

# **SUCCEEDING IN A VOLATILE MARKET 2018 - THE FUTURE VALUE CHAIN**

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## **INTRODUCTION**

Let us begin by going back two years and looking at a little bit of history. The report '2016: The Future Value Chain', published by Global Commerce Initiative (GCI) at the end of 2006, set out a vision of how the consumer goods industry would look in 2016. This vision was built on the anticipated development of a series of global trends that were expected to influence the consumer goods industry. The report also highlighted key areas where companies must collaborate in order to manage the value chain in 2016, and aimed at encouraging debate and dialogue on these vital issues.

The report was a major success. It generated extensive media coverage. It was translated into 10 languages. It was discussed at leading international conferences, and it triggered wide-ranging debates across the industry.

In 2008, the GCI Board decided the time was right, two years later, to revisit this subject, and they asked Gerd Wolfram from the Metro Group and myself to lead this programme. From the start it was clear to both of us that this offered us a great opportunity to not only revisit the valuable work done on the 2016 report but also to take it a lot further. It was a chance for us to consider how the previously identified global trends would affect our industry at a more operational level and to balance the original report's European and North America-centric view with a view from a region. And we knew that that region had to be Asia.

Why Asia? Well, Asia is a vast and diverse land that covers nearly 45 million square kilometres, twice the size of North America and five times that of Europe. When Marco Polo returned to Europe from his epic Asian journey in 1295, the trade routes between Asia and Europe opened up and Asia became central to Western commerce. Seven hundred years later and Asia is, again, central to not only Western commerce but to global commerce. In the consumer goods industry Asia is both a rapidly developing as a massive consumer market and also a major source of ingredients and manufacturing.

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And then we decided to focus even further down in Asia, to focus on two Asian markets; Japan and India. To us, these represent the two extremes of Asia. Having long been a global economic powerhouse, Japanese thinking is responsible for many of the leading business practices adopted by the West in the last 30 years. However, the country now faces similar challenges to those confronting Europe and North America, including competition from emerging power economies.

And India is one of those new competitors - but it, too, has its problems, ranging from a lack of modern infrastructure to widespread poverty.

### **THE FOCUS OF THE 2018 REPORT**

Now we had decided where to focus; we had to start the work! It has always been the GCI way of working to bring companies together and drive projects and programmes through collaborative engagement. This makes GCI reports very different from many others. For this report, 130 people, representing local and international retailers and manufacturers, third-party partners, academia and industry associations, took part in four workshops: in Utrecht, to look at the global perspective; in Hong Kong, to address the overall Southeast Asian market; in Mumbai to focus on India; and in Tokyo, to explore Japan. I attended all four and I was overwhelmed by the enthusiasm of the participants.

In the workshops we asked the participants to answer the following questions:

- \* Which trends, including those identified in the first report, will have the greatest impact on retailers and manufacturers in the coming decade?
- \* How will these trends differ in their impact between global, regional and country?
- \* What actions must the industry take to secure its future and best meet consumer needs in 2018?

In Hong Kong, a regional retailer told me that in his 10 years in the industry he had never sat down with his competitors and suppliers and talked frankly about how, by working together, our industry can better serve our joint consumers. I heard similar stories from many other participants, who were as excited as we were by the ideas generated and the commitments made on regional and national industry initiatives.

But now let us discuss what we found through these workshops. First was that the mood of the market is less optimistic than it was when this report's predecessor, 2016, was published. But today's negative outlook does not have to prevent our industry from thriving. By working together with strong collaborative efforts, the industry can counter

these downward trends and, together, we can choose our future.

1. Things Move Fast!

In many respects, the world has become more volatile since 2016. Three trends in particular have accelerated faster than forecast: the economy, raw material prices, and the importance of environmental sustainability. Some trends have grown as predicted: urbanisation; the move from products to services; and the shift from traditional to modern trade, are all examples.

2. Markets are more similar than different

It was clear from the workshops in Hong Kong, Mumbai and Tokyo that many of the trends that will impact the Asian industry on the way to 2018 will be similar to those affecting the global industry. This creates significant opportunities for sharing, as East and West can both learn from each other.

3. Even though the challenges are similar across the world, the markets are in different phases of adopting solutions. Many of the approaches that are already being explored in Western countries are also being adopted in Asian markets with Asia having the potential to leapfrog Western developments.

