Number 2, Winter 2013/14

Perspectives on
retail and
consumer goods

MIX
Paper from
responsible sources
FSC® C021826

Perspectives on
retail and consumer goods

Foreword

We are proud to bring you the second edition of *Perspectives on retail and consumer goods,* our twice-yearly journal in which McKinsey practitioners and experts address topics of the highest relevance for retailers and consumer-goods manufacturers. Drawing on our proprietary research, extensive on-the-ground experience, and collaboration with many of the world's leading companies, this edition explores issues that are top of mind for retail and consumer-packaged-goods leaders worldwide—issues such as profitability and growth, the increasing importance of digital technologies, and various elements of operational excellence.

The consumer industry today is dynamic and intensely competitive—rife with challenges but also bursting with opportunities. To that end, McKinsey has developed new, cutting-edge capabilities and solutions to help address our clients' most pressing challenges and most critical opportunities. We highlight five of these new capabilities in a special section of this journal.

We hope these articles will encourage you to continue the conversation and share your thoughts and reactions with us. Let us know what you think by e-mailing us at Consumer_Perspectives@McKinsey.com.

Sincerely,

Peter Child
Director, London

Sandrine Devillard
Director, Paris

In need of a retail turnaround? How to know and what to do

More than 50 retailers in Europe, the Middle East, and Africa have been in distress since the global financial crisis, and many are in distress today. Some are in denial about their situation; others are busy fixing the wrong problems.

Peter Breuer,
Thierry Elmalem, and
Chris Wigley

Over the past few years, sales growth at the top publicly listed European retailers has been a mere one or two percentage points above inflation; average EBIT[1] margins have dropped to around 0.5 to 1.5 percent of sales. The short- to medium-term forecast doesn't suggest any respite from these gloomy numbers. Changing consumer lifestyles and preferences, the Internet, and continued economic uncertainty are putting pressure on—and, in some cases, causing financial distress among—many traditional retailers.

There are broadly two types of distressed situations a retailer can face. One is a cash or liquidity crisis,

requiring immediate cash-management and debt-restructuring measures. The other, which is trickier to detect, consists of a set of issues that may not threaten immediate bankruptcy but pose fundamental challenges to the sustainability of the business model. In this article, we discuss how to recognize—and emerge victoriously from— the second type, an undertaking we refer to as a "distressed turnaround."

How do you spot a distressed retailer?

What's a good reality check for retailers? How can a retailer tell whether it's in a distressed situation? We recommend both an analytical and a strategic approach.

[1] Earnings before interest and taxes.
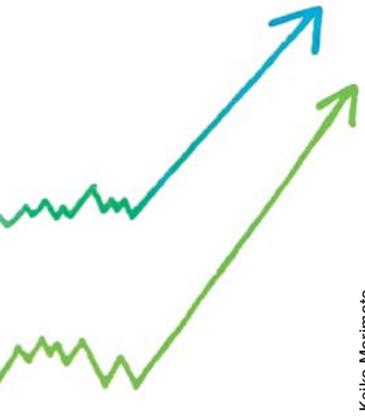
In analytical terms, we suggest these criteria: a publicly traded retailer is in distress if its total return to shareholders (TRS) has been negative for two consecutive years and is 50 percent or more below its industry peers' TRS.[2] By this definition, more than 50 retailers in Europe, the Middle East, and Africa have been in distress since the global financial crisis. These retailers range from department stores to restaurant chains to consumer-electronics players, and from smaller national companies to large multinationals.

Strategically, retail leaders should keep a close watch on their performance in the six dimensions of retail excellence: customer focus, merchandising, operations, infrastructure, people, and, most important, customer proposition (Exhibit 1). Material underperformance in any of these

dimensions can be deeply problematic, but if a retailer doesn't have a compelling customer proposition—a reason for customers to choose that retailer over competitors—it simply won't survive.

How do you turn the company around?

The experiences of distressed retailers that have successfully turned their business around, either during or since the global financial crisis, have shown that a five-stage approach to retail turnarounds can lead to sustained success (Exhibit 2).

Stage 1: Wake up

The first stage of the turnaround sounds easy and obvious: acknowledge that your company is in distress. But for executives accustomed to success, this stage can be difficult and humbling. Denial is

[2]TRS is the total return (capital gains plus dividends) that an investor receives from a stock over the period of ownership.

Exhibit 1   **Retailers should monitor their performance in the six dimensions of retail excellence.**
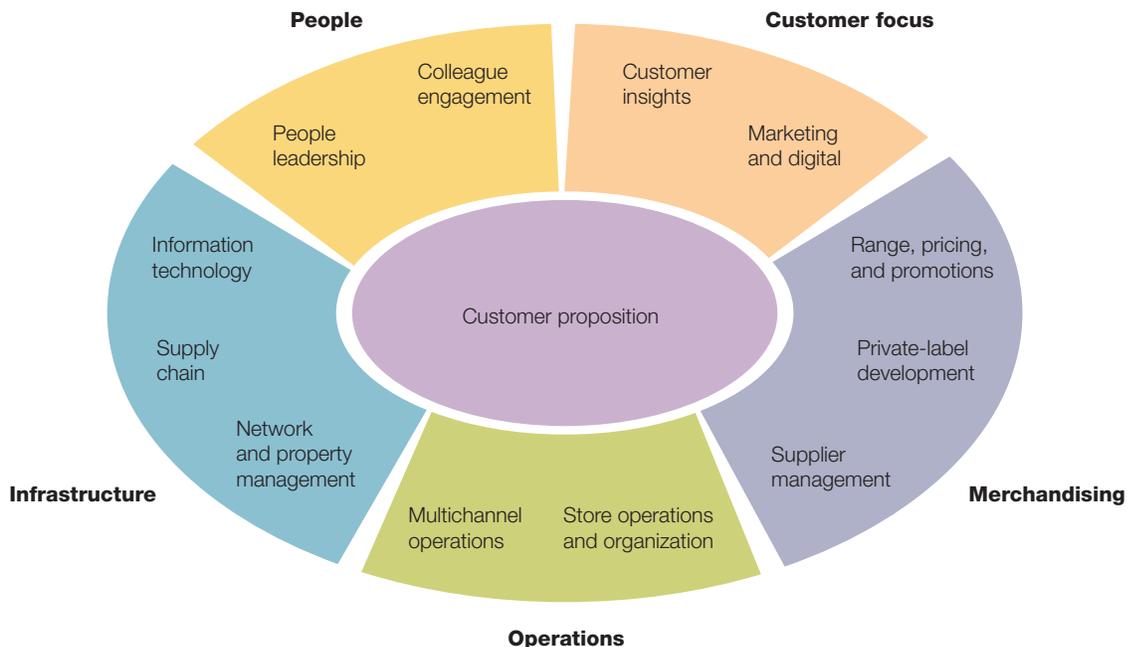
Exhibit 2   **A successful retail turnaround typically undergoes five stages.**

1 Wake up
  • Examine total return to shareholders and
    business performance
  • Bear in mind that 15% of large companies
    are in distress at any given time

2 Believe nothing, prove everything
  • Diagnose strengths and weaknesses
  • Conduct "clean sheet" due diligence

3 Act early and aggressively
  • Build the new team
  • Set aggressive cost targets

4 Fire on all cylinders
  • Survive: create a "cash runway"
  • Fix it: address the root causes
  • Take a new approach: change the business model

5 Make it stick
  • Appoint a chief restructuring officer
  • Create a "control tower"

the norm. When we surveyed more than 1,500
executives who have been in turnaround
situations, over half of them said they had either
underestimated the severity of the problem or
refused to accept that there was a problem at all.[3]
One retail CEO, whose company's TRS was well
below competitors' and had declined by more than
90 percent in a single year, refused to use the
word "turnaround" in discussing the business.
"We are not in a turnaround situation," he insisted.

Our analysis suggests that in most industries 10
to 15 percent of large companies are in distress at

any given time. Take a hard look at your company's
TRS performance; test whether your customer
proposition is resonating with consumers. If your
company is indeed in distress, it's best to come to
terms with it now, while there's still time to act.

Stage 2: Believe nothing, prove everything
Retail leaders must then seek to understand the
causes of distress—and do so in a fact-based way.
Company myths can be pervasive and difficult
to dispel; many companies move reflexively to
action based on long-held beliefs and assumptions,
not taking the time to figure out if they're

[3]The McKinsey global survey
on recovery and trans-
formation was in the field
from January 22 to February
1, 2013, and received
responses from 1,527 exec-
utives representing the full
range of regions, industries,
company sizes, tenures, and
functional specialties.

attacking the right problem. Among our survey respondents, only 22 percent said they conducted a diagnostic at the start of their turnaround program. As one senior executive told us, "We jumped to what we thought the solution was, only to find out later that we had wasted our time and effort."

A rigorous diagnostic increases the program's chances of success: in our survey, 60 percent of companies that undertook a diagnostic achieved a successful turnaround. The success rate was only 34 percent among companies that didn't do a diagnostic.

The diagnostic should bring to light what's not working, but it should also highlight what's working well. Often, companies become too absorbed pinpointing the problems and overlook inherent strengths in their businesses that can help them overcome their difficulties. Our research shows that a turnaround in which the company diagnoses both its strengths and weaknesses is more than twice as likely to succeed as a turnaround in which the diagnostic identifies only the company's weaknesses.

We recommend that retailers take a "clean sheet" approach, which can be laborious but often yields powerful and surprising insights. One retailer, in undertaking a clean-sheet exercise, discovered that no one on the top team knew the total number of the company's back-office locations or the size of its workforce across all subsidiaries. Because of disparate data systems, gathering this information was a surprisingly tedious task. But doing the legwork paid off: after the clean-sheeting exercise, the company found that five of its back offices and several support functions had considerable opportunities to improve efficiency. Within six months, the retailer was able to

generate material cash savings through lease exits and consolidation of back-office teams.

Stage 3: Act early and aggressively

Once the causes of distress are clear, a retailer must move quickly and boldly. In particular, the CEO must put in place an action-oriented executive team and set ambitious cost targets. Both will be critical to survival.

Without major changes in the top team, it's hard for a company to make a radical departure from past decisions and direction. One CEO who has led multiple turnarounds has even gone so far as to formulate the following guideline: "My rule of thumb for the top team is that a third will remain, a third will be promoted from within the company, and a third will come from outside. Otherwise, nothing changes."

Once in place, the top team must then rapidly find ways to cut costs. For retailers, the biggest cost levers are typically head-office costs, supplier funding and cost of goods sold (COGS), and property and store costs.

Head-office costs

Head-office costs can be a drag on retailer P&Ls. A retail CEO should streamline headquarters if one or more of the following is true:

- The company has too many committees and boards that have been built up over the years (as a result of past priority projects or acquisitions) and never culled. One incoming turnaround CEO described encountering "a board for every topic." Company leaders should be taking action, not sitting in meetings.

- The headquarters organization is top-heavy. Simply splitting the head office into salary tiers

can highlight this issue: there shouldn't be more executives at the highest level than in the next couple of levels.

- Executives have too small a span of control. The right span varies for every role, but in general (except perhaps for specialist roles), if each manager supervises fewer than seven or eight team members, the organization would benefit from delayering.

Supplier funding

Supplier negotiations, with the aim of lowering COGS, are a critical lever for most retailers. In distress situations, we have found that assertive and creative approaches to suppliers can create value very quickly.

One retailer was experiencing dramatic sales declines due to "showrooming": customers would browse in the stores but use their mobile devices to buy from Amazon—often while they were still in the store, taking advantage of the free Wi-Fi. The company's analysis of industry-sales data strongly suggested that its in-store displays and promotions correlated with online sales: when a product was displayed prominently in its stores, overall online sales (including Amazon's sales) of that product rose; when stores stopped

promoting the product, online sales went down. The retailer negotiated with its suppliers to get a "fair share" of the value by calculating the online-sales boost from in-store displays. Over the following six months, the retailer rene-gotiated with all of its suppliers and agreed on a level of ongoing funding support that offset the retailer's promotional costs.

Property costs

As sales migrate online, a legacy store network can act as the proverbial noose around a retailer's neck. To get a realistic picture of its store network's future value, a retailer should adjust for industry trends (such as the shift to online) when calculating store profitability.

A European leisure retailer, for example, launched a store-transformation program that initially encompassed only the 5 percent of its stores that were unprofitable. But when the company extrapolated current trends into the future—specifically, the migration of sales from physical stores to online—it projected a 30 percent decline in sales volume across all stores within three years. And after taking into account the allocation of central costs (such as the IT to support store systems), the retailer realized that more than half of its stores could become unprofitable in three years.

The company thus radically redefined the scope of its store-transformation program. It evaluated the entire network from a "zero base"—meaning each store needed to justify its existence. The company divided its stores into four groups based on profitability and ease of lease exit, then developed a different strategy for each group (Exhibit 3).

Stage 4: Fire on all cylinders

Too often, retail executives in turnaround situations think only about cost cutting. While cost cutting is necessary when the company is in survival mode, it won't always address the root causes that led to a turnaround situation in the first place.

In our executive survey on turnarounds, respondents said that cost issues were the cause of distress in one-third of turnarounds; two-thirds of the time the cause was a challenge to the business model, such as discounters entering the market or customers moving online. Yet when respondents listed the actions their company took during the turnaround, almost two-thirds of the actions were focused on costs and didn't address challenges related to the business model. Without thoughtful business-model actions—format renewal or reinvention, shifts in the trading strategy (in assortment, pricing, or communications, for example), or even a major change to the business model—the company faces a heightened risk of returning to a distressed situation.

Exhibit 3

Stores should be categorized by profitability and ease of exit.

Easy

1. Loss making, easy exit: close

Key points to consider:
- Affordability of dilapidation costs
- Measures to retain sales in other stores/channels
- Measures to retain top-performing staff from closed stores

2. Profitable, easy exit: test leases

Key points to consider:
- Rent reform to retain profitable stores at lower costs
- Loss-making, hard-to-exit stores nearby: test potential to transfer trade and transform those stores

Ease of lease exit

3. Loss making, hard exit: get creative

Key points to consider:
- Subletting part or all of store space
- Closing nearby, more profitable stores with easy exit and switching customers over
- Weighing the cost-benefit balance of paying up to end of lease

4. Profitable, hard exit: keep and invest

Key points to consider:
- Sustainability of profit given longer-term trends such as the shift online
- Rent reform to reduce cost base and make leases more flexible

Hard

Low — High

Profitability (multiyear view)

A chief restructuring officer should spur a radical rethink of the company's operating model and challenge managers' assumptions about what is possible.

One accessories manufacturer traditionally sold most of its products to distributors, which would then sell to multibrand retailers. The company also owned and operated a handful of concept stores as brand flagships. It had steered clear of e-commerce to avoid competing with its distributors and retail partners. However, an analysis of channel profitability and customer trends showed that the future sources of profitable growth were the online channel and owned concept stores. The company thus turned its channel strategy on its head. Execution of the new strategy was a critical element of a turnaround that has led to a fourfold rise in share price and TRS uplift of 190 percent in less than two years.

Stage 5: Make it stick

A successful retail turnaround often involves changes across hundreds of stores, brought to fruition by many thousands of frontline staff, which translates into a significant performance-management challenge. According to our research, the average C-level executive spends approximately 15 hours per month in performance reviews, compared with approximately 40 hours per month for a turnaround CXO.

One approach that works well in turnarounds is to establish a "chief restructuring officer" (CRO) role for a limited period, typically 9 to 18 months. The CRO, usually an external hire with extensive

In need of a retail turnaround? How to know and what to do

11

experience in distressed turnarounds, leads the turnaround office—a "control tower" for all turnaround initiatives—and is responsible for spurring a radical rethink of the company's operating model, pushing managers to re-examine how things are done, and challenging their assumptions about what is possible. The most effective CROs engage all stakeholders early and continuously, and they motivate colleagues by telling the positive change story over and over again. As a change leader, the CRO should operate as an extension of the CEO, with the authority and credibility in the orga-nization to make decisions (with the approval of the CEO). The CRO doesn't replace line leaders, but rather supports the CEO in driving the transformation so that the day-to-day tasks of running the business are not neglected.

This level of central control may seem like overkill, but our experience shows that without it, different parts of the business can easily report delivery of "turnaround benefits" while the P&L stub-bornly stays the same. Our research shows that turnarounds with strong governance are seven times more likely to succeed than those without it.

• • •

Times are indeed tough for retailers. But being in a distressed situation isn't cause for despair. If retail leaders face the facts early, identify and address the root causes of their financial distress, take costs out quickly, and ensure disciplined execution, they can deliver—and rapidly move beyond—a turnaround. ○

Building capabilities in digital marketing and sales:
Imperatives for consumer companies

As they embark on their digital journey, companies should focus on a handful of essential skill-building and organizational decisions.

Nicolò Galante,
Cédric Moret, and
Remi Said

Advances in digital technology are reshaping the world of marketing and sales. The potential for real-time connectivity with customers, especially through social networks, has generated seemingly endless possibilities for personalized products, services, and communication. In response, some marketing and sales teams at consumer-packaged-goods (CPG) companies have ramped up digital spending: Unilever, for example, doubled its digital-marketing budget between 2009 and 2011, and by 2012 had allocated 13 percent of its overall marketing budget to digital channels. P&G now markets several products exclusively via digital channels.

Yet even seasoned CPG executives within marketing and sales confess they don't fully understand consumers' digital behaviors or know the best ways to use digital channels and tools. Many executives—from chief marketing officers (CMOs) to brand managers—say their staff lacks some of the skills necessary to capture the full potential that digital platforms can offer. How can CPG companies develop the capabilities they need to achieve sustained excellence in digital marketing and sales?

Drawing on our independent research, in-depth interviews with 30 CMOs and brand managers at a dozen leading consumer companies, and our extensive experience working with CPG organizations around the world, we have identified seven imperatives for CPG companies seeking to systematically build digital capabilities.

Collectively, the imperatives address strategic vision, both "hard" and "soft" organizational challenges, and operational processes—thus constituting a comprehensive approach to digital success. Unlike other approaches—which either have a narrow focus or presume a level of digital savvy that might not yet exist in some organizations—our approach can help CPG companies build their digital capabilities from the ground up and across the entire marketing and sales organization.

1. Integrate digital activities into the overall strategy

A digital-marketing plan shouldn't be designed on its own and simply tacked on to the overall marketing and sales strategy; digital and traditional media planning should be fully integrated to reflect the integrated, multichannel nature of the "consumer decision journey" (Exhibit 1). Integration requires strong signaling from management teams—bold, visible moves that highlight digital marketing and sales as

Keiko Morimoto

Exhibit 1

Digital media can affect every part of the consumer decision journey.

