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The Consumer Goods Industry in the Digital Age

IDC MANUFACTURING INSIGHTS

Consumer goods companies are experiencing unprecedented change — change in terms of not only how they connect with suppliers, customers, and consumers but also the technologies they use to affect these interactions. The implications of this change are both broad and deep and will alter the way that these companies do business. Although the industry's outlook is strong — with business priorities focused on efficiency, productivity, and growth — digitally savvy consumers think differently about the brands they buy. These consumers are looking more to links with lifestyle and fitness than traditionally delivered products. Indeed, the consumer rules the world — he or she is ubiquitously connected, craves individuality/personalization, and is intolerant of complexity and latency. This consumer is a consumer goods company's worst nightmare and also its greatest opportunity. It seems obvious that companies that figure out how to best engage with these consumers will be the ones that get more than their fair share of growth.

CURRENT SITUATION/INDUSTRY OVERVIEW

Consumer goods is a subset of the manufacturing industry characterized by a physical flow of goods that serve consumer markets. Consumer goods companies are dictated by the unpredictable, cyclical nature of consumer demand and include subsegments such as food and beverage, footwear and apparel, health and beauty, and household care. These businesses generally have fairly stable but inflexible supply and manufacturing operations with demand variability.

The traditional consumer goods manufacturer owns marketing, sales, distribution, and the supply side of the value chain, interacting with suppliers of ingredients, components, or packaging materials; converting those inputs into finished goods in either owned or co-packed manufacturing facilities; and then moving these goods into a network of regional distribution centers for shipment to customers. This process is simple in essence, yet it is complicated because the definition of customer — and the relationship with the end consumer — has been changing, a change that has been accelerating over the past couple of years.

Consumer goods manufacturers historically have sold primarily into brick-and-mortar retail channels like grocery, mass retail, drug, and warehouse clubs. While those channels continue to be a significant percentage of the marketplace, online sales have been growing — particularly in the nonperishable consumer goods segments — and the transformation to an omni-channel market is under way.

An even more interesting development is the battle for the consumer shaping up between the "traditional" manufacturer and the "traditional" retailer — a battle that is very much blurring the lines between manufacturing and retail. Although private label has been around, in one form or another, for decades, it has been only in the past few years that retailers have made it a top priority in response to consumer demand for value. Private label is a significant threat to the manufacturer that has responded not only by attempting to improve innovation delivery to the marketplace but also by pursuing "direct to consumer" channels — either an owned website or a third-party ecommerce site like Amazon.com. Consequently, in this industry, retailers are acting like manufacturers and manufacturers are acting like retailers.

The industry's outlook is strong, with business priorities focused on efficiency, productivity, and growth. For the industry as a whole, growth is largely keeping pace with GDP, meaning that for most mature regions, there is greater upside in driving productivity versus most emerging regions where incremental growth is the priority. That does not mean that growth is abandoned in mature regions and productivity improvements are ignored in emerging regions; it is just that the priority is different. Indeed, there is growth to be had in all economies, but it requires understanding of rapidly changing consumer tastes, a willingness to accept modest market share, and the ability to move faster than traditional large consumer goods companies are used to moving or even can move.

Industry Challenges

Consumer goods companies are experiencing unprecedented change. Sole reliance on historical brand power is not enough these days as many brands are beginning to lose their "must-have" status. Consumers are less brand loyal than ever and are increasingly geared toward products aligning with sustainability, health, and wellness. Further, consumers are increasingly looking for "experiences" rather than just products. This does not mean that brand is unimportant. It's just that new consumers think differently about the brands they buy, thus looking more to links with lifestyle and fitness, for example. What this means for the industry is that companies that want to succeed in the long term need to be more agile than ever and model operations and supply chain after companies like Zara and H&M that are able to quickly respond to changing consumer tastes and get products to consumers quickly. It's also worth noting that the idea of "shelf space" is changing from an environment where large manufacturers (often category captains) were able to disproportionately influence assortment to an environment where infinite virtual space negates this advantage.

