

Chapter 2

Wrestling with the Restless Consumer: The Consumer Products Industry in Transition

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Abstract

DSD can provide valuable insight into constantly changing consumer behavior. Working in conjunction with a responsive supply network, DSD enables CP manufacturers detect demand signals and quickly meet consumer expectations. At a time of diminishing consumer loyalty, this can help CP manufacturers differentiate themselves in the market place and maintain competitive advantage.

2.1 DSD in the Context of Changing Consumer Demand

As with any mode of distribution, DSD is beneficial to the extent that it helps companies meet consumer demand in an effective manner. To evaluate the viability of DSD, CP manufacturers first need to understand the changing nature of consumer behavior. This chapter helps put DSD in that larger context – with particular focus on how companies can use DSD as part of a multichannel distribution strategy to meet the constantly shifting demands of the increasingly restless consumer.

2.1.1 *What Keeps the CEO Awake at Night?*

In the CP industry today, no other business issue dominates the minds of CEOs more than shareholder value. In a mature industry such as CP, this is hardly surprising. Shareholders invest in CP companies with the expectation of value – and if they don't get it from the current CEO, they'll start looking for another who can deliver. Fluctuating shareholder value, in fact, is one of the leading factors contributing to the high CEO turnover rate in the CP industry today.

To drive shareholder value, CEOs need to focus on two primary areas: profitability and growth.

In the CP industry, profitability and growth are achieved in large part by meeting consumer demand. The problem for CEOs – and this is what keeps them up at night – is that CP companies find it increasingly difficult to understand this demand. More than ever, CP companies are unable to understand who their customers are, what they want, and how they choose to get what they want. Consider the following:

- Since 2000, more than 30,000 new products have been introduced by CP companies each year (Product Scan press release 2004) – and approximately 65% of them failed (AMR 2007, p. 2). Innovating your way to profitable growth with new products – at least in the CP industry – appears to be a risky proposition. Why is it so difficult for CP companies to identify consumer wants and respond with the appropriate products?
- Less than 30% of all trade promotion programs are profitable. Yet the CP industry continues to spend an estimated \$75 billion on trade promotions each year. Equally troublesome is the fact that more than 70% of CP companies fail to capture and measure their trade promotion results (IBM and SAP 2005). Why does the CP industry continue to spend so much money on nonprofitable trade promotion activities? And why the lack of metrics?
- At any given time, about 8% of the products that should be available for sale on store shelves are out of stock when consumers go to purchase them (Gruen and Corsten 2007). The lost sales due to out-of-stock items cost CP manufacturers \$23 million for every \$1 billion in sales. Why is it so hard for CP companies to meet demand?

These statistics – sobering enough by themselves – should also be seen in the context of a shrinking market of opportunities for CP companies in developed markets such as the United States where consumer spend growth, measured in real dollars, has slowed from 5% to 2.3% since 2004 (Information Resources 2008). With fewer and fewer obvious growth opportunities available, competition in these markets has become a zero sum game. While the situation in emerging markets, to be sure, is substantially different, CP companies should be careful there as well – a point to which we will return. In the context of developed markets, however, it seems appropriate to remark that companies must gain market share at the expense of their competitors if they want to win. This is leading to industry-wide cannibalization as companies drive margins ever lower in the effort to stand out and appeal to consumers. To make matters worse, the market is more crowded than ever before, with challenges constantly posed by players entering developed markets from emerging economies as well as by generic brands and retailer's private labels. All of this makes differentiation the name of the game in the CP industry.

2.1.2 Differentiation and the Restless Consumer

As consumers have become increasingly savvy they've also become increasingly restless – both in terms of their tolerance for and trust of corporate messaging and in terms of their loyalty to any particular brand. The linkage is obvious: less trust means less loyalty. One consumer survey conducted by Forrester found that 73.1% of respondents agreed that there is too much advertising today while 50.6% agreed that the experience they had with most products failed to equal the promises made in advertisements. At the same time, only 12% of respondents agreed that the ads they see are relevant to their personal wants and needs (Forrester Research 2007).

Today's consumers, in other words, are on their guard. As traditional advertising and promotional techniques prove less and less effective, the days of consumers passively receiving push campaigns are waning. The sheer volume of such campaigns – itself a reflection of the level competition in the CP industry – are partly to blame. Today's consumers cannot absorb all the messages coming their way. As a kind of self-defense mechanism, consumers tune out to minimize their option anxiety. Instead, they've become much more proactive. Connected to the world and much better informed, they select the products of interest to them and take the time to understand what is actually being offered. The approach is one of "Here is what I want and here is how I'm going to get it."