■ Key traditional-marketing levers　　■ Key digital-marketing levers

• In-person word of mouth
• Sales assistants/in-store trial
• Catalogs/leaflets
• Internet search engines
• Social recommendations
• Company websites
• Scanning (QR,[1] bar code)
• Live chat

• Shop
• Catalog sales
• Telesales
• Web sales
• Mobile sales
• Merchandising

Brand touchpoints

Active evaluation
Information gathering/shopping

Initial consideration set

Loyalty loop

Moment of purchase

Trigger

• Television
• Radio
• Print
• Coupons
• Sampling
• Display/banners
• E-coupons
• Viral videos

Moment of consumption

Brand touchpoints

• Telephone
• Subscriptions
• Newsletters
• E-CRM[2]
• Digital help lines

Social media

[1]Quick response.
[2]E-customer-relationship management.

priorities for the organization. One such move might be to set ambitious spending targets. One CPG company has set its digital-spending target at 10 percent of the overall marketing and sales budget—well above its actual spending of approximately 2.5 percent. CPG companies can also pilot high-profile digital campaigns. In 2010, Pepsi opted not to air TV commercials during the Super Bowl, investing instead in an all-digital corporate-social-responsibility campaign called Pepsi Refresh. While the campaign did little to boost sales, it sent a strong signal to Pepsi's marketing and sales teams about the importance of digital activities.

Integrating digital activities into the broader strategy can be challenging if companies don't yet have strong digital capabilities: organizations might feel they lack the digital-strategy skills to conceive a company-wide plan or feel cautious because they have little historical data and experience from which to draw. Building the right skills is crucial, as we discuss below, but companies shouldn't wait until they have the perfect set of skills in place. Getting started on the digital-marketing journey and creating a path to digital excellence will help build momentum.

2. Create new roles and develop new skills

As digital activities become more important, CPG companies are creating new roles in their marketing and sales teams: for example, chief content officers take charge of content

development, "data whisperers" manage and interpret vast amounts of information, community managers monitor and respond to social-media buzz, and e-commerce experts oversee online sales. But companies must be careful not to create new positions in title only—the people in those roles must have the right skills. And because competition for digital experts is fierce, companies must distinguish among digital activities that require new hires, those that could be handled by employees with additional training, and those that should be outsourced.

Hire experts to oversee strategic activities in-house

Some digital activities that have traditionally been outsourced—such as customer-data analysis and digital-content creation—have recently taken on increased strategic importance. Companies should therefore consider moving them back in-house, which can strengthen brand control and enable faster action and course correction. As part of its digital marketing and sales strategy, one luxury-goods company decided to integrate advanced digital technologies into the in-store experience—showing live feeds of the company's fashion shows on giant TV screens and allowing shoppers to interact with the store's digital content on their tablet devices, for example. To create this type of immersive digital experience for its in-store customers, the company needed complete control over its digital activities—which meant moving them in-house.
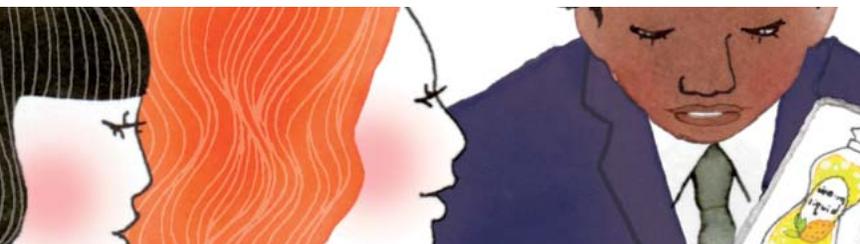
Many companies find that they need entirely new skills and new talent profiles for some digital activities; training the current staff isn't a realistic option. In a 2011 McKinsey survey, global executives more often cited "hiring experts from outside the organization" than either "training current employees" or "outsourcing" as a tactic that would most help address their companies' analytical talent gaps. And 50 percent of the CMOs we interviewed believe recruitment of data analysts will be critical to their success.

That said, the talent of digital experts tends to be highly specialized, and CPG companies should be creative about building digital capabilities more broadly among current staff. An employee-exchange program between Google and P&G offers a case in point: since 2008, a rotating group of about two dozen employees has been attending one another's business meetings. P&G employees gain actionable insights about digital consumers and a better understanding of how to reach them; Google, in return, gains closer ties to the world's biggest advertising spender.[1]

Outsource tasks that others can do better, faster, or at lower cost

CPG companies may still choose to outsource nonstrategic capabilities or activities that third parties can offer at a higher quality, at a more rapid pace, or at a lower cost. Examples could include data management or development and maintenance of certain software programs and applications (such as digital payment systems or clickstream tracking).

Although outsourcing isn't a new concept, there are new complexities in the context of digital marketing and sales that make vendor management more time-consuming and

resource-intensive. For one, there are many more vendors to manage, simply because of the ever-expanding range of digital activities. Contracts are often shorter in duration because of the "test and learn" approach required in digital teams. The abundance of real-time data means marketing and sales departments interact with vendors much more frequently. They also tend to switch vendors more often because the market is highly dynamic and has many small, specialized service providers. CPG companies should take these factors into account when making decisions about which activities to outsource.

3. Rethink the way digital activities are organized

CPG companies must not only decide which digital activities to execute and whether to outsource them—they must also be deliberate about how and by whom in-house digital activities are done. We've seen three models work well: a central operative team can handle organization-wide execution, a central "catalyst" team can guide local teams on execution, or fully empowered local teams can implement plans independently in their markets (Exhibit 2).

Companies should weigh the pros and cons of each model, but in general, our view is that activities such as developing the digital strategy, defining brand-equity guidelines, and conducting global agency negotiations should remain centralized, while digital activities that require daily intervention (customer service, for example) should be managed locally to ensure maximum relevance and speed.

CPG companies can learn from digital organizations outside their industry. Dell, for instance, uses the catalyst model for its social-media

[1] See Ellen Byron, "A new odd couple: Google, P&G swap workers to spur innovation," online.wsj.com, November 18, 2008.

Exhibit 2   **Companies typically use one of three models in setting up digital activities.**

	Central operative team	Central team as a catalyst	Local teams
Structure			
Roles	• Central team performs digital tasks on the ground	• Central team disseminates best practices and guidelines • Local staff is responsible for execution	• Local markets are fully responsible for actions to be done
Pros and cons	• Deep knowledge development within center of excellence, but only applicable when local differences can be ignored	• Combination of central expertise and guidelines with local execution, but enforcement of guidelines remains a challenge (blended responsibility)	• Close and fast to market, but uneven delivery due to little coordination
Examples	• Search-engine marketing	• Social media	• Customer service

activities. The company established a Social Media Listening Command Center, which tracks more than 20,000 Dell-related topics in 11 languages. Dell also created Social Media and Community University, which offers Dell employees worldwide a range of courses on social-media policies and processes. Only graduates of the university can blog and tweet as official Dell representatives. The company estimates the university has trained between 5 and 10 percent of employees.

Companies must also decide where to situate digital activities within the larger organization.

Some CPG companies establish a digital subdepartment in the marketing and sales group; others create a separate digital department for each brand.

4. Establish rapid-response mechanisms
Speed is key in digital marketing and sales. Customers who make online inquiries expect a response within an hour, and 88 percent say they're less likely to make a purchase if their question goes unanswered.[2] Companies should create a comprehensive plan for responding quickly to online events, from customers' questions to public-relations crises.

[2] *The Consequences of Ignoring Your Customers: A Survey of Consumer Expectations for Customer Service on Social Media Platforms*, Conversocial, December 2011.

Marketing and customer-facing teams are best positioned to identify emerging online threats and must be trained to react in a way that protects both the company and the brand. Three levers can equip companies to respond to crises quickly: systematic monitoring, anticipation, and organizational readiness.

Systematic monitoring. A company must monitor online discussions about itself, its brands, and its products—and it needs well-defined teams, tools, and processes for doing so. One company we interviewed, for example, monitors YouTube for videos that could damage its reputation. Recently, a video that put company employees in a bad light went viral. Because it had monitoring systems in place, the organization became aware of the problem immediately and was able to quickly post its own YouTube video in which a senior executive detailed the company's response. Social-media employees, without further guidance from the corporate office, continued to respond to customers' online inquiries and comments.

Anticipation. Companies should define response plans before a threat actually arises. McDonald's offers a strong case for this type of preparation: when the company encouraged its customers to use the hashtag "#McDStories" to tweet their positive experiences with the brand, the campaign was hijacked by customers who posted derogatory tweets. McDonald's quickly pulled the hashtag; it was promoted for less than two hours. Within an hour of pulling #McDStories, negative tweets about the company decreased from 1,600 per hour to a few dozen per hour. According to a statement from McDonald's social-media director, "With all social-media campaigns, we include

contingency plans should the conversation not go as planned."[3]

Organizational readiness. Social-media activities can be managed by a centralized group (which limits the need for coordination and helps keep tighter control of messaging) or through decentralized teams. If companies opt for the latter model, teams must have clear guidelines and well-defined decision-making and escalation processes. Organizational readiness can sometimes be about responding to crises, but it can also help capture unexpected opportunities. When the lights went out during the 2013 Super Bowl, cookie manufacturer Oreo, which had set up a command center to respond to social-media buzz in real time, sent out its now-famous "You can still dunk in the dark" tweet. The instant ad got more than 15,000 retweets and 20,000 Facebook "likes" in a matter of hours, and Oreo's Instagram following ballooned from 2,000 to 36,000.

5. Leverage big data and analytics

As of late 2012, computers around the world generated an estimated 2.5 exabytes of data each day. In theory, big data and advanced analytics can offer useful insights, but CPG companies are just starting to leverage them. Big data and analytics can help CPG marketing and sales organizations in five distinct ways.

Driving product innovation. CPG companies can use big data and digital platforms to develop and test new products and track the impact of product launches in real time. Kraft, for instance, invited a small number of consumers from key target groups to join its online communities. Members help test

[3] Gus Lubin, "McDonald's Twitter campaign goes horribly wrong," businessinsider.com, January 24, 2012.

A consumer-goods company discovered that its digital campaigns had nearly as much sales impact as its TV ads, with less than one-fifth of its TV budget.

products and alert Kraft to product ideas. The company introduced Nabisco 100-calorie packs—packages with measured portions of popular snacks—after identifying two trends in online discussions: the need for portion control and the idea of snacking as a reward. Nabisco 100s generated $100 million in sales within a year of launch.

Developing customer insights. CPG companies can use information from digital channels to generate insights from—and about—customers in real time. Gatorade's Mission Control Center, for example, monitors and analyzes consumers' online comments about Gatorade products. Five employees use data-visualization tools and dashboards to understand consumer preferences, get ideas about new products or innovative uses for existing ones, and optimize the landing pages of Gatorade's websites.

Increasing sales. Big data can help drive sales conversions. A European CPG company recently applied advanced analytics to consumer data to refine its retailer-specific assortments. By understanding which SKUs were selling well in which retail formats and determining which SKUs to swap in and out to best meet consumer preferences, it achieved 10 percent sales growth in a low-growth category.

Informing pricing decisions. Companies can use information about market trends and competitors' moves to inform their own pricing choices. Amazon has developed a computer algorithm that adjusts its prices throughout the day based on competitors' prices.

Collaborating with business partners. Big data can help companies increase efficiencies with suppliers and other stakeholders. One major

big-box retailer, for example, uses a sophisticated software system to share inventory information and product prices with suppliers in real time, ultimately saving the company several million dollars each year.

As a first step in its big-data journey, a company can choose a single area where a focused investment in big data and analytics can prove the business case quickly. Early successes can create strong support and buy-in for larger, longer-term big-data efforts.[4]

6. Measure and manage digital performance

According to a 2012 McKinsey survey, 91 percent of companies don't believe social media significantly affects sales. Indeed, measuring social-media return on investment (ROI) isn't easy: the industry has yet to adopt standard metrics, and unlike search-engine marketing, social-media campaigns don't lend themselves to straightforward ROI calculations. Because these campaigns are relatively inexpensive, some leaders don't think that measuring their ROI is worth the trouble. But robust ROI measurements are critical if marketers are to make the most of digital platforms.

Some promising measurement tools are emerging. Marketing-mix modeling (MMM), for example, is an established tool that quantifies the sales impact of each type of marketing activity. An enhanced MMM methodology incorporates a metric called "Social GRP," which calculates the value of social-media buzz.[5] Modeled on the gross-rating-point system widely used to measure the impact of TV advertising, Social GRP quantifies the value of "earned media"— publicity that a company hasn't paid for, such as tweets or blogs about a product.

MMM is even more powerful when combined with insights about which digital touch-points are most influential in every stage of the consumer decision journey.[6] Based on such insights, a consumer-goods company discovered that its digital campaigns had nearly as much sales impact as its TV ads, but its digital-marketing spending was less than one-fifth of its TV budget. The company subsequently tripled its digital budget.

In addition to using new analytic tools, we recommend that CPG companies create and monitor a dashboard of key performance indicators (KPIs). To make sure they're measuring the right things, they should calibrate how specific metrics relate to business results. For example, how does the number of clicks on a certain page correspond to a product's sales? Companies can then track the six to eight metrics most closely correlated with sales (Exhibit 3). The KPI dashboard should be recalibrated at least semiannually.

7. Foster a mind-set of rapid testing and learning

Building digital capabilities is a long-term undertaking that can bear fruit only in an environment that encourages testing and learning. In our experience, five factors are necessary to create such an environment. First, the organization must quickly generate a critical mass of experience: it must get large numbers of people involved in digital projects and create and track many data points from which to learn. Second, it must tie incentives to test-and-learn processes; Nestlé, for instance, gives out internal awards for best practices. Third, CPG companies need systematic methods for testing their digital efforts. A/B testing can help here: it exposes users to different scenarios

[4] See Peter Breuer, Lorenzo Forina, and Jessica Moulton, "Beyond the hype: Capturing value from big data and advanced analytics," *Perspectives on retail and consumer goods*, Spring 2013.

[5] See Rishi Bhandari, Jonathan Gordon, and Andris Umblijs, "Getting beyond the buzz: Is your social media working?" FT.com, October 2012.

[6] See David Edelman, "The consumer decision journey explained," mckinseyon marketingandsales.com, March 2013.

and presentations (such as different wording of the same offer), allowing marketers to analyze which one delivers the best results. Fourth, employees must have access to experts who can share the full portfolio of best practices and offer tactical advice. And finally, CPG leaders must allow space for failure—a critical part of the rapid-learning process. Marketers accustomed to the "TV campaign" culture are often risk-averse; leaders must act forcefully to change that.

There are many ways to create effective, accessible networks of digital experts and information. Aside from formal interactions (for example, Coca-Cola's quarterly meetings of marketing directors) and formal project teams, some companies create easy access to expertise through knowledge portals that serve as a repository for best practices. Others offer job-rotation programs designed to help strengthen the links among different markets. In some cases, CPG

Exhibit 3

Top management should focus on only a few key performance indicators.

ILLUSTRATIVE

- ■ Low
- ■ High
- ■ Selected for dashboard

	Define measurable digital metrics	Determine and calibrate relationship to business results	
		Sales impact	Statistical significance[1]
Display advertising	Ad impressions	1%	
	Clicks	3%	
Search	Search volume	5%	
	Search visibility	3%	
	Impressions	4%	
	Clicks	5%	
Social	Number of friends/followers	0%	
	Buzz volume	2%	
	Engagement	2%	
	Sentiment	4%	
	Social GRP[2]	6%	

[1]Based on marketing-mix modeling.
[2]Gross rating points.

companies might appoint organizational "integrators"—at P&G, for example, a group of internal digital experts advises teams throughout the company on advertising topics and best practices.

•   •   •

Digital activities are an increasingly important part of any marketing and sales strategy. The ability to harness the power of digital platforms will soon become table stakes. By acting on these seven imperatives, CPG companies can accelerate the development of digital capabilities in their organizations and begin to tap into the immense opportunities in the digital arena. ○

Nicolò Galante is a director in McKinsey's Paris office, where **Remi Said** is an associate principal; **Cédric Moret** is a principal in the Geneva office. Copyright © 2013 McKinsey & Company. All rights reserved.

A fresh take on food retailing

Excellence in the fresh-food department requires close attention to several factors, two of which are particularly challenging for retailers: sourcing and shrink reduction.

Raphael Buck and
Arnaud Minvielle

Fresh categories—fruits and vegetables, meat, fish, dairy, and baked goods—typically account for up to 40 percent of grocery chains' revenues. They are also strong drivers of store traffic and customer loyalty. Fresh food, however, has always been exceedingly complex to manage: prices are volatile, suppliers are fragmented, the products are perishable and sometimes fragile, and replenishment and quality-control processes are laborious. And due to rising consumer demand, retailers are carrying an ever-expanding range of fresh products, many of which have different temperature and handling requirements. In light of these challenges, many grocery chains struggle to achieve satisfactory margin levels in their fresh departments.

But thriving, profitable fresh departments do exist. In our work with retailers in Europe, the Middle East, and Africa over the past three years, we have seen that the most successful fresh-food retailers excel in five critical dimensions: value proposition, merchandising, sourcing and supply chain, store processes, and end-to-end "shrink" reduction and quality management (Exhibit 1). A retailer's value proposition—how the company positions its fresh department and what makes it distinctive in the eyes of target customers—is an overarching factor that should inform the rest of the retailer's fresh-food practices and policies.

Retailers that have a strong value proposition and bolster it by implementing best practices in their fresh departments can boost revenues by as

much as 10 percent. The most important dimensions to invest in will vary by retailer, and every company should diagnose its current performance and how far it falls short of best practice to identify where the greatest opportunities for improvement lie. In this article, we zero in on two dimensions that hold high potential but tend to be difficult for retailers to master: sourcing and shrink reduction.

Smart sourcing

The cost of goods sold in the fresh department typically amounts to up to a third of the total cost base of a grocery chain. But despite the importance of fresh sourcing, many retailers approach it unsystematically and thus end up paying above-market prices. Typical pitfalls in fresh sourcing include the following:

• buyers who believe their primary respon-sibility is to secure sufficient supply, and thus spend most of their time processing orders

rather than managing suppliers and con-ducting fact-based negotiations

• limited transparency into the performance and strength of individual suppliers and the supplier base as a whole (many retailers track only one of the following metrics: buying price versus benchmark, margin, availability of products, and quality)

• quality-control processes that rely on a single indicator—for example, evaluating fruits solely on their appearance instead of testing for taste indicators

• lack of a systematic, comprehensive monitoring of the performance of buyers and purchasing units

To uncover opportunities to improve its fresh-food sourcing, a retailer should reevaluate its answers to the following questions: What should we buy? Where should we buy it? And how should we buy it?

Exhibit 1

Excellence in fresh-food retailing has five dimensions.

