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MAPPING UNCHARTED ISSUES

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Mapping uncharted issues

The World Economic Forum piloted a new poll last month with Food & Beverage, Consumer Goods and Retail Governors to find out what was on their minds. By January 12, 2005, 19 Governors had responded, and their top five interests included the falling dollar, doing business in China and India, industry consolidation, marketing effectiveness and innovation. Perfectly navigating such unknowns may be a stretch, but collectively we hope to begin to chart shoals and passages. The results of the survey are shown in the table at right. (See figure 1.)

The World Economic Forum will use these responses to orient the general discussion and suggest initiatives. As the discussion touches on each key issue or concern the goal is to move beyond how each topic affects individual companies and instead ask, “What collective action can Governors take to address these issues, working either through industry bodies or in cooperation with public-sector organisations, including the World Economic Forum?”

The falling dollar: Hedging your position

The falling dollar is a top concern of Food & Beverage, Consumer Goods and Retail industries and a major concern for any global company today. Since 2002, the US currency has fallen more than 30% in value against the Euro; 21% against the pound; and 24% against the yen. That has coincided with a rise in crude oil prices from $26 a barrel in 2002 to nearly $50 today at constant exchange rates. According to Walter Kemmsies of J.P. Morgan, European firms lost 8% to 10% of their revenue growth in 2003 owing to the dollar’s slide. How much farther will it tumble?

Such monetary uncertainty means companies need to hedge their financial positions and consider currency risk in strategic decision making more than ever before. A long-standing contingency of multinationals, requirements for hedging have increased by degrees as globalisation accelerates and vast markets like China (whose currency now is pegged to the dollar) and India crack open.

The dollar’s decline also spotlights the growing importance of global macroeconomics in companies’ decisions about how they market and price and where they produce their goods. For an individual company’s competitive strategy, it raises questions around another kind of “hedging”: risk-proofing your brand through localisation. For example:

- **Can companies strengthen brand loyalty and decrease costs** and vulnerability to currency fluctuations by increasing local inputs?
- **Can they further risk-proof their brands against geopolitical backlash** by locally orienting packaging and advertising?
- **What does the dollar’s fall mean for local pricing strategies?** And what if China unpegged its currency from the dollar? How would that affect the price of Chinese goods?
- **How and where should companies invest in local government relations** and local corporate alliances to guide them through changing local regulation?

Still, at root, the falling dollar is an issue that seems to defy the response of any one company, beyond committing resources to better understanding the monetary policies of governments and tightening exchange-rate forecasting.

So let us ask, What collective actions would the Food & Beverage, Consumer Goods and Retail industries want to take regarding the dollar? Other than a call for stability and predictability as relates to exchange rates, is there a collective “desired outcome”? Or does any outcome depend on an individual company’s relative exposure?

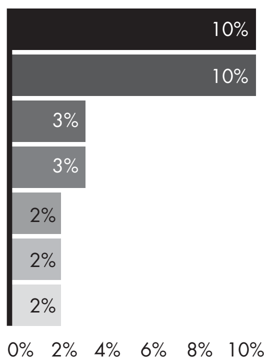
Figure 1: Top five issues

19 responses received as of 12th January 2005; Scores attributed to responses (i.e., high = 3, medium = 2, low = 1)

Source: World Economic Forum.

Figure 2: Discretionary spending forecast to grow fastest in China and India

CAGR for discretionary spending '02-'20F (PPP nominal terms)



Source: Bain study of the five largest consumer sectors in America, the UK, France, Germany, Italy, Australia and China; World Bank & OECD statistics and trends.

China and India: Making the most of sourcing and selling

The Governors ranked China and India as another top issue, reflecting indicators that the two regions are becoming lynchpins for both sourcing and selling for multinationals. In short, CEOs ignore these two markets at their peril. Clearly, China and India's talent pools are sources of inexpensive, skilled labour, but something else is happening there, too: The centre of gravity for discretionary spending is shifting—from the developed to developing nations (particularly China), and from young to old. (In Europe and Japan, those over 65 will control approximately 30% of discretionary spending by 2020.) (See figure 2.)