For the CP company that resists change, the billions of new consumers entering the market from the BRIC countries (Brazil, Russia, India, China) add little comfort. It is expected that most of these consumers will leapfrog into modern consumer culture without passing through any of the stages that marked the progression of the consumer base in earlier developed countries. These consumers, in other words, will be just as restless as their counterparts in North America, Europe, and Japan. They'll be just as bombarded with messages, just as turned off by advertising, and just as empowered by the Internet to circumvent traditional channels, zero in on the information they want, and get what they need.

2.2 Revisiting the Fundamental Questions of Consumer Demand

In light of the challenges articulated thus far, the ability of CP companies to understand the needs and wants of the restless consumer is more important than ever before. This is forcing many CP companies back to the drawing board – back to marketing fundamentals where the basic questions can be revisited. Who am I trying to sell to? What do they want? How do they want to communicate – and how, where, and when do they want to buy? The company that can answer these questions and respond effectively is the company that can best differentiate itself in the marketplace and create ongoing value for its shareholders.

2.2.1 Who and What: The Need for Better Information

In today's CP markets, a lack of understanding of who the customer is and what the customer wants has led many companies to bring the wrong products to market. The obvious antidote to this situation is more insight into demand. This is why successful CP companies have become information experts – implementing processes for gathering information and adopting the tools necessary for analyzing this information to reveal valuable consumer insights. These insights are used to drive innovation and inform the new product development and introduction (NPDI) process, so that the right products are made available to the right customers.

2.2.2 How: The Need for Better Ways to Interact with the Consumer

As already mentioned, today's consumers distrust traditional modes of marketing communications, feeling they're being "advertised to." At the same time, many consumers show a willingness to take advantage of the new opportunities available to them to be more proactive regarding how they interact with vendors. The most obvious example in this regard is the rise of online communities. Many CP companies have nurtured such communities because they lead to deeper consumer relationships, more profitable customers, and exceptionally effective ways of collecting data on consumer wants and behavior.

New modes of interacting with customers, however, are unlikely to entirely replace traditional retail-based interaction channels any time soon. This means that CP companies also have to think smart about how to make these traditional modes work more effectively. The relatively dismal state of trade promotion management, mentioned earlier, presents itself as a candidate for improvement. How can companies better measure the effectiveness of their trade promotions and determine the extent to which their customers are either motivated by specific promotions or put off?

2.2.3 Where and When: The Need for Better Demand Signaling and Improved Responsiveness

Just as market communications have grown more complex in the CP industry, so have supply chains. Today we have CP manufacturers moving into the retail business and retailers moving into manufacturing. Wholesale distributors, meanwhile, are trying to move in both directions. The smooth, linear supply chain with its clear delineation of responsibilities is disappearing. This makes it more difficult to

get the right products to the right consumers where and when they want it. This is why CP companies are looking for more flexible supply networks and better ways of monitoring demand.

2.3 The Example of Procter & Gamble

As one of the leading companies in the CP industry, Procter & Gamble (P&G) has sought to improve performance across all aspects of consumer demand discussed so far. For P&G, the crux of the issue is what the company calls the *two moments of truth* (McKinsey 2005):

1. **The shelf availability moment:** When consumers buy a product because it's on the shelf at the time they want it
2. **The product quality moment:** When consumers look for and buy the product again because they liked it the first time.

By collecting, analyzing, and acting on consumer insights gathered from multiple channels, including traditional trade promotion activities, P&G has had significant success on both counts. Receiving demand signals directly from the shelf at retail locations in near real-time fashion, P&G has increased its understanding of demand dynamics and improved its ability to react almost instantaneously. This has helped the company reduce its out-of-stock ratio to approximately 5% – significantly below the industry average (Steinert-Threlkel 2004).

2.4 Responsive Supply Networks

One can summarize P&G's success with a single phrase: supply network responsiveness. One of the most frequently cited shopper frustrations is out-of-stock situations. After all, nobody likes it when they show up at a store only to learn that the product they want is unavailable. This makes higher on-the-shelf availability one of the primary areas of improvement for the CP industry. As Fig. 2.1 depicts, this is true not only for manufacturers but for retailers as well – who stand to lose just as much, if not more, when items run out of stock. By extension, we can assume that suppliers at the other end of the supply chain also stand to lose when poor product availability leads to a drop in consumption.