With economic uncertainty in key players like the United States and China, as well as subpar performance of emerging markets like Brazil and Russia, consumers are becoming more hesitant to spend and are looking for greater value when they do spend. The hesitation to spend can also be attributed to increased technological capabilities of customers worldwide. Consumers now possess the ability to conduct research and compare prices before making purchases, as well as to influence other buyers — either positively or negatively.

Consumer goods manufacturers must address the challenges mentioned in the sections that follow to achieve success in the next decade.

Continuing Pressures on New Product Development and Introduction

Omni-channel commerce, the implications of either selling or marketing directly to the consumer, and the importance of personalization and new product development remain critical to consumer goods companies. Leading manufacturers are complementing traditional sources of internal innovation with external sources for new ideas including "crowdsourcing" via social media. They are also continuing efforts to streamline the innovation and new product development and introduction (NPDI) process, including both the acceleration of promising new ideas and products and the early termination of those products that show little promise.

However, increasing both innovation and new products is continuing SKU proliferation, greater customization (either sourced from the factory or managed through modern postponement techniques at the warehouse), and the requirements for more diversified sales channels. Manufacturers must also keep in mind that much of the innovation in consumer goods is to "beat the fade," where declining SKUs need to be refreshed and replaced. As we enter the "age of the customer," this role becomes even more important. It's also important to be cognizant of proliferating SKU portfolios and to ensure that as new products are added through the innovation process, poorly performing products are removed.

The Omni-Channel Consumer and Increasingly Demanding Customers

Pressures on consumer goods manufacturers persist. With the growth of demanding omni-channel consumers, manufacturers must increase agility across channel formats to support the resulting product quality and service performance demands from their customers. The ideal omni-channel strategy effectively blends the retail channel with the direct-to-consumer channel, thus resulting in a more balanced portfolio and a more relevant product offering for consumers. This strategy is accomplished through a unique model of branding, merchandising, category management, and promotions. Leveraging this digital model, consumer goods manufacturers will focus on how to manage trade promotions in an omni-channel environment, how to improve fulfillment and distribution performance, and how to manage customer differentiation and personalization through things like custom pallets and BOGO promotions.

Global Supply Chains with Varying Degrees of Visibility

The supply side of the overall supply chain continues to elongate as manufacturers look to low-cost manufacturing for certain categories of products and profitable proximity sourcing to get closer to expanding markets in new regions. While consumer goods tend to use local or regional manufacturing more than any of the other manufacturing segments, it still experiences long lead times and a lack of both upstream and downstream visibility. Visibility is a particular challenge when manufacturing is a combination of both owned and outsourced facilities. Improving connectivity to suppliers, increasingly through B2B networks, is critical, as is the ability to see into not only tier 1 supply but also tier 2 and 3 supplies.

Distributed Fulfillment

The demand side of the overall supply chain also continues to experience change with compressing order and delivery cycle times. Consumer goods manufacturers are increasingly expected to deliver in one day, or even same day, thereby necessitating profound changes in distributor networks globally. The need to engage with consumers in more personalized ways means that the traditional fulfillment network may not suffice, certainly not exclusively, and companies will need to look to third-party distributors or logistics companies to help them manage complexity. Further, in a more globalized world where consumer goods companies are selling not just in their region or country but also across continents, companies that have deep visibility into their distributor networks will be most effective.

Ongoing Challenges Connecting Supply and Demand

As we have noted for some years now, elongating supply networks are "complemented" by increasingly volatile and fast demand expectations, thus creating a cycle time discrepancy across the two sides of the supply chain. Using downstream data to improve forecasts (being demand aware) helps, as does the employment of more agile inventory (think "postponement"), but the reality is that agility in the form of operational resilience is critical. Many companies find themselves inadequately prepared and with insufficient capability to respond to disruptions.