As capabilities in the East grow in areas like R&D and engineering, and rising disposable incomes approach levels that will trigger new spending on categories beyond the basics, the key question becomes, What will it take for companies to make the most of sourcing and selling in this region?

Specifically, on the demand side:

- **Where should industry or government-industry bodies band together to open markets** and to collect the detailed consumer information that companies will need to create the right offerings and find the right distribution models?
- **How fast should companies move?** China is likely to account for 20% of global retail market growth over the next 15 years; India, 5%. Related research indicates that that the best store locations in the largest cities in China will be saturated within three years.[1]
- **And where are the key opportunities for Chinese companies expanding west?** Chinese imports to the United States have been growing nearly 16% per annum, and imports to Europe, 12%. In both places Chinese imports are growing at more than twice the rate of imports from other low-cost countries and more than three times the rate of imports from high-cost countries. Does that mean that strategic partners could become strategic threats? Bain research shows that if China were to move into direct competition with its current outsourcing partners, even assuming "Western" marketing costs, it would enjoy up to a 20% cost advantage over its Western rivals.[2]

On the supply side:

- **What to outsource?** A December 2004 survey of 138 global executives in consumer products and other lines of manufacturing found that more than 80% of respondents believed that migrating costs to lower-cost countries like China and India was a high priority.[3] Yet too often companies are failing to think functions instead of just factories as they assess opportunities. In the manufacturing study, only 15% saw the benefits of offshoring value-added activities like R&D.
- **Where to outsource?** Forrester Research predicts that up to 3.4 million service jobs will move to India and other low-cost locations by 2015. Meantime, Wal-Mart purchased more than 70% of its merchandise in China in 2004 through relationships with more than 5,000 local suppliers. But companies still need to weigh cost advantages against exposure to risks and ask themselves what the "right shore" is before they offshore. "Right-shoring" means moving costs and capabilities to the right locales—sometimes nearest customers.
- **How to outsource?** What are the advantages of direct outsourcing versus using an in-country agent? And how much top-down organisational change do companies require to capture the full benefits of sourcing in India and China? The survey of manufacturers found many companies left outsourcing up to individual business units; less than two-thirds of respondents had made cost migration a significant companywide initiative.

[1] Bain & Company estimates based on World Bank data.
[2] Bain & Company, "The Consumer of 2020," *Global Agenda*, January 2005.
[3] Bain & Company, *Lessons from Leaders in Cost Migration* study, December 2004.

While companies work out the relative importance of China and India in their own strategic planning, some key issues may call for collective discussion and action. These could include promoting fair trade between both markets; setting standards for the environment and value chain accountability; and cooperation on labour rights, manufacturing audits, intellectual property rights and stemming counterfeiting. Equally, there may be opportunities for companies to work together with public-sector interests to tackle how best to support development of consumer classes or tough infrastructure issues, including distribution networks.

Consolidation: What does it mean for your business model?

The pattern of consolidation in Food & Beverage, Consumer Goods and Retail industries—a third key issue—is clear. Indeed, is it hard to name a multibillion-dollar company in one of these industries that *hasn't* grown through merging with major or niche competitors or both. But it's not hard to see why: Companies require new products and sites for growth, and it's usually cheaper to buy than to develop a new drink, snack food or chain of stores.

Still, one overarching reason that consolidation commands such concern is the emergence in most categories and subcategories of "category killers", which force companies to constantly ask, "Must we eat or be eaten?" That's especially true in retailing. Big-box value retailers in Western countries are reducing their markets to a handful of competitors. Surprisingly, that opens at least one opportunity for incumbents: Those that can aggressively reduce their costs *and* differentiate themselves on attributes like choice and quality can outrun competitors being gobbled up by the low-cost entrant and emerge a strong No. 2. Witness the Wal-Mart effect in the US, which has seen Target's stores strengthen their position in the wake of the bankruptcies of competitors like Ames, Bradlees and Caldor.[4]

- One question for any incumbent: **What will it take to survive and thrive in the face of low-cost mega-retailers** like Wal-Mart, Tesco and Aldi?