So now, let us look in a little more detail at the findings of the workshops. Across all four workshops eight trends were identified. Each workshop did not set out to address all eight trends. Instead they focused on those trends that were particularly important to the markets that they were covering and those that they felt that they had the opportunity to address with collaborative programmes.

### **DECLINING ECONOMY**

The global workshop predicted economic decline in the West, which was given added impetus by the events that are now rocking the financial markets. Although, in reality, consumer confidence has been declining for several years.

At the same time, the predicted economic shift to the East has been further emphasised by the high number of Asian and Middle Eastern investments in Western companies. According to the Chinese Ministry of Commerce, by the end of 2007, more than 7,000 Chinese investors had put \$118 billion into over 10,000 enterprises in 173 countries.

The workshop participants saw increased market volatility over the coming 10 years with a levelling off of growth in emerging markets. Inflation and the increasing cost of goods and logistics will place pressure on companies' growth and profits, while slow

growth and rising costs will likely lead to a low return on capital employed - meaning that assets must work harder.

The declining economic environment will raise a number of opportunities and challenges for growth in a volatile, cash-constrained market. The need for collaboration will increase as companies turn to joint ventures to enter markets and mitigate risk.

More flexibility in manufacturing will be necessary. Manufacturers will try to realise economies of scale by consolidating orders and will look for alternatives, substitutes and cheaper ingredients. Outsourcing will increase.

## **CHANGING SOCIETY**

By 2018 consumer polarisation is expected to become more apparent creating complexity for manufacturers and retailers. Understanding consumer segmentation will be key to business success.

In the Asian workshops a number of specific consumer changes were highlighted. Asia is undergoing rapid urbanisation. Projections indicate that more than 500 million Asians will move to cities in the next 25 years - almost 2 million people per month. People will live in smaller homes with less storage space and smaller appliances. High property prices will lead to more multi-family or multi-generational housing.

But the remaining rural communities will still be important in 2018. In India, for example, which has also seen growing urbanisation, the rural communities and second-tier cities still make up 70% of the overall market and are a distinctly older and poorer population.

Improved health care is resulting in the elderly living longer. This is a good thing for many reasons. The increase in the elderly population is particularly significant in Japan, where more than 20% of the population is over 65. In Japan, unlike many other markets including much of the West, Japanese retirees have economic security and considerable buying power. They also command a great deal of respect from society - the Japan 2018 workshop took place the day after Respect for the Elderly Day, a national public holiday that celebrates the lifelong contributions of senior citizens.

This growing demographic group presents unique physical and emotional needs and requires different product design, formulations, packaging, merchandising, marketing and retail distribution. By 2018 this group will have triggered a surge in products that focus on the elderly, from preserving health and wellness to spicier foods to stimulate

aged palettes.

In most Asian countries, average household incomes are increasing significantly. This prosperity has revolutionised consumer aspirations. At the same time as average income is rising, there is still a vast segment of Asian households that live on very low incomes. The challenge of serving the needs of the low-income consumer played a prominent role in the both the Asian and Indian workshop.

According to the World Bank's report 'The Next 4 Billion', the 'bottom of the pyramid' population, though made up of very low-income groups, are the largest consumers of food. The 4 billion people at the base of the economic pyramid have incomes below \$3,000, yet together they constitute a \$5 trillion global market.

It is expected that the Asian consumer goods industry will, running up to 2018, work with government and local communities to ensure that poorer consumers do not lose out. Rather than facing limited choice and low-grade products, the industry will work to ensure that quality products and solutions are

- Affordable
- Available
- Appropriate

...to those that need them most.

To deliver this, in addition to working with government and communities, our industry will need to work together to develop innovative products and services. This innovation will need to extend to the supply chain to provide a simplified, low-cost route to get products to these needy consumers.

The potential exists for our industry to improve the quality of life across the region for many low-income consumers. However, it was also recognised that the increasing price of raw materials over the coming 10 years will make it harder to deliver low-cost, good-quality options.

## **RISING COST AND SCARCITY OF RAW MATERIAL**

The cost of raw material, including fuel, will continue to be very volatile but with an underlying trend of increasing cost. These high prices will impact all aspects of our industry. Both direct - ingredients, packaging and transportation will cost more - and indirect - our consumer will have less money to spend. To respond to the rising costs of raw materials, the industry will need to make changes affecting ingredients, packaging, energy, labour and water.