Sustainability, Being Green, and the Assurance of Supply

Sustainability continues to be an important driver for consumer goods companies, particularly as it relates to operational efficiency (e.g., consumption of energy and water) and environmental stewardship. But increasingly, companies are concerned about the "assurance of supply," and that constrained input will impact the business. Whether we call this sustainability or something else, the ability to manage the available supply is critical for continued operation and service delivery. We hear, again, companies talking about "conflict supply," buying of "capacity" rather than "volume," and the trade-offs of increasing vertical integration.

Despite this shift, it remains important for consumer goods companies to communicate that they are behaving in a "green" and sustainable way. Sustainability remains an important marketing/branding exercise as well, and companies need to not just be green but also have a strategy for communicating their "green"-ness to consumers — in particular, millennials — who are demanding sustainable products and business practices

Globalization

Globalization is both a challenge and an opportunity for consumer goods companies, particularly in emerging markets where consumers are much more difficult to reach and disposable income requires a different approach. SKU management becomes a challenge, as does interacting with established wholesalers and traditional trade retail outlets like bicycle vendors and mom-and-pop stores. Developed markets require cost control, SKU and inventory management, and operational efficiency. Emerging markets on the other hand require responsiveness, SKU and inventory flexibility, and more precise product price points.

Globalization also presents a challenge to consumer goods manufacturers from the perspective of extended lead times, complex global supply networks, and distributed fulfillment networks. Manufacturers are just now recognizing that optimizing labor costs from low-cost manufacturing countries may be more than offset by growing logistics and lead-time costs. Indeed, for a notable consumer goods company, logistics now exceeds labor in cost of goods sold, leading it to more of a regional supply model than a global supply model.

IDC Analyze the Future

THE FUTURE FOR THE CONSUMER GOODS INDUSTRY

As previously noted, consumer goods companies are experiencing unprecedented change — change in terms of not only how they connect with suppliers, customers, and consumers but also the technologies they use to affect these interactions. The implications of this change are both broad and deep and will alter the way that these companies do business. How that will happen is open to debate, but we foresee two key trends influencing the future of the consumer goods industry.

Two Key Future Trends

Over the Next Decade, 90% of Industry Growth Will Be Captured by Companies That Successfully Engage Directly with Consumers

The consumer rules the world — he or she is ubiquitously connected, craves individuality/personalization, and is intolerant of complexity and latency. This consumer in effect is a consumer goods company's worst nightmare and greatest opportunity. Companies that figure out how to best engage with these consumers will be the companies that get more than their fair share of growth. And, by the way, as older consumers give way en masse to millennials, the "problem" just gets worse.

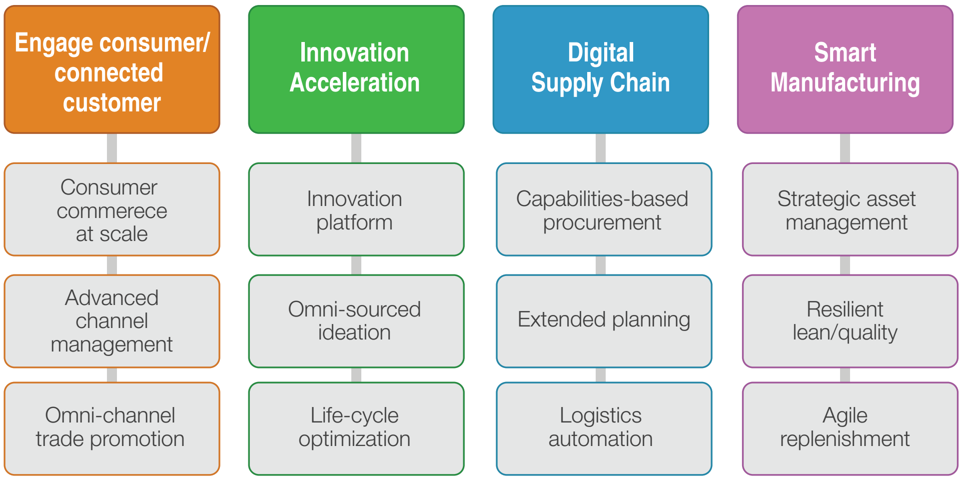
The implications of this change are profound, in terms of rethinking not only fundamental business models but also the underpinning technology. Engaging effectively with consumers means doing so how, when, and where they prefer, which, by extension, means adopting a pervasive mobile strategy for both commerce and communication. Further, data accuracy and analytics capabilities become much more challenging as thousands of retail customers become millions of consumers. This is particularly problematic for companies that don't have the right infrastructure in place to collect and manage all of their consumer and customer data. It's not only an aggregation problem to get the data in one place to get a complete view of both constituents but also a consumption problem to make that view easily available to people in the business who need to analyze it to make decisions.