1. Value proposition

| Fruits and vegetables | Meat and poultry | Baked goods | Dairy | Fish | Cold cuts and cooked meat |

2. Merchandising

3. Sourcing and supply chain   **4. Store processes**

5. End-to-end "shrink" reduction and quality management
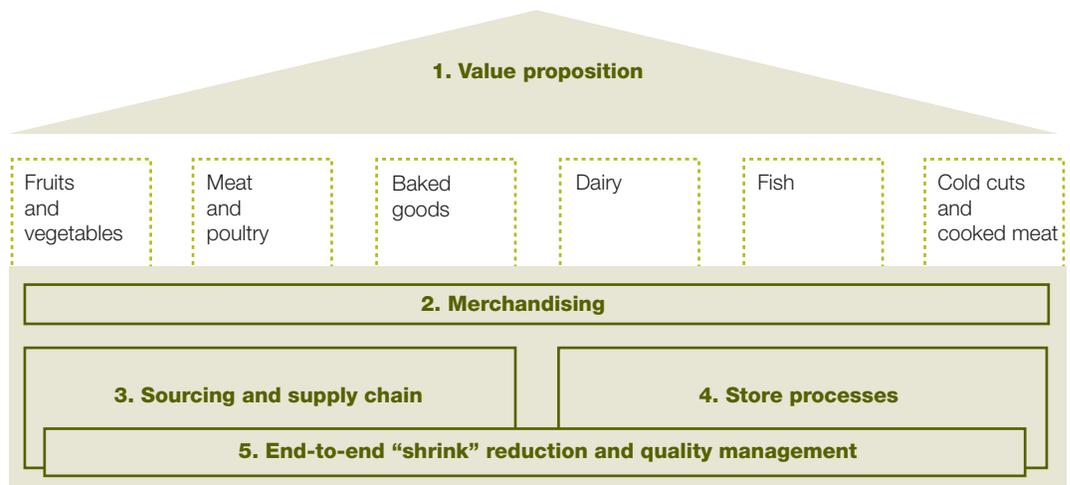
Product specifications: What to buy?

Most retailers know that product specifications in the fresh department should align with the retailer's value proposition. A retailer competing on price, for instance, should have different product specs from one competing on quality. But few retailers make the effort to figure out which particular fresh products most affect consumer perception. We found that in most countries consumers form their opinions based on only a handful of products. Best-practice retailers conduct consumer research and then refine their product specs based on how much a product influences consumer perception and how their offering stacks up against the competition's. The idea is to have the most stringent specifications for the products that have the greatest effect on consumer perception.

The most successful retailers also align product specs with the product attributes that consumers value. Often, a retailer's specs include attributes that don't matter to consumers and therefore increase costs unnecessarily. For instance, customers shopping for apples may care about the fruit's color, texture, taste, and shelf life and pay little attention to its size, in which case the diameter of the apple shouldn't be part of the product specs. Furthermore, to make sure their products embody the attributes that do matter to consumers, leading-edge retailers use scientific but practical tools: to assess a fruit's taste, for instance, they use pH meters to measure acidity and Brix refractometers to gauge sugar levels.

Sourcing strategy: Where to buy?

A retailer must determine its optimal position in the value chain for each product category. To do so, it must first develop a thorough understanding of the supplier landscape and the economics (that is, the costs and markups) in every part of the value chain. The retailer can then decide on ways to reduce its total costs and improve its negotiating power. Potential actions include cutting out intermediaries that do not add value, allocating activities to specialists (in meat, for instance, the breeding, feeding, slaughtering, deboning, and packaging could all be done by different providers), or achieving various degrees of vertical integration through insourcing.

When defining its sourcing strategy, a retailer should decide on the right number of suppliers as well as the types of relationships it ought to have with suppliers. Every supplier relationship should be based on the product's supply volatility (in quality or volume) and importance to customer perception. Products with high supply volatility and a strong influence on consumer perception are best sourced primarily through stable— perhaps even exclusive—supplier relationships. Products that are neither volatile nor critical to perception, on the other hand, can be sourced through transactional or even spot-market purchasing, which allows retailers to respond to changes in demand. For most fruits and vegetables, a combination of stable partnerships with joint capacity planning and some spot-market purchasing tends to be most beneficial.

Sourcing process: How to buy?

Leading retailers regularly compare suppliers' prices against one another and against published market prices. This benchmarking exercise alone, which many retailers don't do, can uncover significant savings potential: even when buying the same product at the same time, a retailer

can end up paying markedly different prices by supplier (Exhibit 2). Of course, there are valid reasons for paying above-market prices—supply security, for example, or better product quality—but we've found that buyers often can't explain why they're paying higher prices.

Price is only one factor in the how-to-buy equation. The most disciplined retailers track not just price but also product quality, timeliness of delivery, and the delivery accuracy of every single order. These supplier "scorecards" give buyers transparency into the performance of suppliers over time and are a critical input into the supplier strategy—for example, suppliers with consistently better quality should be allocated higher volumes at the agreed-on prices.

Retailers should rigorously monitor not just how their suppliers are doing but—just as important—how their own buying staff is performing. To prevent wide variability in buyer performance, clearly defined negotiation rules and guidelines are indispensable. Some retailers provide buyers with a detailed description of the weekly negotiation process, specifying the activities that need to happen on certain days of the week as well as those that must be done daily.

Given that fresh sourcing often entails daily or weekly negotiations, the impact of sourcing initiatives can become evident very fast. A European grocer boosted fresh margins by seven percentage points; a national retailer in the Middle East saw its fresh margins rise by six

Exhibit 2

Supplier prices can vary wildly.

EUROPEAN RETAILER EXAMPLE

Price of banana
€

Week of purchase
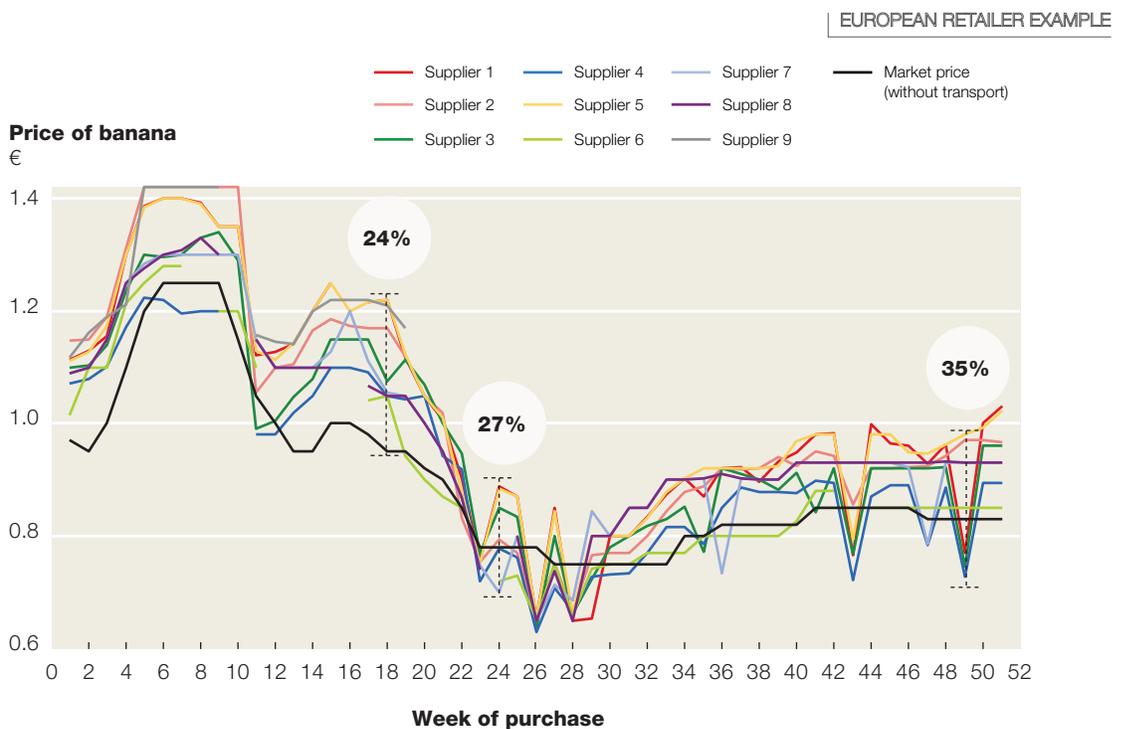
percentage points. In both cases, the company captured 50 percent of the improvement potential within ten weeks.

Shrinking shrinkage

We define shrink (or shrinkage) as the cash value of products that a retailer has bought but that it neither sold nor has in stock. As retailers well know, there are many components to shrink, including products past their sell-by or expiration dates, damaged goods, theft, and cashier errors. For many retailers, shrink also includes markdown, the cash value of products that were sold at a reduced price.

Some retailers assume that high shrink levels are an unavoidable consequence of ensuring product availability. But leading retailers manage to keep availability high and shrink low. Shrink rates (including markdown) vary widely: 3 to 5 percent of volume in fresh produce at best-practice retailers, 6 to 8 percent among average performers, and 9 to 15 percent at under-performing retailers, due mostly to climate and long-distance transport. Some retailers admit to not knowing what their shrink levels are.

Opportunities to reduce shrink can be found in every part of the supply chain, from the supplier to the warehouse to the store. The highest-value opportunities will vary by retailer. For example, a retailer with a lax in-store culture might want to prioritize the standardization of operating procedures and the introduction of strict markdown policies. On the other hand, a retailer whose stores are in geographic regions with extreme climate conditions may need to concentrate on refining its operating procedures to keep food at the right temperatures from supplier to store. Done right, such initiatives can reduce shrink by as much as 10 percent in the

first 10 to 20 weeks and as much as 35 percent over the longer term. Some of the highest-impact initiatives retailers can undertake involve a revamp of ordering processes and reallocation of shelf space.

Fact-based ordering

Even at large retailers, fresh departments' ordering processes tend to be somewhat ad hoc. In the words of one fruits-and-vegetables manager at a major European grocery chain, "The department manager basically orders products based on last week's sales, without ever checking the current stock levels in the store." Some fresh-department managers place orders for the next day based on a mix of gut feeling and prior experience. Others are a little more scientific: they use simple algorithms that take into account past sales and safety-stock requirements.

The most sophisticated ordering systems calculate the optimal size of a daily order by using an algorithm that incorporates seven elements: current stock, estimates of the current day's and the next day's sales (based in part on the day of the week and store promotions), estimates of the current day's and the next day's waste, the stock required for in-store presentation purposes (so that shelves don't look empty), and a small security buffer in the event of an unforeseen sales spike. Retailers that rely on such an algorithm—and make sure to train their staff to use it—are able to simultaneously reduce shrink, increase availability, and have fresher products in their stores.

Reallocation of shelf space

Department managers tend to rely solely on their own judgment—not only in placing orders but also in allocating shelf space. Some managers stock large shelves full of a certain product just

because they like how it looks, even though the store may sell only a fraction of the display each day. One retail store's experience is unfortunately all too common: it displayed 12 boxes of green peppers and 4 boxes of eggplants, but two hours before closing time, 10 boxes of green peppers remained untouched while all the eggplant boxes were empty.

A European grocery chain redesigned its space-allocation processes to make them more demand-driven. Shelf space dedicated to slower-selling products was reduced and some fresh items were comerchandised with dry items (for example, peelers and juicers next to oranges, or salt and pepper next to tomatoes). Store employees underwent training in shrink-reducing levers: for instance, they were taught that products that mature at different rates—

such as carrots and peaches—should not be stocked on the same shelf. These changes helped bring about a 20 percent reduction in shrink levels.

•   •   •

Of course, high performance in fresh-food retailing will last only if it is measured and managed. A performance-management system that incorporates clear key performance indicators, frequent and robust performance dialogues, and reliable tracking tools is critical to sustained success. Instilling a performance culture—not only in the fresh department but across the entire organization—will take time, practice, and consistent attention from leadership, but the payoff will be a revitalized and profitable business in fresh food. ○

'**Get the strategy and the team right**':
An interview with the CEO of Henkel

Kasper Rorsted has been head of the global manufacturing company since 2008. Here, he discusses Henkel's growth plans, what it takes to hire good people, and how he fosters dialogue with customers and employees.

Klaus Behrenbeck

As consumer companies continue to expand their global presence, they face a host of formidable challenges: among them, staying close to the consumer, finding and attracting local talent, and managing an increasingly complex and far-flung organization. These challenges are familiar to Kasper Rorsted, who in April 2008 was named CEO of Henkel, the Düsseldorf-based manufacturer of home- and personal-care products and adhesive technologies. Henkel's roster of brands includes Persil detergent, Dial soap, Fa deodorant, and Loctite glue. In recent years, the 137-year-old company has fared well—in large part by dramatically boosting its presence in emerging markets, which today

account for 45 percent of its global revenues of €16.5 billion.

Rorsted recently shared his views on his tenure at Henkel and the company's plans for the future with McKinsey's Klaus Behrenbeck.

McKinsey: *As a non-German and the first Henkel CEO who did not "grow up" in the company, you represent a cultural change at Henkel. How would you characterize that change?*

Kasper Rorsted: Henkel has become much more global in the past few years. We now employ

Keiko Morimoto

about 47,000 people from more than 120 nations, working in more than 75 countries; over 80 percent of our employees work outside Germany. Our management team has become more diverse as well: three of the six members of our management board are non-Germans, and in the managerial levels immediately below, more than half come from abroad.

Today, 55 percent of our employees are in emerging markets. By 2016, we expect this number to be 60 percent.

I am convinced that we need this diversity; it's a competitive advantage. Our company should reflect the markets in which we operate. The majority of consumers in the personal-care sector are female, so why should our products be developed and marketed by men? In that respect, too, we are leading the way among DAX-listed corporations: the share of women in management positions at Henkel is around 31 percent and has grown an average of one percentage point annually in recent years.

McKinsey: *And by 2016, if all goes according to plan, emerging markets will account for half of Henkel's sales.*

Kasper Rorsted: That's right. We have set the ambitious target of generating €20 billion in sales by 2016, €10 billion of which we expect to come from emerging markets. We're aiming for growth in both emerging and mature markets.

To be very clear: we are concentrating on markets where we hold leading positions or are able to generate sustainable growth. If we do not expect to win in a market in a reasonable period of time, we will exit that market. We will go

deep in the markets where we already have a strong presence, and we will selectively enter new growth markets.

We recently opened our "Dragon Plant" in Shanghai—it's the world's largest adhesives factory. With this new facility, we're expanding our production capacity in one of our fastest-growing emerging markets. We will continue to strengthen our position in growth markets like China, Russia, and Brazil. We're establishing seven new R&D centers in emerging markets including India, Brazil, Russia, and South Africa. We expect that in 2016, 12 of Henkel's 20 highest-revenue countries will be in emerging markets.

McKinsey: *At the 2013 World Economic Forum in Davos, you told reporters that "the price for high growth is volatility." What are some of the steps Henkel has taken to manage volatility in emerging markets?*

Kasper Rorsted: Large, international corporations tend to become complex organizations, which makes them inflexible. But in fast-growing emerging markets, you cannot expect the same stable conditions that we are used to in mature markets—just think of the political unrest in the Middle East, for example.

To succeed in an increasingly volatile market environment, we need simple structures and processes. We are constantly adapting our structures to become faster and more flexible. In the future, we want fewer but larger manufacturing sites and a reduced number of global suppliers. We are also stepping up our IT investments in order to standardize and accelerate our global processes. And we will continue centralizing functions in shared-service centers.

McKinsey: *What are your plans for mature markets?*

Kasper Rorsted: Mature markets will remain important for us. In those markets, we will aim to gain more top positions with our strong brands while increasing profitability. One example is our home market, Germany, where we're making very high capital investments; with around 13 percent of sales, it's our second-most-important market after the United States, and it will remain a cornerstone of our success. That said, at Henkel we are also affected by the effects of the recession in Europe, and I expect Europe will continue to face an extremely challenging period over the next few years.

McKinsey: *You mentioned the role of your strong brands. Since becoming CEO, you've significantly reduced the number of Henkel's brands. Will you continue to do that?*

Kasper Rorsted: When I joined the company, Henkel had about 1,000 brands. Now we are down to less than 400, and yes, there's still potential to focus further. While our ten top brands currently account for 46 percent of sales, we're aiming for 60 percent by 2016.

At the same time, however, we will continue to invest in innovation. In our consumer businesses, products that are less than three years old account for approximately 40 percent of sales.

McKinsey: *One of your newest product lines is Gliss Restore & Refresh, developed specifically for Middle Eastern women who wear veils. Tell me more about how Henkel came up with that product line.*

Kasper Rorsted: To succeed in the highly competitive consumer-goods environment, we need both a management team that reflects the diversity of markets in which we operate and the innovation capabilities to address a broad range of varying consumer needs. The innovation you mentioned is a remarkable example of targeted customer relationship management. In the Middle East, which is one of our growth regions, many women wear veils. Their hair is covered for hours every day and as a result needs special care. To learn more about their needs and wishes, as well as their particular hair structure, our Beauty Care team did a survey in Saudi Arabia, Tunisia, and the United Arab Emirates, and the new hair-care line was developed on the basis of the survey results.

One of our values at Henkel is, "We put our customers at the center of what we do." We have to understand their needs and wishes and enter into a dialogue with them.

Kasper Rorsted

Vital statistics
Born February 24, 1962,
in Aarhus, Denmark

Married, with 4 children

Education
Earned a degree
in economics from
Copenhagen Business
School

Participated in executive
programs at Harvard
Business School

Career highlights
Henkel
(2008–present)
CEO

(2007–08)
Vice chairman of the
management board

(2005–07)
Executive vice president
of HR, purchasing, IT, and
infrastructure services

Hewlett-Packard
(2002–04)
Senior vice president and
general manager,
Europe, Middle East,
and Africa (EMEA)

Compaq
(2001–02)
Vice president and general
manager, EMEA

(1995–2001)
Various management
positions, including head
of EMEA enterprise
business group

Fast facts
Serves on the boards of
international media
conglomerate Bertelsmann
and Denmark-based
industrial company Danfoss

McKinsey: *To that end, Henkel recently set up a ShopperLab and a Beauty Care Lighthouse. How do these two concepts help generate consumer insights?*

Kasper Rorsted: The ShopperLab is a room that re-creates the shelves of a real store. We designed it to help us further understand customer behavior in shopping environments. We can study the impact that product designs have on shelf appearance and occupancy, point-of-sale materials, and the various aspects of buying behavior. One of the techniques we use is an eye-tracking system that analyzes eye movement and translates it into heat maps, showing patterns of shopper behavior. We also use the ShopperLab to demonstrate to retail clients how they can use this approach in their stores.

The Beauty Care Lighthouse is a unique venue where we host customers, business partners, or investors. Specific areas of the Lighthouse are devoted to topics that are important to us, such as sustainability or digital innovation. It's a space where customers can try out, for instance, new digital tools that let them test hair colorants at the point of sale. This creative atmosphere helps us engage and interact with our customers more deeply.