In China, the entry of Carrefour and Wal-Mart in the hypermarket format has reduced traditional forms of distribution. About half of all food and beverage sales today are made through recognized store formats, instead of kiosks.[5] Local retailers in China need to ask:

- **How much more consolidation of local firms will there be?**
- **What can local retailers do to compete with foreign retailers?** Or can they take steps to brush up their businesses for sale?

For brand owners in Food & Beverage and Consumer Products, the consolidation of retail channels and the rise of category killers hold another set of implications. Bain analysis shows that the top 10 food retailers across Europe, which held 37% of the market in 2000, hold 46% today and will likely grow their share to 60% by 2010.[6] This increases cost pressure to move production to cheaper and cheaper regions, with implications for value chain accountability. A critical question:

- **Should brand owners alone be held responsible for the squeeze?**

And where lies the need for collective action? Is there a role for industry public-private partnerships to play in challenging traditional views of competition, as the battle for market share switches from one between look-alike companies to one between manufacturers and their channels?

Marketing effectiveness and innovation: Growing with the consumer of 2020

As competition increases, CEOs have highlighted the importance of improved marketing effectiveness and innovation. On both fronts, the path to insight is shifting. Simply put, marketing effectiveness today requires following the customer, not the marketing

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[4]Rigby, Darrell K., and Dan Haas, "Outsmarting Wal-Mart," *Harvard Business Review*, December 2004.
[5]Bain & Company China retail practice estimate, January 2005.
[6]Bain & Company, "Revitalizing European Retailers" study, 2004.

presentation in the boardroom. Meanwhile, innovation calls for paying almost anthropological attention to the customer experience, not just to products or services, and making that experience even more compelling.

How should companies prepare? A Bain study of the five largest consumer sectors in America, the UK, France, Germany, Italy, Australia and China found that firms will need to come to grips with a number of emerging consumer trends, including:

- **The end of classic consumer segmentation and rise of crossover consumption.** The same limited-income shopper who seeks Wal-Mart-style value will also purchase clones of high-end products and experiences. Meanwhile, the same upscale consumer who seeks out the "retail theatre" of an Armani store to purchase a suit will travel to Wal-Mart over the weekend to stock up on bulk items. Understanding consumers "in the middle"—and how they make purchasing decisions depending on category, time of day and even mood—will continue to be key to developing products and services. On the other hand, given crossover consumption, understanding the market's extremes will help companies better reach the mid-market. To do that will likely require segmentation that can be deployed from the corner office to the front lines.
- **The rise of cross-category competition.** De Beers, for example, markets diamonds on behalf of the industry, recognising that it is competing not simply against other gems but against other discretionary spending by affluent consumers—on travel, cars, watches and, more recently, technologies such as home theatres. That seems fairly self-evident. But a recent study showed a decline in confection sales among teens. The cause, according to the findings of one European confectionary producer? Mobile phones. Teens were using their pocket money for text messaging, not candy bars. That's unexpected.
- **The rise of the consumer experience.** Companies don't just sell products, they sell experiences. To improve marketing effectiveness, companies will need to look beyond the usual suspects for product innovation—branded consumer products manufacturers—and increasingly seek marketing insight from industries like traditional retail, telecom and financial services, which have been talking directly to their end users for decades. They'll also need to look beyond traditional marketing levers and their metrics to get their messages across. For example, some global marketing directors are calling into question the practice of heavy media buying at a time when channel surfing and competing media are eroding the reach of TV ads.
- **The importance of new categories of innovation.** Consumer expectations are high, and much is at stake: As a chief executive officer in 1974, you would have expected new products or categories to account for roughly 15% of consumer spending by 1984. But today's CEO can expect new products or categories to constitute roughly 35% of consumer spending by 2020, based on Bain's projections of representative companies in several sectors.

Is there a place for collective discussion and action on such issues? Or do they primarily inform individual company decisions on R&D, sales force and marketing efforts—the very essence of corporate strategy and competitive positioning for the decade to come?

Perhaps we should engage collectively on some subissues, for example, guidelines for categories where overconsumption has become a concern, like tobacco, fatty foods, alcohol or even cell phone use among teenagers? Perhaps we should discuss and act collectively on setting standards for marketing to children or making the most of social responsibility programs?

Such questions, across all five of our Governors' key issues, form the starting point for our discussions.

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