With high **ingredient** prices, companies will need to first protect their contracts and seek vertical integration to help guarantee supply. At the same time, they will seek alternative ingredients or develop product innovations that are less dependent on that ingredient.

With oil and timber prices impacting the cost of **packaging**, companies will need to reduce the amount of packaging, or focus on reusable packaging (for instance, the use of refills in many parts of Asia, most noticeably in Japan).

**Energy** is a big part of the cost structure for products, impacting the full cycle from production to distribution, retailing and recycling. The opportunities for energy reduction (through more efficient assets or asset sharing) as well as alternative forms of energy will be plentiful. In the Asian workshops it was the rising cost of energy that was singled out for specific focus.

The participants predicted that **government, industry and consumers** would each pursue a raft of remedial measures to tackle the impact of these high prices. They predict that Asian **governments** will shift funding to reducing energy consumption by, for example, improving public transport and introducing consumption and congestion taxes and providing incentives for alternative and efficient energy solutions.

Our **industry** will, in the coming 10 years, focus on wide-ranging innovation - throughout the supply chain and product range - to become more energy efficient. The high cost of transportation will lead to major changes in our manufacturing and logistics networks such as a migration from centralised manufacturing facilities (which has been, of course, the industry trend for the preceding decade) to the local production or finishing of products.

High domestic energy prices will drive **consumers** to choose products that require less domestic energy consumption. The pressure of high energy costs will drive innovation across our industry. The challenge we face is to ensure that the innovation benefits the entire value chain and is not just shifting energy consumption from one point to another.

Across the workshops, participants identified several actions that could help alleviate this situation:

- Collaborative lobbying of government in areas such as agricultural and water policy and energy strategies.
- Providing consumer education focused on ingredient substitution and energy conservation.

- Working together on shared warehousing and logistics solutions, as well as alternative energy sources to reduce the dependency on fossil fuel.
- Research and development in controversial areas such as GMO, cloud seeding and nanotechnology.
- Working together with cooperatives to find better farming solutions.

However, it may not be possible to reverse the increasing supply chain costs in the near term. This may cause margin pressure and prevent the necessary investment in longer-term innovative development.

### **INCREASING AWARENESS AND ACTION ON SUSTAINABILITY**

Environmental sustainability has become a priority faster than expected. The consumer's appetite for sustainability is growing - both for more environmentally friendly choices and for more ethical options. By 2018 all consumers will recognise the importance of a sustainable lifestyle, regardless of their economic status. They will demand responsible behaviour from companies and will not pay a premium for sustainable products. Likewise, corporate action on sustainability will grow, with companies accepting responsibility for the entire product lifecycle, including waste.

The workshop participants identified a whole series of actions which are included, of course, in the full report. The defining principles for all of these activities will be trust, transparency, accountability, and the application of an holistic view.

A potential scenario considered by the workshop is the enforcement of strict environmental measures by governments, particularly in China, which witnessed what could be achieved in Beijing with the 2008 Olympic Games.

Japan saw itself as one of the Asian countries that would lead in environmental awareness in the run up to 2018, with the Japanese industry moving towards more eco-friendly business models. Japan has often demonstrated to the business world the benefits of innovative business practices and it may be that Japan can do the same for sustainability.

However, Japan sees many challenges in creating a more environmentally friendly industry, challenges that will be common across the region. First, although consumers prefer to buy green products, they will not pay more for those items. This will make it hard to reach the critical mass on environmental goods that would result in cost reduction.

Second, a better understanding of the environmental impact of our industry, and the ability to measure improvements, will be an important input in driving an industry-wide communication programme. This was considered particularly important on carbon emissions. And thirdly, manufacturers and retailers across our industry need to be open to sharing best (and worst) practice information to benefit our industry and our consumers.

## **GROWING CONSUMER ACCESS TO TECHNOLOGY**

Asian consumers are increasingly at ease with new technology. Many Asian markets are on par with Western economies in their adoption of broadband Internet and mobile communications. The penetration of these new consumer technologies is increasing even more rapidly in urban areas, with Internet penetration in large Chinese cities close to that in the West. China, in fact, has now more Internet users than the USA.

Without the legacy of 20<sup>th</sup>-century communication infrastructure, many of the Asian markets, particularly the developing markets, can leapfrog the developed nations and so we can easily see Asian consumers, in 2018, having access to retail and consumer product information anytime and anywhere using any communication device.

To get to this position, great changes in the way we think about and share information will be needed. And consumers will need to develop trust in the information that they receive.