You cannot run a global company from your desk. That's why I spend around 170 days per year abroad, meeting employees as well as customers and business partners.

Only when we are close to consumers can we offer them products that cater to their specific needs. To give another example, in our Laundry & Home Care Business, we have a global consumer-insights program that includes visits to local households by our team. Sometimes it's that easy: simply talk to people. Henkel managers from marketing or R&D regularly visit households.

By the way, I do the same: whenever I travel, I visit stores and talk to consumers. What do you like about the product? What do you miss? Where do you see room for improvement?

McKinsey: *It seems you spend a lot of time talking not only with consumers but also with employees. Do you feel that's important to do as a CEO?*

Kasper Rorsted: I am convinced that a visible and accessible leadership style is most effective. My door is open; I encourage colleagues to call me directly. Our employees know who I am and what I'm doing. I eat with employees in our canteens whenever I am traveling or here at headquarters. You cannot run a global company

from your desk. That's why I spend around 170 days per year abroad, meeting employees— from top executives to young high-potential individuals—as well as customers and business partners.

As CEO, I believe that a primary task for me and the management board is to shape Henkel's growth strategy and clearly communicate it to all employees. Last year, to present our growth strategy for 2016, the management board and I visited 28 sites in 22 countries. Overall, more than 70 town-hall meetings have taken place around the world. And of course, a critical part of my role is to make sure Henkel has the right team in place. So in summary, those are my key tasks as CEO: get the strategy and the team right.

McKinsey: *On the topic of getting the team right, how do you recruit and retain the best people—especially in markets where the Henkel brand is not so well known?*

Kasper Rorsted: It's certainly a challenge to find and keep good local employees, especially in emerging markets. The turnover rate in China is around 25 percent. In these markets, a large

number of companies are competing for a relatively small, although steadily growing, pool of candidates. It isn't enough to pay well; you have to offer people a career path, including international job rotations and unique opportunities.

Developing an employer brand takes time. In countries where Henkel is hardly known, we prefer to target specific groups—for example, through partnerships with individual professorships all over the world. We also increasingly recruit cross-border: at international recruitment fairs, we meet highly qualified candidates studying abroad and encourage them to work for Henkel in their home countries.

And once we recruit them, we have to retain them. We do that in part by investing in their development. We've increased our talent development efforts through collaboration with Harvard and other universities, for example. This enhances our position as an attractive employer.

We have a results-driven performance culture. We put great emphasis on internal promotion and talent development. Hence, Henkel has one of the youngest management boards among European public companies, and all the members

of the management board—aside from me—came from within Henkel.

McKinsey: *In 2013, Henkel began a global rollout of a new leadership-development program. Can you say more about that?*

Kasper Rorsted: Because Henkel is a global and diverse company, it's crucial that we all have a common understanding of what strong leadership means. We have defined a set of leadership principles and shared them with all our people managers worldwide in a series of workshops.

Our global leadership team is aware that they will be assessed on the basis of their leadership conduct. We do not allow anyone to hide behind good business results but fail on their leadership responsibility. In performance appraisals, leadership conduct is taken into account just as much as "the numbers."

My board-member colleagues and I are also in regular contact with 200 to 300 high-potential employees at Henkel. Anytime we travel, we arrange informal breakfast meetings or roundtables with them. We know who is performing particularly well in a country and might be ready for the next steps. This system works very well—around 80 percent of

managerial positions at Henkel are filled through internal promotions. When I first joined the company, I was surprised how many colleagues had spent half of their lives at Henkel! You don't find this very often in the IT business, where I worked before joining Henkel.

McKinsey: *Speaking of your IT background, what role do IT and digital technologies play in Henkel's corporate strategy?*

Kasper Rorsted: Markets are reacting much faster than ever before. We see faster decision making, faster information transfer. These trends fundamentally change the business environment. Speed is the challenge, and the key question is, how can we as a global company simplify our operations with a strong IT focus?

We aim to turn Henkel into a "real-time enterprise." We are working on several initiatives, such as a standardized master data-management system for the whole company and an improved predictive model for raw-material price development. We have just established a Digital Council to coordinate Henkel's digital activities, develop a digital vision through 2020, and explore digital opportunities for our businesses.

Currently, e-commerce plays a minor role for us. Shopping for household items like shampoo or detergent still happens largely offline, and we don't expect this to change substantially in the

near future. Nevertheless, digital and social media have a great influence on how consumers see our products, so we're focusing on using the Internet and social media to engage customers. As an example, we aim to promote responsible use of our products. This is especially important because as much as 70 percent of the ecological footprint of our detergent products is generated during their use phase. On the Persil website, for instance, consumers can learn about reducing the water temperature in their washing machines and saving money at the same time, without compromising the superior performance of Persil.

McKinsey: *Corporate social responsibility and sustainability are topics of growing importance. Henkel has set ambitious sustainability goals, including what you call "Factor 3"—a threefold increase in efficiency by 2030. And you've been recognized by external experts as a leader in sustainability. What lessons have you learned that other companies can also learn from?*

Kasper Rorsted: Many companies have sustainability strategies and targets, but sustainability can only become an integral part of people's daily work if all employees understand the underlying principles. When I am asked how many employees are working on sustainability at Henkel, I always reply: 47,000. Each employee has the responsibility, and each makes a contribution. But in order to do this, they need to know and understand our strategy.

This is why we held workshops on our sustainability strategy for 2030. In these meetings, managers at all levels and their teams developed a sustainability action plan for their own particular areas, defining concrete measures for achieving the targets on the road to Factor 3. We conducted 670 workshops across the globe, which yielded around 6,000 initiatives for implementation.

As one example, our colleagues from Laundry & Home Care developed the idea of supporting employees to become "sustainability ambassadors." These ambassadors go out and talk about sustainability to coworkers, suppliers, customers, and students. They visit schools and hold sustainability classes. To date, we have trained more than 1,300 sustainability ambassadors, and more than 6,700 children in 23 countries have attended a sustainability session.

McKinsey: *Is there anything else you'd like to share with our readers?*

Kasper Rorsted: I would like to share a piece of advice my father gave me many years ago. He told me, "If you do something, do it with your full heart and do it properly. Then you'll be successful." This advice has become my life motto. Whether it's your studies, sports, or your job, if you're not willing to do it with all your energy, you should leave it. Another piece of advice that I've taken to heart: stick to your goals, but be flexible in how you achieve them. o

Klaus Behrenbeck is the leader of McKinsey's Retail and Consumer Packaged Goods practices in Europe, the Middle East, and Africa. He is a director in the Cologne office. Copyright © 2013 McKinsey & Company. All rights reserved.

A multifaceted future:
The jewelry industry in 2020

The trends that have unfolded in the apparel sector over the last three decades appear to be playing out in the jewelry sector, but at a much faster pace.

Linda Dauriz, Nathalie Remy, and Thomas Tochtermann

The jewelry industry seems poised for a glittering future. Annual global sales of €148 billion are expected to grow at a healthy clip of 5 to 6 percent each year, totaling €250 billion by 2020. Consumer appetite for jewelry, which was dampened by the global recession, now appears more voracious than ever.

But the industry is as dynamic as it is fast growing. Consequential changes are under way, both in consumer behavior as well as in the industry itself. Jewelry players can't simply do business as usual and expect to thrive; they must be alert and responsive to important trends and developments or else risk being left behind by more agile competitors.

To chart the most likely course of the jewelry sector, we analyzed publicly available data, studied companies' annual reports, and interviewed 20 executives at global fine-jewelry and fashion-jewelry companies and industry associations. Our research indicates that five trends that shaped an adjacent industry—apparel—over the past 30 years are becoming evident in the jewelry industry as well, and at a much faster pace: internationalization and consolidation, the growth of branded products, a reconfigured channel landscape, "hybrid" consumption, and fast fashion. In this article, we discuss how these trends could affect the future of jewelry and what jewelry companies should do to prepare.

Toko Ohmori

Internationalization of brands and industry consolidation

In the 1980s, national apparel brands were the clear leaders in their respective markets: C&A in Germany, for example, and Marks & Spencer in the United Kingdom. Today, many national brands have been outpaced by international brands such as Zara and H&M. Others have built or expanded their international presence. Hugo Boss's sales outside Germany, for example, grew from 50 percent of its total sales in 1990 to more than 80 percent today. Apparel has become a truly global business.

We expect jewelry to follow a similar path. Today, the jewelry industry is still primarily local. The ten biggest jewelry groups capture a mere 12 percent of the worldwide market, and only two—Cartier and Tiffany & Co.—are in Interbrand's ranking of the top 100 global brands. The rest of the market consists of strong national retail brands, such as Christ in Germany or Chow Tai Fook in China, and small or midsize enterprises that operate single-branch stores.

Our interviewees expect that a handful of thriving national or regional jewelry brands will join the ranks of top global brands by 2020—Swarovski is an oft-cited example. In addition, some local brands will almost certainly become known globally as a result of industry consolidation: international retail groups will acquire small, local jewelers. Some industry observers project that the ten largest jewelry houses will double their market share by 2020, primarily by acquiring local players. And if the apparel industry does indeed hold any lessons for the jewelry industry, incumbent jewelry houses will soon be fighting bidding wars against private-equity players with deep pockets.

The apparel industry is about ten times the size of the jewelry industry as measured in annual sales, but the average M&A deal value in apparel (€12 billion) is almost 20 times that in jewelry (€700 million). That said, average deal value in jewelry has been rising—by a compound annual growth rate of 9 percent between 1997 and 2012, compared with 5 percent in apparel. Recent deals include British company Signet Jewelers's 2012 acquisition of US-based retailer Ultra Diamonds and the Swatch Group's acquisition of Harry Winston in January 2013.

Growth of branded jewelry

Branded items already account for 60 percent of sales in the watch market. While branded jewelry accounts for only 20 percent of the overall jewelry market today, its share has doubled since 2003 (Exhibit 1). All executives we interviewed believe branded jewelry will claim a higher share of the market by 2020, but their views differ on how quickly this shift will occur. Most expect that the branded segment will account for 30 to 40 percent of the market in 2020.

In our research, we identified three types of consumers driving the growth of branded jewelry:

- "new money" consumers who wear branded jewelry to show off their newly acquired wealth (in contrast to old-money consumers, who prefer heirlooms or estate jewelry)

- emerging-market consumers, for whom established brands inspire trust and the sense of an upgraded lifestyle—a purchasing factor quoted by 80 percent of our interviewees

- young consumers who turn to brands as a means of self-expression and self-realization

Exhibit 1   **Branded jewelry is on the rise.**

Branded vs. unbranded jewelry
%

Source: Expert interviews; McKinsey analysis

In the past, most of the growth in branded jewelry came from the expansion of established jewelry brands, such as Cartier and Tiffany & Co., and new entrants such as Pandora and David Yurman. By contrast, future growth in branded jewelry is likely to come from nonjewelry players in adjacent categories such as high-end apparel or leather goods—companies like Dior, Hermès, and Louis Vuitton—introducing jewelry collections or expanding their assortment.

Every jewelry company should seek to strengthen and differentiate its brands through unique, distinctive designs. The trend toward branded jewelry will be especially hard on small artisans, who don't have the marketing muscle of the large jewelry groups. One option for smaller players would be to seek distribution through ventures like Cadenzza, Swarovski's chain of curated multibrand jewelry stores featuring well-known luxury brands as well as up-and-coming designers.

Reconfiguration of the channel landscape

In all major markets over the past decade, online sales of apparel have grown at double-digit rates; in the United Kingdom, for instance, online sales now account for 14 percent of total apparel sales, up from approximately 1 percent in 2003.[1] Our analysis suggests online jewelry sales are only 4 to 5 percent of the market today, with substantial variations across regions, brands, and types of jewelry. Our interviewees believe this number—at least for fine jewelry—will reach 10 percent by 2020 and won't grow much beyond that. Their rationale: most consumers prefer to buy expensive items from brick-and-mortar stores, which are perceived as more reliable and which provide the opportunity to touch and feel the merchandise—a crucial factor in a high-involvement category driven by sensory experience. As for fashion jewelry, our interviewees predict a slightly higher online share of sales, in the neighborhood of 10 to 15 percent by 2020. The bulk of these sales will come from affordable branded jewelry, a

[1] *E-Retail in the UK,* Verdict, September 2, 2012.

somewhat standardized product segment in which consumers know exactly what they're getting.

Jewelry manufacturers can use digital media as a platform for conveying information, shaping brand identity, and building customer relation-ships. According to a recent McKinsey survey, two-thirds of luxury shoppers say they engage in online research prior to an in-store purchase; one- to two-thirds say they frequently turn to social media for information and advice.

The offline landscape is also evolving. In apparel, monobrand stores have been gaining ground at the expense of mail-order players and some multibrand boutiques; department-store sales are stagnating (Exhibit 2). The same is happening in jewelry. Pandora, for example, quadrupled the size of its store network in just four years—from 200 locations in 2009 to more than 800 in 2012. In 1990, there were just 2 Swarovski boutiques; by 2012, there were 860.

Jewelry players might consider focusing on mono-brand retail, which gives them more control over their brands, closer contact with consumers, and higher margin potential. Another potentially promising channel is multibrand boutique chains that provide a carefully curated assortment of brands and products as well as a unique shopping experience—which is what the aforementioned Cadenzza store concept aims to provide. To achieve sufficient margins, however, such concepts may need to operate on a global scale.

Polarization and hybrid consumption

In apparel, both the high and low end of the market are growing—while the middle market stagnates. High-end apparel players have been able to create a substantial premium: our analysis shows that a Gucci suit that cost €1,200 in 2000 now sells for €1,700, rather than the €1,300 one would expect based on inflation. At the same time, mass-market prices have dropped: an H&M suit that cost €106 in 2000 now sells for €103, not the €119 that inflation rates would lead us to expect.

In part, this development has been brought on by consumers' tendency to trade up and down at the same time. The jewelry industry is starting to see evidence of this hybrid consumption. One of our interviewees observed that in some parts of the world, more people are trading up from what some consider to be the standard one-carat diamond engagement ring to two, three, or four carats—with five- or even six-digit price tags. At the lower end of

---

Exhibit 2

The channels that are gaining share in jewelry are also winning in apparel.

	Monobrand stores	Multibrand boutiques	Department stores	Online shops	Other
Jewelry trends, 2013–20	⬆	⬇ ⬆	➡	⬆	⬇
Apparel trends, 1990–2013	⬆	⬇ ⬆	➡	⬆	⬇
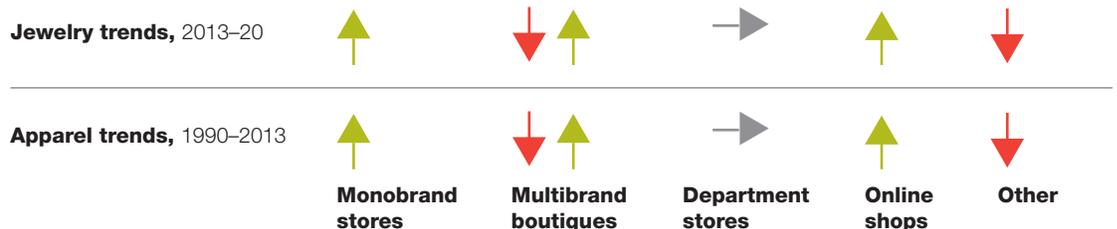
Source: McKinsey analysis based on data from Euromonitor and Mintel

the market, however, department stores and other general retailers are waging price wars.

Furthermore, the previously clear-cut boundaries between fine jewelry (characterized by the use of precious metals and stones) and fashion jewelry (typically made of plated alloys and crystal stones) are starting to blur. For example, fine jewelry used to be almost exclusively a gift purchase, but today's consumers are buying higher-end items for themselves. Some fine jewelry is available at bargain prices: Tchibo in Germany sells gold diamond rings starting at €99. On the flip side, brands such as Lanvin and Roberto Cavalli sell fashion jewelry for thousands of euros.

Industry insiders expect that segments will increasingly be defined by price points and brand positions rather than purchase and wearing occasions. One of our interviewees put it as follows: "We encourage our customers to layer and mix high and low price points, and just go for it—to do what they're doing with apparel." In this spirit, actress Helen Hunt paired $700,000 worth of Martin Katz jewelry with an H&M dress at the Academy Awards in 2013.

In light of this trend, fine jewelers might consider introducing new product lines at affordable prices to entice younger or less affluent consumers, giving them an entry point into the brand. Alternatively, fine-jewelry players could decide to play exclusively in the high end and communicate that message strongly through its advertising, in-store experience, and customer service. A brand like Harry Winston, for instance, is very clear about what it stands for; a lower-priced offering would be dissonant with its image and dilute its brand.

Fashionability and acceleration

Over the last two decades, "fast fashion" has revolutionized the apparel industry. This trend is characterized by two factors.

The fashionability of everyday apparel.

Clothes inspired by haute couture are now available at bargain prices faster than ever before—sometimes within days of a fashion show. Mass-market retailers sell items that look like they're fresh off the catwalks of Paris, Milan, London, and New York. Additionally, large retailers are teaming up with top designers: Gap worked with Stella McCartney, for instance, and H&M with Karl Lagerfeld. There is also a constant information feedback loop from the stores and the streets that helps manufacturers and retailers reflect the latest trends in their merchandise. Zara, for instance, has reporting systems that allow store staff to regularly send feedback to headquarters—anything from "the sleeves on this jacket are too long" to "our customers don't like to wear yellow."

An acceleration of supply-chain processes.

Fast-fashion players have dramatically shortened time to market: new products can go from concept to shelf in a month. Stores receive a continuous stream of fresh merchandise—as many as 12 themes each year.

Fast fashion started in the affordable-clothing segment in the mid-1990s, led by the likes of H&M, Zara, and Topshop. It has recently spread to higher-end brands: Coach, Diesel, and Juicy Couture, to name a few, have introduced "flash programs" and a greater number of collections per year.

Fast fashion is well established in developed markets—in the United Kingdom, for instance, it already accounts for 25 percent of apparel sales and its growth may be flattening—but it has just arrived on the scene in emerging markets and will almost certainly experience explosive growth there. The combined market share of fast-fashion players in China totals only about 3 percent today, but the number of Zara stores in China grew 60 percent every year between 2007 and 2012, compared with only 3 percent in the United Kingdom.

Fine jewelry has so far been immune to the effects of fast fashion, but the same can't be said of the fashion-jewelry market. An example of fashionability: H&M, as part of its guest-designer collaborations, introduced a flamboyant jewelry-and-accessories collection by *Vogue Japan* editor Anna Dello Russo in December 2012, with item prices ranging from €20 to €300. And an example of acceleration: Beeline, a German branded-jewelry player, is adding hundreds of new items to its assortment every month—an unheard-of pace in an industry where two collections per year is standard.

