisfied customers in all channels to survive and prosper.***

Understand that Amazon will soon be in all markets and that they are a strong competitor for CPM companies as well as with retail. What compelling case of price- selection- convenience- experience can companies make to convince enough consumers to do business with them? And the overarching question: Who is willing to embrace MOE and make the tough choices needed to move beyond the crossroads to be successful?

There is no doubt that retailers and CPM companies live in exciting times. But these are not easy times. To further help unravel the opportunities and solutions of *CPM at a Crossroads*, see the graphic presented on the next page. This picture reveals the nature of the crossroads and the path to achieving online sales success.

The tipping points are already starting to slant toward the crossroads, and success lies in understanding and following MOE and the Pillars of Success.

The “consumer is king (or queen).” With online sales, social media, and multichannel distribution peaking, this statement has never been truer. It is time to meet at the crossroads and move forward.



About Tompkins International

Tompkins International transforms supply chains to help create value for all organizations. For more than 35 years, Tompkins has provided endtoend solutions on a global scale, helping clients align business and supply chain strategies through operations planning, design and implementation. The company delivers leadingedge business and supply chain solutions by optimizing the Mega Processes of PLANBUYMAKEMOVESTORESELL. Tompkins supports clients in achieving profitable growth in all areas of global supply chain and market growth strategy, organization, operations, process improvement, technology implementation, material handling integration, and benchmarking and best practices. Headquartered in Raleigh, NC, USA, Tompkins has offices throughout North America and in

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