Online retail channels already exist in much of Asia but in India and China this was seen as a particularly strong growth area. These countries have the opportunity to learn from the global experience of implementing online retail models, and the growth potential is enormous.

The diversification of communication channels between both manufacturers and retailers and consumers (and shoppers) opens up the opportunity to develop uniquely personalised brand and retail communications. In fact, to do so will be essential by 2018 as existing mass-market communication channels will continue to decline in importance for a large share of our consumer base.

The technology-adept Asian consumers of 2018 will expect consolidation of marketing messages from the brands and the retail channel that they buy the brands from. Otherwise they will simply look elsewhere. This means that manufacturers and retailers will have to work more closely together on how they co-market to consumers.



## **GROWING AVAILABILITY OF INFORMATION ACROSS THE SUPPLY CHAIN**

One of the most significant findings of the 2016 report was the importance of information, and the enhanced performance that better use of information could make, to the supply chain.

In India and Japan the opportunities for using information to improve the supply chain were considered to be high-priority activities. In India, as our industry rapidly grows, the existing supply chain is beset by decreasing efficiency, increased wastage and rising costs. The fact that there is also very little sharing of supply chain information can be seen as both a result of the problems and, more importantly, a cause of those problems. The good news is that the Indian industry is well placed to learn from its global colleagues about how data sharing can improve the supply chain, although a technology skills gap will hamper progress.

Getting basic product information standards in place provides a massive opportunity for India today, whilst for Japan, information standards in more advanced areas such as consumer data, RFID and advanced logistics are all longer-term opportunities.

Japan also considers that the development of a common IT platform to share consumer data would also be a significant opportunity and would help the industry address other trends such as serving the needs of the elderly consumer. This sharing (or pooling) of data is also an opportunity in India where trading partners need to consider new models for data sharing.

## **CHANGING BUSINESS MODELS**

The retail market in Asia is, of course, growing at a very strong pace. And the workshop participants predicted the share of 'modern' trade to grow to 50% of the market in 2018, up from about 20% in 2008. Of course the variance across the region is enormous. In India today organised retail accounts for less than 5% of the overall market, representing just 1% of the largest segment, food and grocery. But this idea of 'modern' and 'traditional' hides what is really seen as a growth in hybrid models that blur the boundaries and open up opportunities for new routes to market.

And it was clear to the workshop participants that modern, traditional and the hybrid models in between can all benefit from the supply chain improvements, greater information sharing, and the many other collaborative programmes.

Asian companies need to invest in data sharing, based on common standards and supporting initiatives, which are relevant to modern trade as well as traditional trade. And logistics companies will need to invest in aligning and supporting collaboration and standardisation, leveraging already established practices, standards and distribution centres.

### **INCREASING CONCERN ABOUT PRODUCT SAFETY**

Japan pioneered the business world on total quality management programmes. This was a natural extension of the Japanese quality culture. Japan's reputation for quality has taken a hit in 2008 in the food industry, however, due to a number of food scares where contaminated food entered the food chain. It is no surprise, therefore, that the Japanese workshop raised the concern about product safety as a trend to focus on.

Japanese consumers of 2018 will have put increasing pressure on manufacturers and retailers to disclose product history and product safety and wellness information. This is already starting today with Japanese shoppers being able to access product information on fresh produce, including images of the farmers who grow the produce, on their mobile devices by scanning an on-pack bar code using a standard mobile phone camera.

There is opportunity for our industry in Japan to work with government to develop 'food defence' measures, including the development of government and industry strategies for preventing and containing food contamination outbreaks.

### **ASIAN PROJECTS**

In addition to providing insights on how the industry will develop over the next ten years, the workshops also proposed a series of possible projects that could take place here in the region and prepare our industry for 2018. The regional workshop identified three projects and four on-going activities.

#### **Southeast Asia Project 1: Collaborative Transport Footprint Reduction**

To address the challenges of increased energy prices, further collaboration in the physical distribution system needs to be improved. The objective of this project is to establish a pilot to reduce the transport footprint in two ways: by collaborative freight tendering and by improving inner-city multi-drop distribution using alternative fuel vehicles.

## **Southeast Asia Project 2: Carbon Dioxide Emission Information**

The industry in Southeast Asia needs to establish common measures for sustainability, notably on the CO<sub>2</sub> footprint for environmental impact.