The point is that the answer to the challenges posed by the restless consumer requires a coordinated response from all of the key stakeholders in the consumer products ecosystem. Success, in other words, depends on the ability to collaborate. Today, no CP company can afford to act alone. Instead companies need to build responsive supply networks together with key partners to more effectively meet shifts in demand and keep pace with an increasingly fickle consumer base.

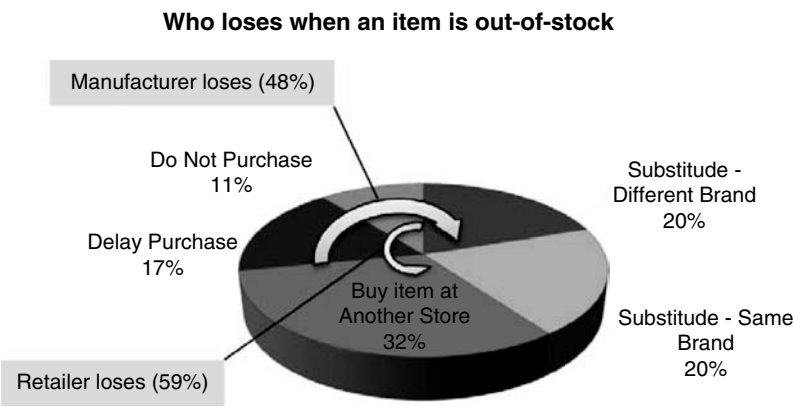


Fig. 2.1 Impact of out-of-stock in a store

But what exactly is a responsive supply network? Simply put, a responsive supply network is a supply chain that’s oriented to the fluctuating demand and high product complexity that characterizes today’s CP markets. A 2005 study by The Economist Intelligence Unit shows that 80% of surveyed executives expect demand, not supply, to drive the production of goods and services in the future (*The Economist* 2005). In such an environment, instead of a linear supply chain that depends on often inaccurate long-term forecasting to meet demand, CP companies need a responsive supply network that can sense and respond faster and smarter to demand and supply dynamics across a globally distributed environment. By gathering and sharing insights into consumer demand and acting on demand fluctuations on a near real-time basis, all participants in the responsive supply network stand to increase revenues and ensure growth under increasingly challenging

Table 2.1 Improvements based on better demand sensing (AMR Research, 2008)

Benefit category	Percentage that think improvement is possible	What improvement is possible?		
		High percentage	Median percentage	Low percentage
Shrinkage	40–50%	75%	18%	0%
Out of stock	50–60%	100%	20%	3%
Returns management	40–50%	50%	20%	2%
Margins	70% or greater	6%	4%	2%
Sales	50–60%	100%	7%	0%
Labor costs	50–60%	70%	5%	0%
Restock	50–60%	75%	25%	0%

market conditions. The business case is persuasive. According to AMR Research, the most advanced demand-sensing companies have 15% less inventory, 17% better order performance, and a 35% shorter cash-to-cash cycle time (AMR 2008).

2.5 The Importance of Being Direct

How does all this relate to direct store delivery? How does a mode of distribution – a process traditionally associated with the world of logistics – help companies more effectively address the shifting demand of the restless consumer? The answer, of course, has a lot to do with the fact that today DSD can be much more than drivers in trucks dropping off goods at the back door of a given retail outlet. The value of DSD as a mode of distribution is that it's exceptionally close to consumption – and to better meet consumer demand, that's exactly where CP companies need to be.

Supported by best practices and augmented with proper monitoring tools and data gathering technology, DSD moves from a narrow focus on logistics to a larger process that can help companies address a wide range of issues in the context of the fundamental questions of consumer demand discussed earlier. While many of these issues are discussed at greater length in the opening chapter of this book and elsewhere, they are worth reviewing here, if only briefly.

To the issue of gathering information to get at the who and what of consumer demand, CP companies can use DSD to generate critical insights on consumer behavior. Because DSD brings organizations so close to consumption, it's easier to gather accurate information over time and observe long-term trends. It's also easier to monitor shifts in demand and react in something approximating real time. With order-to-delivery lead times that are sometimes less than 24 h, DSD can play a critical role in supporting the responsiveness CP companies need to compete more effectively (Otto and Shariatmadari 2008).

CP companies can also use data and insight gleaned from the DSD process to improve customer interaction and deliver what consumers want. Part of what makes this possible is the close collaboration and communication with the retail outlet where the goods are sold. CP companies can work with retail outlets to fine-tune issues such as product presentation, pricing, and trade promotion details – and then monitor results to understand what works and what consumer desire.