By 2019, a Third of Consumer Goods Companies Will Have Benefited from Digital Transformation, with the Remainder Held Back by Inflexible/Outdated Business Models, Processes, or Functional Structures

IDC research has shown that one of the biggest current gaps between digital thrivers and survivors is in the area of leadership. Only 29.6% of manufacturers have achieved a level of maturity in digital transformation leadership to reach the top 2 levels of "digital transformer" and "digital disruptor." Leadership holds the responsibility for creating a vision of where their companies are headed in the next decade, and most are not ready to change directions through adopting new business models or functional structures.

Not every company with a vision will be able to fully leverage its digital transformation investments in the supply chain because there are many dimensions to digital transformation. But in the market, we can already see which supply chain leaders are laying out a road map for their companies to evolve in the next decade. Look at Bayer's move to join forces with Monsanto to increase innovation in agriculture or Under Armour's investments in technology-enabled products and health information. These moves required executive leadership to recognize how both their business models and enabling processes must change — and change not just incrementally but also fundamentally.

FIGURE 1 Digital Transformation in Consumer Goods Companies



Source: IDC, 2017

Digital transformation is a "journey," however, and not all companies will advance in all areas of digital transformation at once. In fact, we would counsel companies that priorities should be identified and managed at a speed that works for each unique business. Regardless, the digitalization of the consumer goods enterprise must happen, and it must happen across the key functions of sales, marketing and supply chain.

The underpinning technologies to enable the digital transformation will involve deep mobile capabilities, including ubiquitous access to mobile-friendly business applications; the comprehensive use of data and "fast" analytics to extract insight and value; and the adoption of cloud-based networks to enable both intra- and interparty collaboration and communication.

The enormity of the digital transformation opportunities and challenges absolutely requires that business and technology leaders immediately assess and adapt their IT investment priorities and map how they relate to the capabilities required for digital transformation — and it must be a collaboration between IT and the line of business.

Just as manufacturing has been outsourced by consumer goods companies, digital transformation efforts should similarly leverage external players, whether vendors, enablers, platforms, or process experts.

ESSENTIAL GUIDANCE/ACTIONS TO CONSIDER

In this document we have argued that while the consumer goods industry is generally healthy, it is undergoing significant changes, mainly driven by an evolving, digitally savvy consumer. It will be incumbent upon companies in this industry to redefine how they generate revenue and monetize products and services. While this shift will not happen tomorrow, the "seeds of discontent" are being sown now, and it is important for businesses to begin thinking about how they will compete in the future.

Based on our conversations, we would suggest the following for consumer goods companies:

- Begin to understand the implications and opportunities of modern digital technologies, whether in consumer outreach, customer engagement, or supply chain operations.
- Be open to innovation — harnessing customer (or consumer) innovation ideas to drive product development productivity and success.
- Focus on contextualized and customized customer experiences delivered through the right/consumer-preferred channel.
- Identify priorities and manage at a speed that works for each unique business.

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