## **Southeast Asia Project 3: Transparent Sales Database**

For the industry to better serve the needs of low-income consumers (improving their wellness and quality of life by offering affordable, available and appropriate products) the value chain must become more transparent and simplified. Establishing a common, consolidated and standardised platform for information sharing across the whole chain will support this. The main focus needs to be on transparency of sales-related data (like EPOS data) involving manufacturers, distributors and retailers.

In addition, the workshop agreed on a strong pledge to continue to pursue four underlying initiatives:

- Strengthening industry associations
- Collective lobbying of government
- Adoption and implementation of industry best practices
- Support development and implementation of standards

In assessing the prominent trends, the **Indian** workshop group found that certain opportunities were common among different trends. The four key initiatives developed cut across those different trends.

The Collaborative Logistics initiative is committed to improving supply chain efficiency in India. It aims to drive agreement on industry standards, pursue agreement on identifying and developing common logistics hubs, and improve the overall efficiency of the entire value chain.

The Standards Implementation initiative endeavours to support data sharing in India. It aims to establish the foundation for data sharing by industry-wide compliance with Global Trade Identification Number Information (GTIN) and Global Data Synchronisation Network (GDS) standards.

The Category Management initiative will address emerging markets. Manufacturers and retailers will work together to drive category management and improved customer service, by ensuring that customers can get what they want, at a fair price, whenever and wherever they want it.

The Training/Education initiative will address the Indian skills gap. It seeks to transform Indian retail by developing an all-inclusive training programme and fostering the programme's success by encouraging the participation of major stakeholders, including government and industry associations.

The GCI-Japan board has approved the commencement of the FVC-workgroup (Future Value Chain) from Oct 2008. This workgroup will work towards problem solving, and the collaboration throughout the value chain of the future and will use the Global project as a template.

Two areas of output from the 2018 workshop, in particular, will be incorporated in the FVC scope:

- Sustainability
- Wellness and Safety

## CONCLUSION FOR ASIA

Asia is known as a land of contrast, and the three Asian workshops demonstrated the amazing diversity across the region. However, there are also clearly areas of common ground among the markets, with global trends having widespread impact, albeit, with different 'local' twists.

Certain global trends and developments impact strongly on Asia. For example, global technology developments - in both the consumer and business-to-business arenas - will be important in the Asian industry.

Sustainability is another common theme. There is significant industry drive to improve collaboration on sustainability topics, including addressing NGO activities and consumer awareness. Across Asia, industry will have more and greater opportunities to lobby government involvement, on areas like sustainability, raw material prices (including energy) and trading models.

In all Asian regions a number of follow-up initiatives have been identified. These all have a regional flavour - but in many cases they will also be able to leverage the learnings and practices from similar pre-existing initiatives elsewhere in the world.

But to make progress, the Asian industry - both the 'local' companies and the regional offices of the multi-nationals - needs to embrace the fundamental concept of Efficient Consumer Response (ECR); collaboration across our supply chain reduces the inefficiencies in our supply chain allowing us to better serve our consumers and to grow our industry.

The bottom line resulting from our 2018 workshops is clear: What got you here, won't get you there!

The next 10 years are expected to bring as much change as we saw in the last 50. The difference between success and failure in the consumer goods industry in the coming decade will be our ability to adapt to these changes.

A successful business in 2018 will:

- Prioritize the importance of consumer insight and the ability to act on it fast, especially regarding issues such as sustainability.
- Prepare for flexibility and agility to react to global forces on their business model.
- Intensify collaboration with trading partners.

The 2018 report includes 23 questions that we recommend companies ask themselves to see if they are ready for 2018. But to start off, ask yourself these questions now:

- Do I know who my shoppers and consumers will be in 10 years and what they will need and want?
- Can I and my trading partners collaborate to respond to changing consumer needs?
- Will I be at risk when global forces hit?
- Is my organization agile and capable of managing increased uncertainty?

Finally, I would like to thank Capgemini which, as well as co-sponsoring the project, facilitated the workshops (in conjunction with Zacatii for Tokyo). SAP and Hewlett-Packard also co-sponsored the project and provided invaluable input to the workshops. Thanks too to ECR Asia, GS1 Hong Kong, GS1 India and GCI Japan, which provided local support for the Asian workshops and were instrumental in driving their success.

On behalf of the companies who have participated in the 2018 project we also express our thanks to Sabine Ritter, General Manager of GCI, for her active leadership of this project.