Finally, DSD can be a highly effective process for detecting demand signals. When manufacturers own distribution up to the point of sale and consumption, it's easier to see what's moving and match demand quickly. With DSD, CP companies can speed replenishment cycles, reduce inventory levels and minimize out of stock situations. Ultimately, as Fig. 2.2 summarizes, DSD can play a critical role in helping CP companies not only understand consumer demand but to consistently act on it as well.

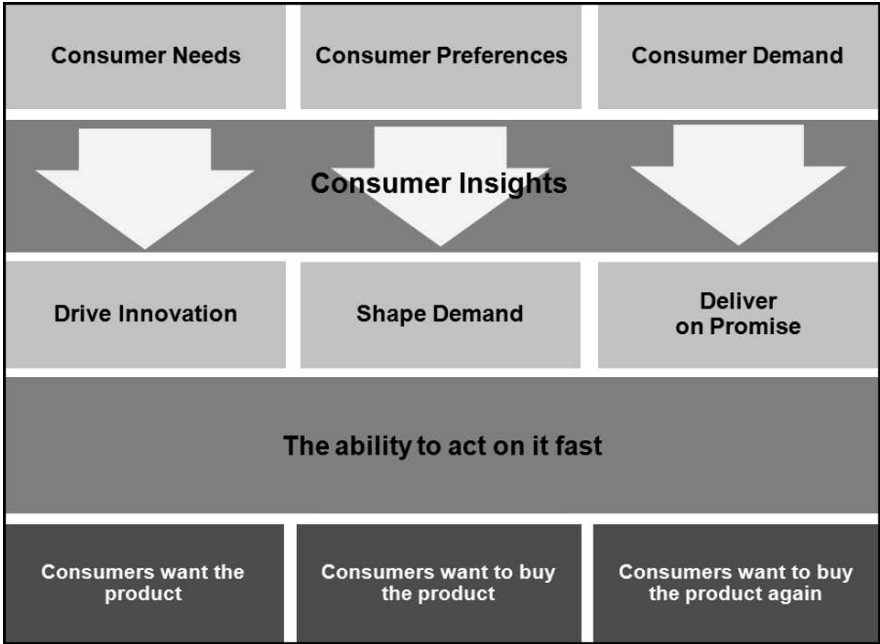


Fig. 2.2 Consumer insights and the ability to act fast (SAP AG 2008)

To broaden the scope slightly, CP companies would be well served to also consider DSD in the context of other, emerging forms of direct distribution. Take, for example, some interesting developments in the area of store-independent vending machines. These vending machines are becoming smarter and increasingly able to deliver the critical point-of-sale data required to help organizations respond most effectively to consumer demand. At the same time, the smart vending machine space is giving way to modern virtual store technologies such as multimedia kiosks and smart phones – already a reality in Japan – that have the potential to make data, people, and objects accessible everywhere and immediately.

Direct distribution is also critical for any online business dependent on direct home delivery. The Global Commerce Initiative predicts that home shopping will account for somewhere between 15% and 25% of all shopping by the year 2016 (GCI 2006). If manufacturers want a piece of this business, they’ll need to adjust. Here, the challenges will focus on issues of order picking and fulfillment (in store, at the back of the store, separate local distribution centers). How well companies adapt will depend on the success each has in implementing distributed production with integrated logistics. Based on the opportunities available, it is expected that neighborhood distribution covering the “last mile” to the home will improve significantly. In some areas convergence will take place between home shopping and neighborhood distribution, with convenience stores acting as central pick-up locations. At the same time, rising energy costs may also spark the emergence of bundled demand and bundled transport/delivery in the form of a “single

mailman” who delivers complete household needs – groceries, restaurant meals, pharmaceuticals – in one drop-off.

The point here is not to enumerate all of the areas in which direct distribution will come into play in the world of consumer products. Nobody can predict the future. At the same, however, it does appear that modes of direct distribution are becoming increasingly important as consumer behavior shifts. Companies that cut their teeth and gain experience in one mode of direct distribution – such as DSD, where the process is mature and the benefits clear – may find themselves in a better position to expand to other modes as business opportunities emerge.

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Direct Store Delivery

Concepts, Applications and Instruments

Otto, A.; Schoppengerd, F.J.; Shariatmadari, R. (Eds.)

2009, IX, 220 p. 70 illus., Hardcover

ISBN: 978-3-540-77212-5