In the fast-fashion world, flexible companies with adaptive business systems reap disproportionate rewards. Innovative jewelry players will emulate fast-fashion apparel companies: they will react to trends quickly and reduce their product-development cycle times. Doing so will require closer collaboration with partners along the entire value chain, from suppliers to designers to logistics providers.

●   ●   ●

The evolution of the apparel industry provides an interesting template for how the jewelry industry might develop. To what degree the two industries will mirror each other remains to be seen, but it seems likely that the jewelry market of 2020 will be highly dynamic, truly globalized, and intensely competitive. Those jewelry companies that can best anticipate and capitalize on industry-changing trends—particularly the five described above—will shine brighter than the rest. ○

Linda Dauriz is a principal in McKinsey's Munich office, **Nathalie Remy** is a principal in the Paris office, and **Thomas Tochtermann** is a director in the Hamburg office and the leader of McKinsey's Apparel, Fashion, and Luxury Group in Europe.

Capturing the full potential of design to value

The design-to-value approach can help consumer-goods companies boost sales and profitability—but rolling it out across an entire product portfolio is no easy task.

Søren Fritzen,
Heiko Nick, and
Jan Wüllenweber

In today's increasingly competitive environment, consumer-packaged-goods (CPG) manufacturers must balance a careful focus on their customer and consumer value proposition with tight control over costs. To achieve both simultaneously, some CPG companies are implementing design to value (DTV), a portfolio-optimization approach that helps them understand precisely which product features are important to consumers and whether consumers are willing to pay for those features. Insights from DTV often lead to altered ingredients, recipes, packaging, or shelf presentation, but they can also spur changes in supply-chain processes and logistics. Unlike

the better-known (purely cost-focused) design-to-cost method, DTV can result in either cost reductions or cost increases; it taps into the potential to raise prices or sales volume by designing products that better reflect customer preferences. Well-executed DTV projects can yield margin improvements of three to ten percentage points.

DTV, however, can be difficult to implement. Many programs founder during their early stages, and even more lose momentum as companies try to expand their efforts across geographies and product categories. In this article, we describe the

Keiko Morimoto

obstacles that often hinder CPG companies from enjoying DTV's full benefits and put forward solutions that have generated quantifiable impact. We also discuss the various phases of the DTV journey, from start-up to rollout.

Success factors for managing DTV at scale

We've found that the most successful large-scale DTV programs have four factors in common: a clear vision set by top management, effective cross-functional governance, standardized tools and processes, and a dedicated working team.

A vision from senior leadership

At some CPG companies, middle managers from individual functions design initiatives independently, without any input from other groups. The procurement team of a branded-food manufacturer, for instance, launched an initiative to decrease complexity by reducing the number of seasonings in its products—a change that would lower costs but create no discernible difference in flavor. But when the product-development group learned of the initiative, it objected, claiming that wider ingredient variety was essential for product differentiation. The processing group, for its part, maintained that there was insufficient technical support to embark on a large-scale reformulation effort. Faced with this resistance, a budding DTV effort stalled.

Top management can avoid such problems and align functions across the organization by developing and communicating a clear vision for the DTV program. Leaders can make that vision actionable by setting ambitious targets (for example, margin improvements of ten percentage points across the portfolio) to

challenge teams and force them to think creatively and by defining concrete action plans with timelines (for instance, analysis of 80 percent of core products within 18 months) and specific responsibilities for each function. Senior management would then need to ensure that all functions adhere to the DTV vision, perhaps by holding monthly progress reviews.

Cross-functional governance

Lack of cross-functional alignment isn't just a problem during the design phase of DTV, when program goals are set; it can also hinder implementation. Without an overarching agenda or a coordinated timeline, one or more functions might fall behind on DTV work, potentially jeopardizing interdependent projects. In some instances, functions could lose sight of program goals and execute one-off initiatives that don't contribute to the desired impact.

Therefore, companies should consider creating a governance body for their DTV efforts. This entity would include managers from all relevant functions—including R&D, marketing, procurement, finance, manufacturing, and product development—and, when appropriate, business-unit representatives. The governance body has an important role to play early in the DTV process, both by ensuring that the company generates enough high-impact ideas in its priority areas and by selecting the ideas to be implemented.

As DTV efforts progress, the governance body would monitor performance; help resolve any conflicts among functions, emphasizing the importance of finding feasible solutions that deliver the best value for consumers; and ensure

A governance body can help build a sense of
ownership within functions and business units,
and counter a 'not invented here' mind-set.

that important projects receive sufficient funding.
If it appears that a function cannot feasibly
support a DTV effort and should discontinue it,
ideally the function would do so only with the
governance body's permission.

Members of the governance body can also maintain
momentum by serving as DTV "ambassadors" to
each of the functions and business units, helping to
build a sense of ownership within the groups and
counter a "not invented here" mind-set, which can
be highly detrimental to a DTV program's success.

Standardized tools and processes

At many CPG companies, each functional group
selects its own tools or processes for designing,
tracking, and evaluating DTV activities. The
marketing and product-development groups, for
instance, may use different tools or approaches
for assessing which product features are most

important to customers. The lack of a common
language makes alignment and collaboration
difficult; one function may not understand
another's analytical approach or results.

Best-practice CPG companies use standardized
tools and processes across the organization.
These include comparative teardowns to
systematically analyze competitor products;
clean-sheet cost-modeling techniques to build
a detailed understanding of product-cost
structures; and a combination of surveys, focus
groups, mystery shopping, and conjoint analysis
to generate retailer and consumer insights.

As CPG companies develop new tools, they
will often need to invest in essential infra-
structure and equipment, including laboratories
for comparing and benchmarking products
or producing test batches. In addition, CPG

companies should create work environments that are conducive to the cross-functional interactions required to make difficult trade-offs in design and implementation. One food manufacturer established team rooms containing samples of all relevant products—including those of competitors—so that teams could engage in insightful discussions about the appearance, smell, texture, or taste of the actual items, rather than just offer hypothetical musings based on photographs.

Dedicated DTV teams

Many companies fail to allocate enough employees to DTV projects. A dearth of creative thinkers early in the project may result in an insufficient number of high-impact, feasible ideas; a shortage of technically competent staff may jeopardize rollout. The problem isn't usually a lack of in-house talent—it's that the functions or business units are reluctant to release people from their daily responsibilities to work on DTV.

Some companies have solved this through a top-management mandate creating core DTV working teams for key product categories, and ensuring that these teams remain intact for the duration of DTV projects. As with governance bodies, these teams should include experts from sales, marketing, R&D, purchasing, manufacturing, and finance. Ideally, team members will be collocated in a DTV lab and devote the majority of their time to DTV. Team members should adopt a collaborative mind-set and take a broad view of DTV initiatives, focusing on the benefits to the company as a whole rather than to specific functions. Controllers can question product packaging, for example, and R&D engineers could contribute ideas about product positioning.

Expanding DTV efforts across the portfolio

A successful DTV program can yield improvements across the value chain. One branded-food manufacturer used DTV to reduce a product's ingredient costs and create a flavor profile that more closely corresponded to customer pref-erences. Simultaneously, the company made changes that reduced packaging costs by 15 percent, increased shelf life, and reduced the supply chain's carbon footprint. Overall, the company increased its absolute contribution margin by about eight percentage points.

But it takes time for DTV efforts to generate such results. Although many companies will see benefits from DTV after only a few months, it typically requires two to three years from start to finish, including embedding the approach across the product portfolio. In our experience, successful DTV projects generally proceed through three phases before producing their full impact: start-up, idea generation, and rollout.

During the start-up phase, typically three to six months long, the company establishes the basic organizational and management structure for DTV and develops the necessary technical skills and tools while working with a few core products. One CPG company spent the first weeks of its DTV project compiling data (on target positioning in the market, customer perception, list prices, promotional prices, and a variety of other topics), calculating costs and revenue margins for each product, determining a solid cost baseline, and conducting market research. This brief but intense data-gathering period created a solid foundation for idea

generation. After a successful pilot in one part of the value chain, teams can apply the new tools across the entire value chain of the selected products.

Once a company gains confidence in its DTV technology and infrastructure, the idea-generation phase—usually a six- to nine-month journey—begins. Teams apply the approach to a greater number of products and start using more sophisticated tools across the value chain, expanding their efforts to include processes that occur at supplier sites. For instance, a food company had previously communicated with suppliers only during commercial negotiations and new-product-development efforts. But during a DTV initiative, it held workshops with current and potential suppliers to discuss cost-reduction strategies and product enhancements. Suppliers that refused to attend the workshops were replaced. At one workshop, a potential supplier proposed new, lower-cost specifications for all meat products—speci-fications that would have no effect on the product

features that consumers valued. The food company implemented the new specifications. Ultimately, its DTV effort generated a reduction in production costs that was four times higher than what the company had achieved through conventional cost-reduction methods the previous year.

The rollout phase—during which the company applies the DTV approach across the majority of the product portfolio and fully integrates DTV tools and processes into its day-to-day business—takes 12 to 24 months, depending on the number of products and categories involved and whether DTV initiatives are conducted sequentially or in parallel.

●　　●　　●

DTV is not a quick fix for CPG companies facing acute problems, but it can help them design products that consumers want while optimizing costs—thus boosting both sales and profitability on a sustainable basis. As they embark on DTV efforts, companies must not overlook a critical element of any DTV program: rigorous training and capability building that extends across the organization and involves larger numbers of employees as the project progresses. Training helps address the greatest challenge of DTV by permanently embedding the philosophy and approach into an organization's DNA and its daily activities. ○

The retailer as technology company

In this article, adapted from their recently published book, *Reshaping Retail*, the authors assert that digital technology must be at the center of every retail organization.

Marco Catena,
Stefan Niemeier, and
Andrea Zocchi

The modern retail system has worked to dazzling effect. Since the 19th century, store owners have emerged from humble beginnings and created an industry in which some retailers have become nationally or even globally dominant. Their expansion was propelled by the lowering of tariff borders and the exponential growth of international trade of consumer goods. Better production techniques, communications, and information technology enabled efficiency gains and reinforced a virtuous cycle of lower costs and lower prices. Along the way, savvy operators turned retailing into an impressive combination of art and science. Today, retailers in emerging markets appear to be living out the story all over again, except on a scale and at a speed beyond anything we have seen before.

Given this history, it can be hard for retailers to accept that the industry as they know it is living on borrowed time, on the brink of transformation. But it has become clear during the course of our research that the retail industry is in the grip of a revolution powered by digital technology. This revolution may be as dramatic in its effects as the mercantile revolution that saw the birth of retailing and the Industrial Revolution that kicked off the modern era.

Toko Ohmori

The many interviews we conducted with industry executives and experts confirmed both the urgency with which conventional store-based retailers must now act and the extent of the challenges this revolution represents in strategic, organizational, and, above all, technological terms.

Technology has long underpinned retail operations, so why is today any different? The main reason is that technological innovation hitherto has served primarily to help retailers do what they have always done, but better. Retailers have become ever more powerful intermediaries between suppliers and customers, able to operate at ever greater scale. Today's technology, however, threatens that power—and thus the entire business model.

Since the Middle Ages, retailers have relied on what is largely a "push" system of stock movements. The retailer (be it a merchant with a horse or the operator of a nationwide supermarket chain) anticipated consumer demand, selected the goods to meet that demand, and arranged for those goods to be delivered to a place where people would buy—first the village market, then dedicated stores. Technology did not interfere with this process; it simply made the process more efficient.

All this is changing. Advances in computing power, storage capacity, and network connectivity are driving three parallel and mutually reinforcing trends that will define the digital era of retailing: mobility, measurability, and agility. The first trend, mobility, is powered by the availability of technology everywhere: in stores, at home, on the go. Measurability will allow for far more activities in the value chain, not least consumers' behavior, to be tracked more closely and quantified more accurately. And agility will come from the development of cloud computing, which enables companies to develop systems quickly and easily.

The technology behind these trends will help retailers improve their processes and create new experiences for customers to a degree previously unimaginable. It will also usher in new competitors and empower customers. Every retailer will have to contend with the power that now lies in customers' hands. New technologies have put an end to the information asymmetry between retailers and their customers. Consumers can browse, choose, buy, and receive products, all without entering a store.

But it is not all bad news for retailers—far from it. Consumers will still want to visit stores for many of the same reasons they already do: convenience, the social experience, and the ability to buy cheap goods (yes, we believe that even in a digital world, some store-based retailers will be able to match the prices of online rivals on certain goods). But retailers will have to put the customer at the center of the business model. This goes beyond customer care. It is customer centricity. Everything in the operating system—pricing, promotions, assortment—should be informed by customers' needs, recorded in real time. In some respects, customer centricity will mean a return to the kind of thinking that prevailed when owners of small stores bought the merchandise they knew individual customers would like. Retailers sacrificed this intimacy in favor of scale, as technology emerged to help them run complex operations more efficiently. Now they have to manage both intimacy and scale.

Retailers will have to put the customer at the center of the business model. This goes beyond customer care. It is customer centricity. Everything in the operating system should be informed by customers' needs.
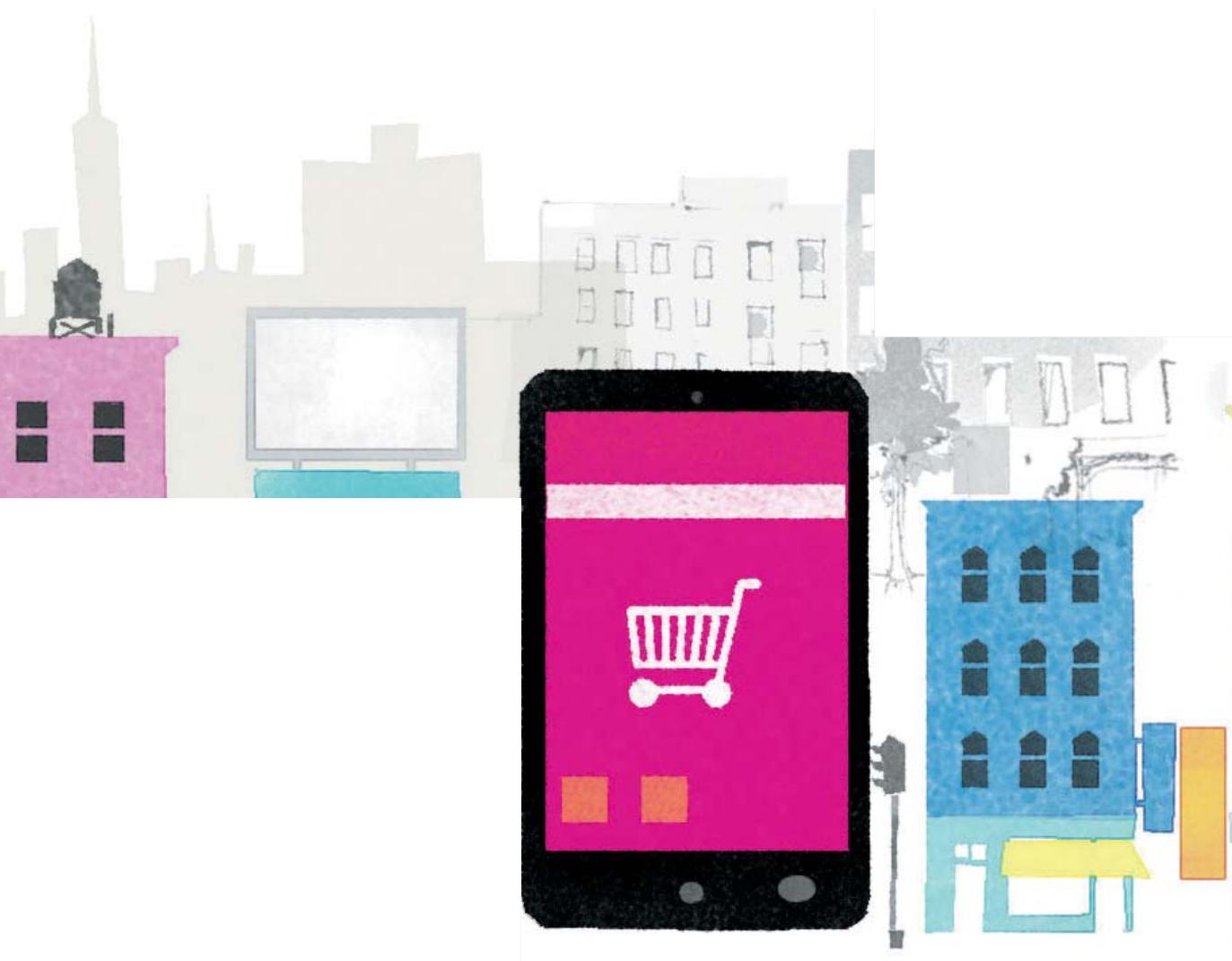
In light of these developments, all sorts of retail skills and practices—some unchanged for a century or more—are fast becoming irrelevant or insufficient for success. Perhaps most difficult for many store-based operators will be the new technology requirements. Organization-wide fluency with technology will be a critical success factor for retailers everywhere, and the robustness and flexibility of their IT systems and the transparency and ease of use of their digital interfaces will become as important as traditional aspects of retailing such as location, store format, or in-store promotions.

Ultimately, success will hinge on more than competence; it will come down to a way of thinking. Customer centricity will need to be valued not just by the store owner but by all employees in the organization; it will need to become embedded in their daily tasks. Technology must be at the center of the organization and recognized as such by everyone. As one senior executive of a global online retailer told us, "If I were forced to choose, I'd say we were a technology company rather than a retailer." Retailers will, in essence, need to change their DNA—a transformation that needs to start now. o

Marco Catena is an associate principal in McKinsey's Milan office, where **Andrea Zocchi** is a director; **Stefan Niemeier** is a director in the Hamburg office.

How to mobilize 20,000 people

Retailers that "lean out" their store operations often find that store employees soon revert to old—and less efficient—processes. Here's how to make new behaviors stick.

Stefan Görgens,
Steffen Greubel, and
Andreas Moosdorf

Over the past decade, many retailers have introduced "lean" techniques into the store environment. And they've done it for good reason: lean store operations can yield significant results—typically a 5 to 10 percent increase in sales, a 15 percent reduction in operating costs, and as much as a 30 percent decrease in inventory costs.

But most retailers, even those well acquainted with lean principles, struggle to sustain the impact of their lean-retailing efforts. According to a recent McKinsey survey of retail managers, 60 to 70 percent of store-transformation programs ultimately fail. In service operations like retail, change must be implemented by many people—as many as tens of thousands

of employees. And when frontline workers have become accustomed to replenishing shelves in a particular way or when store managers have done personnel planning on their own for a decade or longer, making new behaviors stick can be extremely difficult. People tend to revert to old behaviors when they don't fully understand either the problem or the solution, when they're not held accountable, or when they don't see others consistently behaving in the new ways.

As we've worked with leading retailers worldwide, we have identified common mistakes that retailers make in their lean-transformation efforts, as well as a set of practices that can yield significant, lasting impact. These practices, which revolve around building an inclusive core

team and pulling the critical levers that influence mind-sets and behaviors, may sound simple and obvious—but, in our experience, many retailers either execute them haphazardly or overlook them entirely.

Building a core team

From the very beginning of a lean transformation, employees at every level of the workforce—from regional managers to store associates—must feel they have a voice in the project and can contribute to shaping the solutions. Employees' early involvement helps create the conviction, momentum, and passion to effect change.

Too many retailers make the mistake of imposing solutions developed by a small, exclusive team from corporate headquarters. A better approach is to establish a core team that includes handpicked store managers, district managers, and staff from the central functions, so that every part of the organization is represented from day one. This team of high performers should remain intact for the duration of the effort.

Retail executives may object that the size of such a team would be unmanageable and would slow down decision making (as the example in Exhibit 1 shows, 16 people were on the project team in phase one). Experience has convinced us, however, that the trade-off is worth it. A larger, cross-functional team may add complexity at the start of the project, and achieving alignment may initially take longer—but these risks are a small price to pay for the cocreated solutions and

Exhibit 1

A large, cross-functional project team helps generate feasible solutions and company-wide buy-in.

EUROPEAN RETAILER EXAMPLE

Phase	Number of employees involved	Members of project team	Duration (weeks)	Description
0	3	3	4	• Setup of project
1	26	16	5	• In-store diagnostics • Validation of observations through workshops
2	51	27	8	• Development of target concept and rollout strategy • Structured review with key stakeholders • Proof of concept
3	~200	74	12	• Preparation of implementation • Training of coaches
4	~2,400	74	5	• Project kickoffs with all levels of organization
5	~24,000	74	35	• Intensive coaching of store and district managers • Coaching of store employees

organization-wide buy-in that a more inclusive team can generate.

A core team consisting of employees from both the store network and central functions can make better-informed decisions and develop realistic, pressure-tested solutions. For example, at one grocery retailer, store personnel who were on the core team suggested presorting and packaging certain products in a way that would reduce shelving time at the stores. Managers from corporate headquarters were able to weigh in during the discussion: they explained that the goods were stocked in different locations in the main warehouse and therefore couldn't be packaged together without incurring substantial warehouse costs. The team thus came up with a different, more cost-effective solution.

At another retailer, store employees had to use three different formats of price tags, one of which required six times the handling effort of the other two. A team consisting of store employees and marketing experts was able to develop a new price-tag format that had comparable visibility but required much less handling effort—leading to a 10 percent improvement in the efficiency of the overall price-tagging process.

An additional benefit of a large core team is skill building. Store managers who become part of the core team get the opportunity to learn and hone valuable management skills such as how to run analyses, document findings, track performance, and oversee multipart projects. We often find that retailers are pleasantly surprised at the potential they discover in their store managers.

Creating lasting change

Once the core team is up and running, the hardest part begins. Among the team's primary responsibilities should be to see to it that

every individual in the organization makes the necessary changes in mind-sets and behaviors. To do this, they must pay attention to four levers: organization-wide communication of the need for change, formal mechanisms that reinforce the desired changes, a well-designed capability-building program, and role modeling (Exhibit 2).

Communicate the need for change

Most retailers already know that communication is critical to the success of an organization-wide effort. They therefore kick off their trans-formation programs by hosting town-hall meetings, large workshops, or road shows led by senior management; top executives champion the effort in staff meetings and in employee newsletters or internal blogs.

Such activities are important—but we've seen many retailers simply communicate the change, instead of the need for change. They hold pep rallies to build excitement about the change and then send out detailed technical descriptions to help employees implement the new processes. But these types of communications rarely convince the workforce that change is necessary. Why were the old ways suboptimal and how are the new ways better? Without an articulation of the need for change, a lean transformation could be dismissed by employees as a "flavor of the month" or a vain attempt by a CEO to bring about change for change's sake.

The most successful retailers make sure to dis-seminate carefully constructed, persuasive messages about the pain points that the lean transformation is designed to address, the virtues of the proposed solutions, and the expected measurable impact. They craft a "change story" that every employee can relate to. One retailer's change story centered on the

Exhibit 2   **Successful rollout of lean-retail programs requires close attention to four levers.**

Examples of specific interventions

Communicate the need for change
- Create a "change story"
- Use a variety of communication formats and channels

1

Reinforce with formal mechanisms
- Develop a rigorous certification program
- Link incentives to program targets
- Determine escalation process and personnel measures in case of missed targets

Mind-set and behavior change

4

Role model the desired behaviors
- Ensure that senior leaders are visible as role models
- Make no compromises in selection and training of coaches
- Highlight success stories

2

Invest in capability building
- Employ a training approach that blends theory, practice, and assessment
- Provide supporting materials to store managers to help them train their employees

3

company's successful history, recent shifts in the competitive and consumer landscape that made "business as usual" a losing proposition, and the company's responses to those shifts. The CEO told the story on day one of the transformation and company leaders repeated it constantly for the duration of the effort, linking every initiative back to it. The company used a variety of communication formats and channels—including in-person meetings, an employee-suggestion scheme, print and electronic newsletters, and posters—to reach employees regardless of their communication preferences. According to senior executives at the retailer,

the change story helped create strong employee commitment to the transformation program, a sense of urgency and conviction around the need for change, and widespread support for the program's individual measures.

Set up formal reinforcement mechanisms
To help ensure that frontline employees are executing improvement measures correctly and consistently, retailers should establish reinforcing mechanisms—including a strict certification process that assesses various dimensions: understanding (do employees understand the need for change and the new processes?),

implementation (are the new processes in place and are all required tools available?), and impact (are the new processes meeting predefined targets?).

Typically, retailers' certification programs take into account only implementation and impact—neglecting the "understanding" part, which, as discussed earlier, is crucial to surfacing implementation issues and sustaining impact. One retailer has made district managers and regional managers responsible for the certification process: they conduct store checks and in-person interviews with store employees. The interview questions are designed to probe employees on not only what the new processes are but also why they use the new processes.

In some cases, a retailer's certification program isn't as effective as it could be simply because it's used only once: immediately after rollout. Store employees tend to perform well during that time, but without continued accountability, the likelihood of employees returning to old behaviors is high. Smart retailers do multiple certification rounds to reinforce the desired changes: immediately after rollout, then three months later, then again a year later.

In addition, leading retailers link employee incentives, such as pay raises and bonuses, to certification results—making it clear to all employees that there are rewards for getting certified individually and as a store staff, as well as consequences for failing to get certified or for missing targets. The core team agrees on an escalation process and personnel measures to take in the event that targets are missed.

Invest in a capability-building program

Many retailers zero in on one question during lean-retail projects: "Which operating procedures are the best for us?" Once they've identified those procedures, their attention level falls and they end up underinvesting in training the workforce to put those new procedures in place. In our view, the more important question is, "How can we mobilize our entire workforce to adopt the best operating procedures?"

The most advanced retailers employ a blended approach to training—one that combines classroom-style learning with practical application and rigorous assessment. We've found that the ideal training mix is roughly 20 percent theory, 70 percent practice, and 10 percent assessment and evaluation. To train cashiers on a new checkout process, for example, 20 percent of training time could be spent explaining how the new process differs from the old one, what problems it is meant to solve, and exactly how it solves them. Some companies, to guard against the common problem of store managers feeling ill equipped to train store employees, create detailed how-to manuals and training handbooks. One retailer used colorful comic-strip illustrations to show a new shelf-stocking process (Exhibit 3).

The bulk of training time could then be devoted to in-store application of the new processes—for example, cashiers practicing new procedures on cash registers at checkout lines. Our experience has taught us that training store employees outside the store environment (at off-site sessions, for example) has little value. A more effective practice is to designate a handful of "training

Exhibit 3   **Visual aids can be helpful in explaining new store processes.**

1

4 PM: time to go into the storage area and select the item cart for the sales gondola. Do I need to presort? If so, it would be best to do it in the storage area. Are price tags and promotional signage there?

2

What goes where? The item cart with new products is on the left, the empty cart with separated trays goes on the right, and the cardboard cart is across from the sales gondola.

3

Empty the sales gondola: put old sales items on the empty cart. Sort by aisle! Old price tags go in the trash!

6

Clean up! Bring the remaining new items to the proper place in the storage area. When needed, empty the cardboard cart.

5

Is everything arranged perfectly? Are the items snug with shelf edge, and are price tags and promotional signage in place? Bring the empty cart to the next gondola. Is it full? Then you can just put away the goods!

4

Attach new price tags and build the gondola. Make sure to clean the shelves first.

stores"—ideally, stores that are representative of the store network, conveniently located and easily accessible to most employees, and spacious enough to accommodate trainees from other stores.

Training sessions should be fairly small to allow for thorough coaching. One retailer put two "change agents"—typically members of the core transformation team—in charge of training groups of ten employees at a time, for a trainer-to-trainee ratio of one to five. Some retail executives

might worry that such an approach to coaching would take too long, but again, our experience shows that the investment pays off quickly and is crucial to making the changes stick.

Additionally, assessment and evaluation are an indispensable part of a complete training program. We have seen retailers use a variety of tools—including activity boards, checklists, skill matrixes, and individual coaching plans—to help employees know where they stand and how they can improve. Some retailers use daily

briefings for live problem solving, allowing employees to discuss performance and deter- mine corrective actions. Regular check-ins among leaders of rollout teams, as well as specialized workshops to address particular issues, can also be tremendously useful.

Model the desired behavior

Role modeling, whether by higher-ups or by peers, is a powerful lever for changing mind-sets and behaviors. Store managers should consis- tently use the new processes and reward and recognize store employees who behave in the new ways. Regional managers and district managers should visit stores frequently, using these visits not to conduct store audits but primarily to provide coaching on the new processes. Senior executives should drop in on stores as well; their in-store presence can motivate staff and reinforce new behaviors.

Perhaps the most visible role models in a lean transformation are the change agents and coaches responsible for training the store staff. The caliber of these coaches can make or break a lean-retail program. The most successful retailers don't compromise in this area; they select their most talented employees as coaches,

even if it means temporarily taking those employees away from their day-to-day duties. And they don't skimp on the time it takes to train the coaches.

Individuals can serve as role models, but so can entire stores or clusters of stores. For some retailers, digital and social media have been effective tools for highlighting best practices and disseminating success stories across the company. On intranets, internal blogs, or message boards, announcing the achievements of an employee, store, or region can build buzz, establish role models, and engender friendly and healthy competition.

•   •   •

Some of these practices may sound time- consuming, but in our experience, rolling out lean operations to a network of hundreds of stores and tens of thousands of employees can take less than two months. And with a cross- functional core team in place and deliberate attention to the most important change levers, retailers can prevent employees from falling back into old habits. Results can thus be sustainable in the long term. ○

Stefan Görgens and **Andreas Moosdorf** are associate principals in McKinsey's Cologne office; **Steffen Greubel** is a principal in the Berlin office. Copyright © 2013 McKinsey & Company. All rights reserved.

Pinpointing the markets with the highest growth potential

Udo Kopka, Stefan Rickert, and Markus Schmid

A new tool called Cityscope Navigator helps companies identify which cities and product categories will yield the highest returns on investment.

Most of the world's consumers live in urban centers. Today, 70 percent of global consumption can be attributed to the 2,400 largest (of more than 200,000) cities worldwide. By the year 2020, the 100 most populous cities alone could account for 30 percent of global consumption.

As one might expect, cities in emerging markets contribute the lion's share of consumption growth. But these cities are all growing at different rates, some much faster than others. To make the best decisions about which markets to prioritize, consumer-goods companies must be able to determine which cities—or groups of cities—are growing the fastest, and which ones will yield the highest returns on investment. Somewhat surprisingly, a number of cities in developed markets, including Western Europe and the United States, are growing as rapidly as those in emerging markets. Companies that ignore these cities could be missing out on opportunities very close to home.

Market prioritization is made even trickier by the fact that within a city, product categories follow different growth trajectories. For example, in Moscow, the estimated real growth in the juice category in the 2010–20 period is 5.4 percent, compared with only 1.6 percent in soda. Again, to make the best investment choices, companies must accurately predict critical inflection points for particular products in particular markets.

But most consumer-packaged-goods (CPG) manufacturers lack accurate, detailed market information to help them make such predictions. Information sources are fragmented and often inadequate, with many relying on historical data rather than forward-looking statistical analyses. How, then, can companies identify the markets in which the demand for their products will be strongest? How can they increase their chances of selling the right products in the right markets at the right time?

McKinsey's Cityscope capability can help. Cityscope represents a range of proprietary databases, models, and analytic tools that help clients gain granular perspectives on their markets in over 2,400 of the world's largest cities. One of these tools, Cityscope Navigator, enables a fact-based approach to prioritizing growth markets for 45 consumer-goods categories and developing market-entry strategies. By combining historical data on consumers and product categories with socioeconomic indicators, statistical consumption-growth analyses, and insights into local markets, Cityscope Navigator estimates market potential to the year 2020, by city and by category.

Debunking myths about growth

For much of the past 20 years, the discourse on growth markets has centered on the BRIC countries: Brazil, Russia, India, and China. With competition in these markets intensifying, some companies have shifted their focus to other regions of the world, such as Africa and elsewhere in Asia and Latin America. Everywhere, however, competition and high capital require-

ments are making it increasingly difficult to achieve growth and create value through geographic expansion, making it crucial for companies to take guesswork out of their expansion plans. A more granular look at metro markets around the globe reveals where the most promising opportunities lie— and clears up widespread misconceptions.

'Western Europe isn't a growth market'

Most CPG companies have had very low expectations for growth in Western Europe. They've long seen the market as a battle for distribution, where they must secure placement for their products in the fastest-growing retail channels just to maintain their share of a pie that isn't getting any bigger. But this no-growth (or, at best, low-growth) picture isn't entirely accurate. Cityscope Navigator data indicate that between 2010 and 2020, certain product categories—including fruit juices, ready-made meals, and skin-care products—will grow at almost twice the rate of overall consumer spending in Western Europe. Companies can thus generate above-average growth in the Western European market not only by taking market share from competitors but also by making targeted investments in high-growth categories.

Cityscope Navigator further supplements this category perspective with the geographic dimension. The beer category illustrates the power of granular analysis: average consumption growth in Western Europe from 2010 to 2020 is estimated at 0.2 percent, but in a few cities, such as Dublin and Oslo, the projected growth rate exceeds 1.5 percent.

Like Western Europe, the United States has pockets of rapid growth, with some categories expanding at two to three times the national average in certain metropolitan areas. The nominal growth of baby food in Orlando, Florida, for instance, is around 6 percent—comparable to the rate of growth in Mexico City.

'It's too late to enter China or India'
Some companies have written off China and India as unrealistic expansion opportunities; they feel their capital base is insufficient for credible entry into these markets, or that the competitive environment in these countries has already gotten too tough for new entrants to break in. But companies shouldn't dismiss these markets outright. Instead, they should ascertain whether building a presence in only a few select cities is a viable option.

For product categories in which minimum scale requirements are low, even limited entry into China or India can yield returns equivalent to—or higher than—countrywide coverage in other emerging markets. The market for juices in Shanghai alone, for instance, will grow three times as fast in absolute terms as in all of Malaysia. Furthermore, many cities in China and India are continually upgrading to a modern retail and distribution infrastructure, making market entry less complex than it would be in remote or rural areas.

'Emerging-market consumers don't buy premium products'
As they venture into emerging markets, many international CPG companies choose to sell only simple products that meet basic needs. And with good reason: fast-moving categories such as soft drinks and laundry
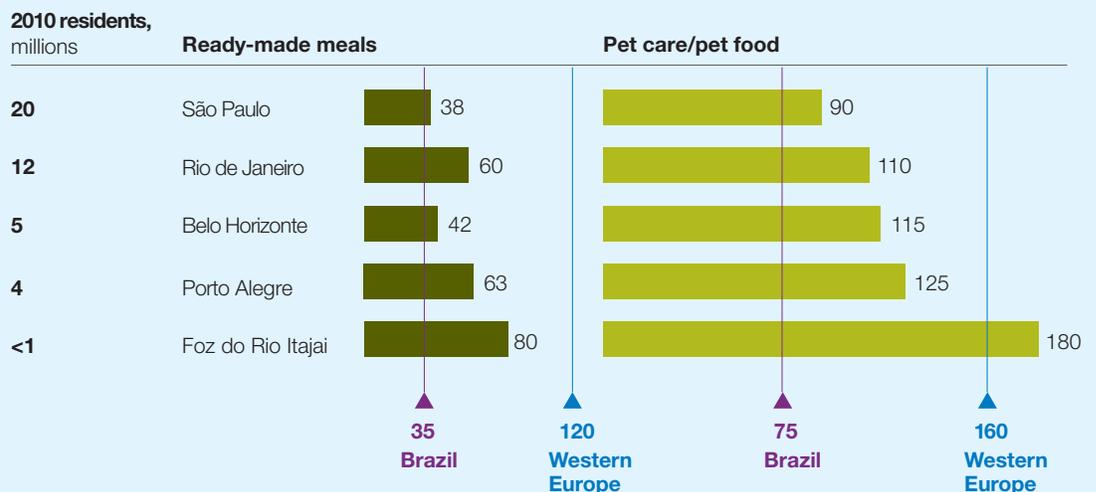
detergent offer the greatest reach and the highest market potential there.

Yet Cityscope Navigator reveals that some large cities in emerging markets have per capita income levels comparable to those in large European and North American cities. Demand structures in these emerging-market cities are becoming increasingly similar to those in their developed-market counterparts—which means higher sales potential for discretionary products such as premium cosmetics, disposable diapers, and pet food. In some Brazilian cities, for example, by 2020 per capita spending on ready-made meals and pet care will significantly exceed Brazil's national average—although Brazil's overall consumption levels will still lag behind Western European levels (exhibit). Companies that meet this nascent consumer demand early on will be well positioned to become market leaders.

Exhibit

Consumption of highly developed product categories is increasing substantially in some emerging-market cities.

Per capita consumption in Brazil and Western Europe, 2020
$

2010 residents, millions	Ready-made meals		Pet care/pet food	
20	São Paulo	38	90	
12	Rio de Janeiro	60	110	
5	Belo Horizonte	42	115	
4	Porto Alegre	63	125	
<1	Foz do Rio Itajai	80	180	

| **35** Brazil | **120** Western Europe | **75** Brazil | **160** Western Europe |

Source: Brazil Cityscope Navigator

# Companies that meet nascent consumer demand early on will be well positioned to become market leaders.

Developing strategies for micromarkets

Using Cityscope Navigator data, companies can develop country-specific profiles for each product category and then prioritize micromarkets within each country. In an in-depth study on Brazil's growth outlook, for instance, we analyzed 45 categories in 550 microregions and more than 5,500 cities.[1] We found that Brazil is indeed poised for speedy economic growth in this decade, with the Northeast region growing the fastest. Consumer spending in the Northeast will increase almost threefold, and in 2020, the region will become Latin America's second-largest consumer-goods market after Mexico.

Notably, some of Brazil's fastest-growing cities aren't sprawling metropolises or state capitals but medium-size cities with populations ranging from just over 20,000 to 500,000—cities that aren't even on the radar screen of many CPG companies. At about 9 percent, the annual growth rate of these cities is comparable to China's. Collectively, they are projected to contribute approximately half of Brazil's total growth in consumer spending.

With Brazilians' increasing affluence, a number of product categories will experience explosive sales growth. One of those categories is sunscreen: sales volumes of this previously low-penetration category are expected to triple by 2020. Other categories will grow at a more measured but still impressive rate—baked goods, for instance, will grow by "only" 40 percent. In Caruaru, a city in the Brazilian state of Pernambuco, by 2020 the average beer consumption per resident will be higher than that of Germany.

But, to date, the leading retailers in Brazil aren't capturing much of this growth. Many large retailers, including Wal-Mart Stores, Carrefour, and Companhia Brasileira de Distribuição, are either underrepresented or don't have even a single store in some of the country's fastest-growing cities.
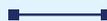
Consistent application of a fact-based, granular approach using Cityscope Navigator data can help consumer companies gain valuable insights into the industry's competitive dynamics. And companies that venture into high-growth regions and categories ahead of the competition will be better able to take—and hold on to—a market-leader position for years to come. ∎

Udo Kopka is a director who splits his time between McKinsey's Hamburg and Shanghai offices, **Stefan Rickert** is a principal in the Hamburg office, and **Markus Schmid** is a principal in the Munich office.

---

[1]Brazil is divided into more than 500 microregions, which are legally defined administrative areas made up of groups of municipalities. Our Brazil Cityscope Navigator database contains information on these microregions as well as on more than 5,500 cities in Brazil.

The power of advanced analytics in revenue management

Peter Breuer, Brian Elliott, and Stefan Rickert

Advanced analytics and commercial-performance solutions can help consumer-goods manufacturers and retailers capture—and sustain—higher returns through better pricing, promotions, and assortment.

In recent years, a number of consumer-packaged-goods (CPG) companies and retailers have successfully used big data and advanced analytics to enhance revenue management. Sophisticated pricing algorithms, for instance, have helped some companies boost their return on sales (ROS) by several percentage points. However, many companies' advanced-analytics efforts falter after the first or second year. In our experience, this is often because their analytic tools don't strike the right balance between ease of use and depth of insight. Sometimes the tools are too difficult to understand, apply, or incorporate into daily work flows—and thus never gain traction with the employees who are meant to use them. In other instances, the tools are easy enough to use but perform only shallow analytics that yield generic insights.

Periscope, a McKinsey Solution, offers a proprietary suite of software-enabled, commercial-performance tools and services that combine user-friendly interfaces with advanced-analytic capabilities.[1] It can help retail and consumer-goods companies excel in revenue management in a number of ways—for instance, by gathering competitive intelligence online, facilitating "leakage" analytics, and improving performance management. In this article, we focus on the use of Periscope for three critical activities: setting and managing prices, analyzing promotions, and optimizing assortment. Companies that use Periscope typically realize a 2 to 7 percent ROS improvement.

Better pricing, better outcomes

With the Internet making it easy for consumers to compare prices, pricing excellence is more important than ever, yet many CPG companies and retailers still engage in suboptimal practices. For instance, they fail to monitor competitors' prices regularly, rely on manual and intuition-based price-setting methodologies, or don't differentiate prices by region, store, or customer segment.

Such was the case at the Brazilian division of a multinational consumer-products company. The division generated over $1 billion in sales, of which 70 percent was through small, local retailers—yet pricing guidelines for more than 10,000 products were set at the national level, with no consideration for regional or local variations in demand or customer preferences. Furthermore, the company had little information on competitors' pricing.

The company embarked on an effort to identify and capture pricing opportunities in Brazil. It began by assessing its pricing strategy in the soap and disinfectant categories—an analysis that required gathering a vast volume of data (including information on each product's sales growth, profitability, competitor pricing, and price elasticity) from wholesalers, retailers, and sales staff across the country. A manual data analysis would have taken months, but Price Advisor, a Periscope solution, provided insights into pricing effectiveness across all products, regions, and channels after only three weeks; it also allowed the company to create scenarios that showed how sales volume and profits would change at different price levels.

With this information, the company was able to recommend specific price changes in each price zone for each product size. For example, the company found that as a result of weak oversight and frequent repricing, it had been charging a higher price per unit for some of its multiunit packs, which was in conflict with consumer expectations of volume discounts. The company thus reduced prices on those packs. The various pricing adjustments yielded impact quickly, increasing ROS by 2.5 percent in just a few weeks.

Data-driven promotions

Many companies' promotional strategies are based on theories rather than data. It's therefore not surprising that despite CPG companies' aggressive spending on promotions (now generally between 15 to 25 percent of net sales), sales volume has grown at a lower rate than promotional spend. Using big data effectively, especially in promotion-driven categories, can help companies boost returns on their trade investment.

A leading beverage company historically launched intense promotions every holiday season, even though there was little evidence that they worked. The company couldn't accurately measure promotion effectiveness, in part because many of its promotional activities were conducted over a short time period or overlapped with one another, making it difficult to isolate the impact of any single activity.

[1] McKinsey Solutions are packages of data, analytics, tools, and services that channel McKinsey knowledge and provide a clear view of complex business problems. For more, visit solutions.mckinsey.com.

Seeking to optimize promotional spend, the beverage company decided to focus on finding fact-based answers to a straightforward question: which promotions are most effective and why? Accurately and comprehensively answering this question required different types of data—including consumer, distributor, retailer, and internal financial data—from disparate sources. Convinced that bad data lead to inaccurate insights, the company invested time and resources in a thorough data-cleaning exercise, making sure to build data-cleaning capabilities along the way. Using Periscope Promotion Advisor, the company was able to reconcile irregularities (for example, retailers using different start and end dates when reporting weekly sales volume) and integrate internal financial data with external information (such as weather data).

Then, using proven analytic algorithms, the commercial team disaggregated the major drivers of promotional performance. Post-event promotion analyses have traditionally revolved around price, but Promotion Advisor takes into account up to ten other important factors including seasonality, competitor promotions, and in-store execution (for example, the number and prominence of promotional displays)—thus shedding light on the most important performance drivers (and combination of drivers) by product, customer, and week. The company could determine, for instance, which combinations of discounts were most effective during specific periods, such as holiday weeks.

Such insights helped the beverage company devise a new promotional strategy. Early results show that the company is on track to improve trade-spend effectiveness by 5 to 10 percent, representing hundreds of millions of dollars, once it rolls out the new strategy and implements a capability-building program—initiatives that will yield the added benefit of standardizing the entire organization's formerly haphazard processes for executing and evaluating promotions. Companies that use this advanced approach to promotion optimization typically see bottom-line improvement of two to five percentage points, mainly through reallocation of promotional spending toward more effective promotions.

Assortment optimization: Going beyond the basics

Many retailers and CPG manufacturers take a simple approach to assortment optimization: they give the most shelf space to top sellers. Leading companies, however, use criteria other than unit sales volume or profits to make assortment decisions. They analyze the effects of changes in the product mix—for example, by quantifying "transferable demand," defined as the sales volume that would be transferred to other items if a particular item were discontinued. This more nuanced approach helps companies discern which products are redundant from the consumer perspective and which products are truly essential to a category. These insights also allow companies to optimize facings and listings, taking into account space elasticity and shelf size; localize assortments based on the shopper mix and item preferences at each store; and account for the effects of service frequency on out-of-stock rates.

A global beauty-products manufacturer used Periscope Assortment Advisor to perform such analytics. The manufacturer first used the solution during a single-country pilot, with the goal of becoming category captain at a major retailer. By mining several years' worth of data on consumers' purchasing behavior and product usage, the commercial team obtained a detailed view of growth opportunities and optimal assortment strategies. For example, if a particular SKU were to be discontinued, Assortment Advisor could predict how much volume would be lost to another SKU in the same brand, lost to another brand, or lost entirely (because the consumer decides to walk out of the store without buying anything—a metric we call "walk rate").

The manufacturer's commercial team also generated insights that would benefit the retailer. During negotiations, for instance, the team shared with the retailer a simulation that revealed that certain hair-care products drove higher sales of related beauty products and thus should be given more shelf prominence. Similarly, the team found that certain SKUs, although not best-selling, had a high walk rate and should therefore remain in the assortment. The new approach helped the retailer look beyond sales results and detect unexpected patterns. For example, the retailer had expected a new hairstyling product to be

a category leader. While initial sales were strong, analysis revealed that few customers made repeat purchases and that the product had little impact on sales of other goods in the category. Without these insights, the retailer would have continued to give the product more shelf space than it deserved.

The beauty-products category grew by more than 7 percent at the pilot retailer, while sales of the manufacturer's products at that retailer increased by more than 10 percent in the six months after the stores were reset. In addition, the manufacturer's decision to share valuable insights with retailers has helped strengthen its relationships with its most important customers, consequently improving its market position. The company has since deployed the new approach and software solution to more countries and categories. It has made contextual adjustments—for instance, some markets have more data available than others—but has been able to replicate about 90 percent of the approach used in the pilot.

❖

As with any major initiative, companies using advanced analytics and commercial-performance solutions must ensure that they have support from top management, a clear vision and objectives, and a disciplined rollout process. Perhaps most important, companies should establish capability-building programs to embed solutions such as Periscope into their business processes. In our experience, a field-and-forum architecture—one in which trainees get coached while applying newly acquired skills in their daily work—is most effective. By combining advanced analytics and commercial-performance tools with a commitment to capability building, companies can bring about lasting impact, even as the retail and CPG landscape becomes more competitive. ∎

Peter Breuer is a director in McKinsey's Cologne office, **Brian Elliott** is the CEO of Periscope in the New Jersey office, and **Stefan Rickert** is a principal in the Hamburg office.

Understanding a local market's sales potential and performance

Thomas Bauer, Jesko Perrey, and Dennis Spillecke

The LOMEX Sales Advisor, a customizable geomarketing tool, helps companies make better decisions about their retail footprint and local sales coverage.

With the advent of big data and advanced analytics, a growing number of manufacturers and retailers are looking to develop a deeper, data-driven understanding of the particularities of local markets. In theory, micromarket analysis—especially in combination with the powerful data-visualization techniques of geographic marketing (or "geomarketing")—can help companies vastly improve sales: companies can zero in on the local markets with the greatest sales potential and develop their retail network accordingly. But many retailers and consumer-goods manufacturers have found that the promise of geomarketing is often far from the reality: they've found most geographic information systems (GIS) solutions to be limited in functionality, not easily customizable to users' needs, or impossible to integrate with existing business systems and processes.

A European manufacturer offers a case in point. The company has a complex distribution network, comprising various types of retail stores to which it sells directly or through a distributor. It knew that its products sold better at certain retail locations than others, even within the same or adjacent postal codes, but it didn't know why. The company historically had very little insight into what factors influence sales in each of its local markets, how its retail outlets and sales force were performing relative to the market's overall sales potential, and how much competition it had in each market. The executive team based its decisions about sales targets, sales-

force coverage, and retail footprint primarily on instinct and anecdotal information from the local sales staff.

The company used off-the-shelf GIS tools in a few countries, with spotty success: although the outputs were visually appealing and contained some insights, they left too many of the company's strategic questions unanswered. For example, although one of the outputs was a map showing competitors' retail locations, the map didn't distinguish one competitor from another and contained no information as to what types of products were sold at which locations. Furthermore, the tool offered poor options for exporting data, which meant executives couldn't easily use the outputs for management presentations or deeper analyses.

The manufacturer decided to embark on a sales-improvement effort in seven of its major markets in Europe. The executive team agreed on a set of questions to ask about each market: How big is the local market for our products? What factors drive sales in this market? How does sales potential differ among products and categories? Given the potential, what are realistic sales targets? Do we have sufficient sales coverage? How does our local presence compare with our competitors'? Do areas with poor sales indicate insufficient coverage or low productivity?

In search of fact-based answers to these questions, the manufacturer turned to an approach underpinned by the Local Marketing Excellence (LOMEX) Sales Advisor, a customizable geomarketing tool from McKinsey. Part of the suite of proprietary LOMEX tools, Sales Advisor allows companies to do three things they can't do with standard GIS solutions:

manage comprehensive data sets, perform sophisticated analyses that directly address their strategic objectives, and integrate these analyses into their decision-making processes. Here, we recount the European manufacturer's experience with the tool.

Managing different types—and massive amounts—of data

LOMEX Sales Advisor is designed to store and manage vast amounts of both internal and external data, and to perform statistical analyses at different levels of granularity (such as by region, postal code, street section, and retail store). The tool also allows for the addition of new data fields and easy uploading of new data.

In the case of the European manufacturer, detailed information—including data on product-level sales, retail format, and number of employees—on each of its 17,000 points of sale (POS) was available internally. But the company identified several other types of externally sourced data that would be critical to answering its strategic questions. The company purchased, for example, social and demographic data including household characteristics, as well as data on commercial entities (such as shopping malls and large companies) and "traffic attractors" (such as train stations, bus terminals, and parking lots). It also used "web scraping" technologies to gather information on competitors' retail locations and estimated sales, as well as on the extent to which products penetrate local markets (for example, which products are sold at which retail locations).

By the end of the data-gathering phase, inputs into the LOMEX Sales Advisor included more

Exhibit

A heat map can inform the sales team's growth plans and priorities.

LOMEX Sales Advisor sample output (illustrative)

Market potential   ▮ Very high   ▮ Medium   ▮ High   ▮ Low

Market potential sales (zip-code level)

Search

Point of sale (POS) 4
Chain: x
Type: client-owned POS
Characteristics: 2,000-square-foot store; 65 parking spaces
City: x
Address: x
Zip code: x
Brands: x
Expected sales: x
Actual sales: x
Sales area: x
Sales representative: x
Additional information: x

Zip code: 88888
Inhabitants: x
Income: x
Area sales representative: x
Total sales potential: x
Expected sales: x
Gap expected vs. potential: x
Gap actual vs. potential: x
Gap actual vs. expected: x
Number of POS: x
Number of competitor POS: x

- ✓ Zip codes
- ☐ Zip-code info
- ✓ Zip-code group
- ✓ POS
- ✓ Other types of POS
- ✓ Shopping malls
- ✓ Airports
- ✓ Train stations
- ☐ Seaports
- ☐ Large companies
- ☐ Automobile clubs
- ☐ Car rentals
- ☐ Motor-bike traders
- ☐ Truck dealers
- ☐ Bus terminals
- ✓ Exhibition centers
- ☐ Parking

than 60 million unique records of product sales; 2 million social and demographic data points; and data on 150,000 competitor POS, 1.9 million traffic attractors, and 28,000 commercial entities covering 44,000 postal codes.

Using advanced analytics to answer specific strategic questions

With LOMEX, a company can design the analytical approach best suited to its strategic objectives. The European manufacturer had constant input into the design and testing of the calculation algorithm used in LOMEX Sales Advisor. Through multiple-regression analysis, the tool was able to isolate the factors that have the greatest influence on sales potential. It then generated outputs that helped the company answer its strategic questions.

One such output was a series of color-coded maps showing the sales potential in a local market, with clearly labeled icons representing the company's POS, competitors' POS, important traffic attractors and commercial activities, and "white spaces," or areas where the market potential was high and current

coverage was low (exhibit). This heat map informed the sales team's growth plans and priorities. For example, the company revised sales targets and budgets based on new growth assumptions, reshaped sales territories to ensure adequate coverage, and began implementing a series of tactical actions to boost the productivity of low-performing retail stores.

Customizing business processes, functionalities, and reports

Many GIS systems suffer from the "black box" problem—users don't understand how they work and can't integrate them into their existing IT systems. Because LOMEX is a custom solution, its interfaces, functionalities, and reporting features are tailored specifically to the users' needs. The manufacturer was able to integrate LOMEX Sales Advisor into its decision-making processes, both at headquarters and at the local-market level. For example, the executive team used the heat maps for its third-quarter planning meeting, at which it examined the company's retail footprint, whereas regional managers used sales

matrixes (showing potential and actual sales in each market) every quarter for sales-coverage analysis and performance management.

With the help of LOMEX Sales Advisor, this manufacturer identified nearly 20 percent in untapped sales potential—due primarily to poor coverage in high-potential areas—and it continues to use LOMEX to guide its broader strategy. The company is now expanding use of the tool to regions outside Europe. Furthermore, it is building capabilities and creating an internal center of competence, so that the impact that the tool helps achieve can be sustained over the long term. ∎

The authors wish to thank Hiek van der Scheer for his contributions to this article.

Thomas Bauer is a senior expert in McKinsey's Munich office, **Jesko Perrey** is a director in the Düsseldorf office, and **Dennis Spillecke** is a principal in the Cologne office.

My manufacturing plant is better than yours—or is it?

Shruti Lal, Daniel Rexhausen, and Frank Sänger

Through benchmarking, consumer-goods companies can optimize their production facilities and processes—but only if they use the right data at the right level of detail. A new McKinsey database and methodology can help.

In their perpetual quest for competitive advantage, many consumer-packaged-goods (CPG) manufacturers are looking to fine-tune their production processes. It's a sensible move—production, after all, on average accounts for 15 to 20 percent of cost of goods sold. P&G, for one, aims to save up to $10 billion by 2016, in part by optimizing production.

But as companies seek to boost production performance, how should they determine what actions to take and which changes will make the most difference? In theory, a benchmarking exercise could surface the strengths and weaknesses, cost drivers, and areas of opportunity in a production facility or process. The problem is, there's no well-known source for operations-related benchmarks in the CPG industry. Furthermore, CPG companies' global production networks, as well as the broad range of CPG products, make meaningful comparisons difficult to come by. Of course, companies can (and some regularly do) conduct internal benchmarking, but even then they must take into account each plant's unique attributes and be careful not to make flawed assumptions.

To help CPG companies find relevant benchmarks and catalyze major improvements in production performance, McKinsey has developed the Consumer Operations Benchmarking Initiative (COBI). The COBI database contains detailed information on more than 120 CPG plants worldwide (see sidebar, "What is COBI?"). And by strictly adhering to a set of guiding principles, the COBI approach has yielded outsize rewards for CPG companies across the globe.

Success factors in benchmarking

Benchmarking doesn't just mean gathering reams of data. A rigorous benchmarking initiative involves collecting and analyzing the right data at the right level of detail. To ensure success in benchmarking, companies should bear in mind the following principles, all of which have been carefully integrated into the COBI approach.

Look at costs as only one part of the big picture. Companies should resist the temptation to focus their benchmarking efforts exclusively on costs. Productivity, quality, and flexibility are also critical metrics. Could a plant's low costs in quality assurance, for example, have something to do with its low first-time-right rate? Does more flexibility justify higher costs? Answering these types of questions requires multidimensional analyses.

Make apples-to-apples comparisons. Benchmarking a rice-noodle factory in Southeast Asia against a pasta factory in Europe isn't a useful exercise; although the plants make similar products, there are important differences in ingredients and production steps. Likewise, two plants may both produce body lotion but with different viscosities or in different container sizes. Comparisons of production facilities will be meaningless if the specific attributes of the products, processes, or packaging aren't taken into consideration. In some cases, it's possible to normalize for the differences by generating a quantitative baseline. For instance, when comparing a ketchup plant that fills small bottles with one that fills large bottles, a company should scale to a common unit and calculate the additional cost per liter of filling smaller bottles. One CPG company found that its process for filling small package sizes cost 20 percent more than its process for filling large ones.

Examine each step in the production process. Some companies gather data on only high-level indicators such as the number of personnel in each plant, the total cost per product, or the amount of waste per batch. These metrics can be helpful, but they might also obscure deeper insights that would emerge if a company instead compared individual steps in the production process. For example, a milk-powder manufacturer might have a highly efficient packaging process, but it might also have an outdated, energy-guzzling drying machine. These two factors can offset each other, resulting in reasonable production costs. Only with a detailed examination of every step in the production process will the company realize that it ought to replace its milk-drying machine.

Get all the relevant parties involved. Benchmarking typically creates additional work for many employees, particularly those in the controlling and accounting functions. A benchmarking initiative should have the buy-in and involvement of the relevant people in the company—not just controllers and their staff, but also top management

Exhibit

A detailed productivity analysis reveals opportunities for improvement.

■ In top quartile ■ In 2nd quartile ■ Below median

Filling-line speed
Maximum output (thousand production units) per filling line and year

22 28 28 26 30 29 45 31

OEE[1] (filling line)
%

69 75 69 40 60 40 80 54

×

OEE × utilization (filling line)
%

31 39 28 20 42 22 40 38

Filling and packaging production productivity
Production units per full-time employee

282 591 388 253 355 276 643 422

Median, Top quartile, Plant A, Plant B, Plant C, Plant D, Plant E, Plant F

Utilization (filling line)
%

62 77 41 51 70 55 50 71

Median, Top quartile, Plant A, Plant B, Plant C, Plant D, Plant E, Plant F

÷

Line manning
Production staff per filling line per day

32 19 20 21 35 22 28 28

Median, Top quartile, Plant A, Plant B, Plant C, Plant D, Plant E, Plant F

[1]Overall equipment efficiency.

and plant managers. The project sponsor, ideally a senior executive, must clearly communicate the goals of the project.

One company's experience
A European CPG manufacturer embarked on a three-month benchmarking effort involving six of its production plants in Europe, Southeast Asia, and Africa. Senior leaders pledged to take decisive action to address any performance gaps revealed by the benchmarking results.

The benchmarking team gathered data on each plant's costs and capital investment, as well as on more than 100 operations-related key performance indicators (KPIs). Then, using the COBI methodology and database, the team compared their data with those of other relevant CPG plants.

The analysis showed that, with respect to costs, two of the company's plants were among the best performers in the industry, and two were among the worst. A breakdown of costs revealed the specific areas in which its plants were overspending. In one case, a plant's material costs were too high; in another, a plant had a disproportionately large staff. An analysis of productivity in individual production lines— taking into account personnel deployment, speed, utilization, and intensity of use— revealed significant downtime in several plants (exhibit). Furthermore, an analysis of energy consumption revealed two inefficient plants. And since both were located in regions with low energy costs, this savings potential would not have come to light through a simple comparison of energy costs.

The team calculated that if all six plants could improve performance to the level of the top-performing quartile in the COBI database, the resulting savings would amount to tens of millions of euros per year—as much as one-fourth of the company's total conversion costs. Thanks to the detailed breakdown of cost levers, what initially sounded like an ambitious savings target was actually within reach, even without any changes to the production network.

Working with plant and production managers, project leaders defined targets for each plant and agreed on improvement actions (such as rotating the workforce across production lines to reduce equipment downtime). The company also created a cross-plant team to identify internal best

What is COBI?

The Consumer Operations Benchmarking Initiative (COBI) is a proprietary database and methodology that consumer-packaged-goods companies can use to benchmark their production processes and facilities against those of direct and indirect competitors. The COBI database contains data on more than 120 plants worldwide, operated by both brand-name manufacturers and private-label producers. Data on each plant include metrics on cost, capital, productivity, quality, and flexibility—in total, more than 100 key performance indicators. Currently, COBI covers five product categories: home and personal-care liquids, laundry detergent, skin-care products, milk powder, and milk (including condensed milk). By 2014, COBI categories will include pasta, sauces, drinks, rice, and confectionery.

practices and transfer know-how to the lower-performing locations. This team tackled the questions that arose from the benchmarking results. For example, why does Plant A use 10 percent less energy per unit produced than Plant B? Why are the material costs for quality assurance in Plant C up to 20 percent higher than in Plant D, even though the two plants produce equal volumes?

Even after the benchmarking project ended, the company's internal-controls function continued to track performance against the KPIs. The plants have been hitting or exceeding their targets, and the company now regularly uses COBI to benchmark its own improvements against changes at competitors. Its success is evidence that through smart benchmarking, CPG companies can achieve far-reaching cost and quality improvements. ∎

Shruti Lal is a specialist in McKinsey's Chicago office, **Daniel Rexhausen** is an associate principal in the Stuttgart office, and **Frank Sänger** is a principal in the Cologne office. Copyright © 2013 McKinsey & Company. All rights reserved.

Radar for the e-commerce market

Karel Dörner, Nicolò Galante, and Carina Kauter

With the E-Commerce Observatory, companies can stay abreast of competitive developments in the fast-changing online retail arena.

The spectacular rise of German shoes-and-apparel retailer Zalando—from a start-up to a €1.2 billion business in five years—took many companies by surprise. Zalando, which now has a presence in more than a dozen European countries, seemed to materialize out of nowhere, leaving established retailers wondering, "How did we not see it coming?"

Indeed, in an increasingly crowded market-place, it's easy to miss—and dismiss—newcomers. As more product categories migrate from physical stores to online, e-commerce is attracting many new players: in Germany alone, for example, more than 400 new e-commerce businesses were established in 2012, according to Deutsche-Startups.de. Market-research firm Forrester estimates that online retail in Europe will grow at double-digit rates for the next few years, reaching €191 billion by 2017. The emergence of Zalando and other innovative, aggressive online players puts pressure on incumbents to quickly identify and assess these new competitors and to strategize accordingly.

But how can retailers and consumer com-panies keep track of their online competition? With hordes of new entrants, how can they tell which ones could pose a serious threat? One approach that has been eye-opening for companies relies on sophisticated analysis of search-engine data.

Search traffic as a proxy for sales

We have found that a website's search traffic (which we define as the number of visitors who arrive at the site via search engines) is a reliable proxy for online sales; in other words, the growth of a website's search traffic is indicative of its sales growth. In partnership with data-analytics firm Xamine, McKinsey has developed the E-Commerce Observatory, a tool that uses search-engine data to help companies keep a close watch on competitive developments in e-commerce. The Observatory currently covers 40 retail categories in five countries: France, Germany, Spain, the United Kingdom, and the United States.

The Observatory runs a daily analysis on a set of 250 to 1,000 keywords or search terms for each retail category (keywords for the furniture category, for instance, would include "sofa" and "bed"). Using a complex algorithm, the tool identifies and ranks the top 100 e-commerce players in each retail category measured by share of search traffic, taking into account both organic and paid search.

The Observatory can generate a number of useful reports. One is a detailed market scorecard that shows the growth, attractiveness, and maturity of the market and identifies the types of players that are gaining or losing ground (Exhibit 1). Another valuable report is a competitive overview that ranks the top 100 players in the relevant product category and country. Insights from this overview can help retailers answer a number of questions: Who are our current and emerging online competitors? Which players are gaining search-traffic share, and are their gains due mostly to paid ads or search-engine optimization? Which companies are potential partners for us, and which are potential acquisition targets?
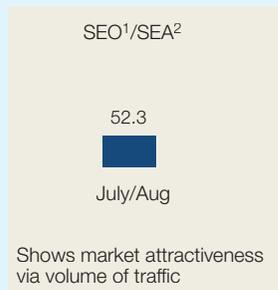
Exhibit 1

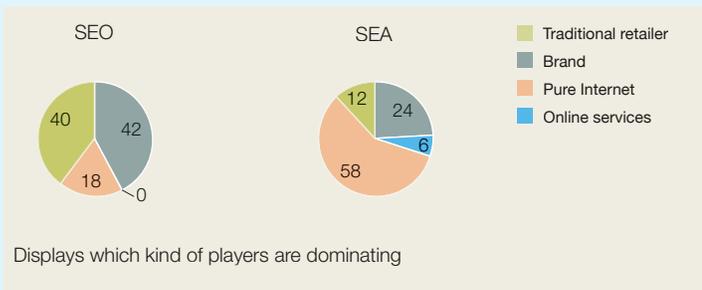**The E-Commerce Observatory can generate a market scorecard.**

Furniture segment in Germany, 2013

Market growth

Generated traffic,
millions

Share of sales by player,
top 50 players, July/Aug 2013, %

SEO[1]/SEA[2]

52.3

July/Aug

Shows market attractiveness
via volume of traffic

SEO

40
42
18
0

SEA

12
24
6
58

Legend:
- Traditional retailer
- Brand
- Pure Internet
- Online services

Displays which kind of players are dominating

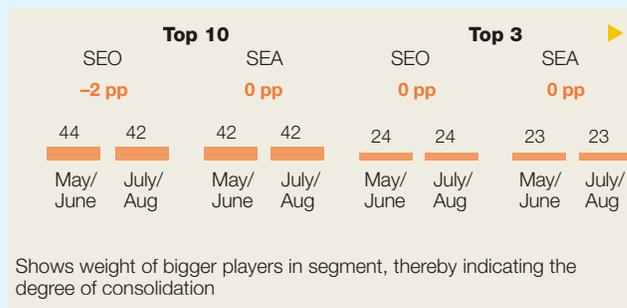**Are we operating in a growing market?**
Currently flat market, already occupied by relevant competition—but large share of pure players investing
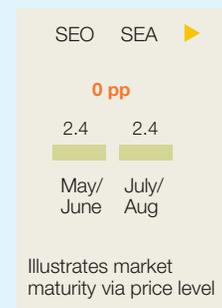
Market maturity

Number of new players
in top 100

Search-traffic share,
%

Cost per click
€

SEO   SEA   ▲

9   22

July/   July/
Aug   Aug

Displays appeal
of market entry

	Top 10		**Top 3**		
SEO	SEA	SEO	SEA
–2 pp	**0 pp**	**0 pp**	**0 pp**
44	42	42	42	24	24	23	23
May/June	July/Aug	May/June	July/Aug	May/June	July/Aug	May/June	July/Aug

Shows weight of bigger players in segment, thereby indicating the
degree of consolidation

SEO   SEA   ▶

0 pp

2.4   2.4

May/   July/
June   Aug

Illustrates market
maturity via price level

How mature is our market?
Market is developing with new entrants, while top players are making slight gains or even losing share

[1]Search-engine optimization.
[2]Search-engine advertising.

Source: Xamine; McKinsey analysis

Exhibit 2

A competitive overview shows which players are gaining or losing search-traffic share.

Furniture market in Germany, July/Aug 2013 vs. May/June 2013

Organic traffic (SEO[1])

Search-traffic share[3]
%

Paid traffic (SEA[2])

Search-traffic share[3]
%

[1]Search-engine optimization.
[2]Search-engine advertising.
[3]Share of search traffic among top 100 players; partial list of the top 10.

Source: Xamine; McKinsey analysis

In Germany's furniture market, for instance, IKEA is the offline market leader, but its position is being challenged by online-only players such as Amazon (Exhibit 2). The Observatory analysis also shows that while traditional furniture chains like IKEA and mail-order companies like bonprix and Schwab are investing the most in search-engine advertising, Zalando is looking to become a contender in the category. Similarly, in the pet-food industry, Observatory analysis showed that the largest pet-food retailer in one European country was under threat from pure-play online companies with unique strategies (such as an online retailer specializing in customized pet food).

Quick insights, quick action
Based on Observatory insights, companies can then decide what to do. They could, for instance, invest to gain scale quickly,

perhaps by acquiring or partnering with faster-growing e-commerce businesses. They could study the assortment, pricing, services, and other features of successful new entrants and adjust their own offerings in response.

The Observatory also identifies the companies investing in search-engine optimization and search-engine advertising. A European chocolate manufacturer, for example, found that the companies with the highest share and growth in organic-search traffic were mostly traditional chocolatiers, while the leaders in paid-search traffic were newer pure-play entities such as World of Sweets and Amazon. These insights helped inform the manufacturer's e-commerce strategy.

The E-Commerce Observatory can produce reports on demand and send out automatic alerts in the event of significant market shifts—

for example, when a new entrant appears. This timely knowledge about the dynamic e-commerce landscape can give companies a crucial competitive edge in the battle for online customers. ∎

Contributors

Thomas Bauer
Senior expert
Munich

Klaus Behrenbeck
Director
Cologne

Peter Breuer
Director
Cologne

Raphael Buck
Principal
Zurich

Marco Catena
Associate principal
Milan

Peter Child
Director
London

Linda Dauriz
Principal
Munich

Sandrine Devillard
Director
Paris

Karel Dörner
Principal
Munich

Brian Elliott
CEO, Periscope
New Jersey

Thierry Elmalem
Principal
London

Søren Fritzen
Director
Copenhagen

Nicolò Galante
Director
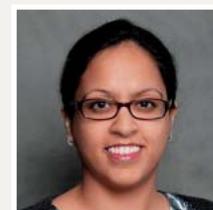Paris

Stefan Görgens
Associate principal
Cologne

Steffen Greubel
Principal
Berlin

Carina Kauter
Associate principal
Frankfurt

Udo Kopka
Director
Hamburg and Shanghai

Shruti Lal
Specialist
Chicago

Arnaud Minvielle
Principal
Paris

Andreas Moosdorf
Associate principal
Cologne

Cédric Moret
Principal
Geneva

Heiko Nick
Associate principal
Cologne

Stefan Niemeier
Director
Hamburg

Jesko Perrey
Director
Düsseldorf

Nathalie Remy
Principal
Paris

Daniel Rexhausen
Associate principal
Stuttgart

Stefan Rickert
Principal
Hamburg

Kasper Rorsted
CEO
Henkel

Jørgen Rugholm
Director
Copenhagen

Remi Said
Associate principal
Paris

Frank Sänger
Principal
Cologne

Markus Schmid
Principal
Munich

Dennis Spillecke
Principal
Cologne

Thomas Tochtermann
Director
Hamburg

Tobias Wachinger
Principal
Munich

Anja Weissgerber
Specialist
Berlin

Chris Wigley
Associate principal
London

Jan Wüllenweber
Director
Cologne

Andrea Zocchi
Director
Milan

Regional contacts

Europe, Middle East, and Africa
Klaus Behrenbeck
Director, Cologne
Klaus_Behrenbeck@McKinsey.com
Magnusstraße 11
50672 Köln
Germany
Voice: 49 (221) 20870

Jørgen Rugholm
Director, Copenhagen
Jorgen_Rugholm@McKinsey.com
Ved Stranden 14
1061 Copenhagen K
Denmark
Voice: 45 (33) 933030

Africa
Bill Russo
Director, Nairobi
Bill_Russo@McKinsey.com
Regus Business Centre,
Delta Corner Tower
Chiromo Road, 6th/7th Floor
Nairobi 00800
Kenya
Voice: 27 (11) 506 8000

Benelux
Dymfke Kuijpers
Principal, Amsterdam
Dymfke_Kuijpers@McKinsey.com
Amstel 344
1017 AS Amsterdam
Netherlands
Voice: 31 (20) 551 3777

Eastern Europe
Martin Nepras
Principal, Prague
Martin_Nepras@McKinsey.com
Na Rybnicku 5
120 00 Prague 2
Czech Republic
Voice: 420 (2) 2141 4111

France
Sandrine Devillard
Director, Paris
Sandrine_Devillard-Hoellinger@McKinsey.com
79, Avenue des Champs-Elysées
75008 Paris
France
Voice: 33 (1) 4069 1400

Germany and Austria
Peter Breuer
Director, Cologne
Peter_Breuer@McKinsey.com
Magnusstraße 11
50672 Köln
Germany
Voice: 49 (221) 20870

Iberia
Enrique Garcia-Lopez
Principal, Madrid
Enrique_Garcia@McKinsey.com
Sagasta, 33
28004 Madrid
Spain
Voice: 34 (91) 3465800

Italy
Stefano Zerbi
Principal, Milan
Stefano_Zerbi@McKinsey.com
Piazza Del Duomo, 31
20122 Milan
Italy
Voice: 39 (02) 724061

Middle East
Hans-Martin Stockmeier
Director, Dubai
Hans-Martin_Stockmeier@McKinsey.com
Level 4, Building 4
Dubai International Financial Centre
PO Box 33538
Dubai
United Arab Emirates
Voice: 971 (4) 389 9000

Russia
Alex Sukharevsky
Principal, Moscow
Alex_Sukharevsky@McKinsey.com
5 Lesnaya Street, Building C
Moscow, Russia 125-047
Voice: 7 (495) 424 8000

Scandinavia
Anders Bärlund
Principal, Stockholm
Anders_Baerlund@McKinsey.com
Klarabergsviadukten 70
6th Floor
World Trade Center
Box 70371
S-107 24 Stockholm
Sweden
Voice: 46 (8) 700 64 00

Southern Europe
Andrea Zocchi
Director, Milan
Andrea_Zocchi@McKinsey.com
Piazza Del Duomo, 31
20122 Milan
Italy
Voice: 39 (02) 724061

Switzerland
Raphael Buck
Principal, Zurich
Raphael_Buck@McKinsey.com
Bleicherweg 30
CH-8002 Zurich
Switzerland
Voice: 41 (44) 876 8000

United Kingdom and Ireland
Thierry Elmalem and Kate Smaje
Principals, London
Thierry_Elmalem@McKinsey.com
Kate_Smaje@McKinsey.com
No. 1 Jermyn Street
London SW1Y 4UH
United Kingdom
Voice: 44 (20) 78398040