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Perspectives on retail and consumer goods

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Foreword

It's summertime! I trust that you and your companies are off to a good start this year—and yet the fact that you are reading this tells me you are open to new ideas on how to change and create impact at scale.

Let me briefly introduce myself: I am Jörn Küpper, the new leader of McKinsey's Consumer Packaged Goods and Retail sector in Europe, the Middle East, and Africa. I am proud to present to you the third edition of our twice-yearly journal, *Perspectives on retail and consumer goods*, in which our practitioners

and experts address topics that are top of mind for retail and consumer-goods leaders worldwide.

The articles in this edition explore issues such as the evolving role of the store, the opportunities arising from big data and advanced analytics, and the competitive edge that companies can gain through supply-chain excellence. Other highlights include interviews with Pierre-Yves Roussel, CEO of LVMH Fashion Group, and Christian Wanner, cofounder and former CEO of LeShop.

Our latest consumer insights point to the growing importance of digitization. To that end, I would like to remind you that *Perspectives* is available in digital formats—PDF and e-book (for Kindle as well as for iPad, Sony Reader, and other devices)—on mckinsey.com. Let us know if you prefer to receive future editions in digital formats only. We'd also welcome any other thoughts and reactions; please e-mail us at Consumer_Perspectives@McKinsey.com.

I hope this journal will make for an inspiring summer read!

Jörn Küpper
Director, Cologne

Toko Ohmori

Making stores matter in a multichannel world

As the role of the brick-and-mortar store evolves, retailers will have to continually refine how they use their real estate.

**Louise Herring,
Tobias Wachinger,
and Chris Wigley**

For decades, the retail industry has followed the same straightforward formula for growth: open new stores. By replicating a proven store format in a new catchment area, retailers could reliably grow their customer base and count on healthy increases in sales.

But the world has changed. In many categories, e-commerce has dramatically lessened the need for physical stores. "Virtual space"—which we define as the floor space that would be required to generate the sales volume that online retail now accounts for, at a sales density equivalent to the industry average—is expanding at a staggering rate. In this new world, what is the role of the brick-and-mortar store?

Many retailers find themselves struggling with the question, and saddled with more real estate than they know what to do with. After all, their property departments are geared up for expansion and acquisition. Their finance departments have traditionally focused on reaping investment returns from stores and tend to be jittery about investing in new and unproven technologies. On the flip side, e-commerce directors are frustrated by their companies' lack of understanding of the pace and mind-set changes they need to make to become digital winners.

To position themselves for success in a multichannel world, retailers would do well to

take a disciplined approach that begins with a reassessment of the role of the physical store. We recommend a five-step approach we call STORE: starting with a clear vision for the future role of the store, tailoring categories accordingly, optimizing the portfolio using forward-looking analytics, reinventing the in-store shopping experience, and executing systematically across channels.

The incredible shrinking footprint

The effects of online migration in the retail industry are evident in every category. In the United Kingdom, between 2008 and 2013, the number of vacant retail shops rose by 355 percent,[1] and in 2013 and 2014, three of the "big four" supermarkets took a combined £1.2 billion (approximately $2 billion) write-down on the value of their undeveloped property. Perhaps the most affected category has been consumer electronics, where a 20 to 30 percent decline in physical retail space in the UK market between 2006 and 2012 was fully offset by the addition of an equivalent amount of virtual space.

Of course, online retail has affected more than just physical floor space. Amazon, for one, has put intense pressure on retailers' top and bottom lines by having prices that are 13 to 20 percent lower than average, an assortment 17 times larger than the average retailer's, a cost base that is 3 to 4 percent lower than competitors', and the highest customer-satisfaction scores in the industry. The combined effects of Amazon and other online retailers have rapidly hurt traditional retailers' return on invested capital, as fewer sales flow through existing physical assets.

Many retailers' instinctive response to manage these headwinds has been to close under-performing stores and to look for operational efficiencies, but these moves only buy time— they can't fully close the performance gap (exhibit). "Shrinking to greatness" is not the answer.

[1] *Openings & Closures Report 2013*, The Local Data Company, March 2014, localdatacompany.com.

Exhibit

Online migration is hurting store economics, and there are no quick fixes.

Estimates for US retail company, assuming a 5% decline in sales per square foot over 5 years,
% of sales

	Earnings before interest and taxes	**Return on invested capital**
Starting point	8	24
	−28%	−32%
In 5 years, given projected online and space trends	5	16
	+18%	+18%
In 5 years, if operations are optimized	6	19
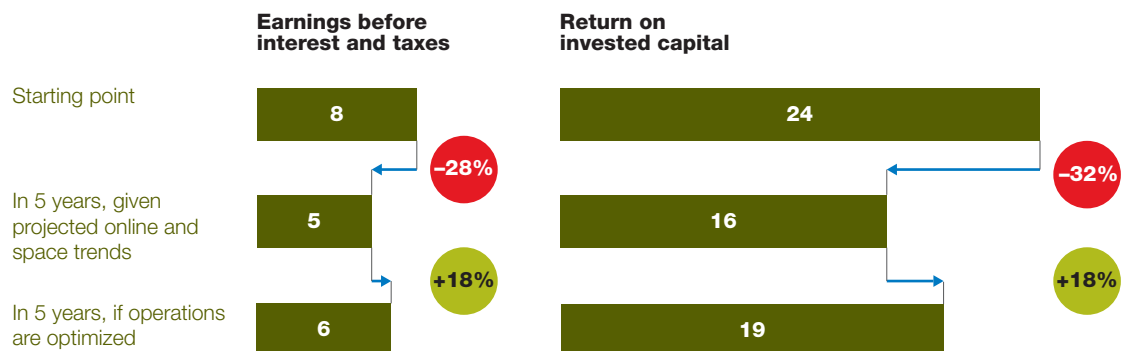
Source: Forrester Research; Internet Retailer; Kantar Retail; retail benchmarks; store plans; 10-K filings; McKinsey analysis

Start by redefining the role of the store

Tailor categories accordingly

Optimize the portfolio using forward-looking analytics

Reinvent the in-store experience

Execute systematically across all channels

A framework for change

Shifting from a store-focused to a multi-channel mind-set requires retailers to change their traditional frames of reference and ways of working. As consumers increasingly shop across channels, terms like "convenience" and "efficiency" take on new meanings. Customer expectations are rising: for instance, customers now expect price consistency across channels, the ability to buy online and pick up in store, and a range of payment options. Price transparency puts pressure on retailers to develop ultraefficient operating models. The wealth of online information available to consumers raises the bar for in-store service and expertise.

But let's be clear: the brick-and-mortar store is not dead. It just plays a different role now. In fact, in a multichannel world, physical stores can provide a competitive advantage. Some multichannel retailers have seen growth in their online sales and penetration among consumers who live near their stores. In several sectors, "click and collect" is proving a popular and increasingly efficient means of serving the customer. Former online pure plays such as Sofa.com and Oak Furniture Land have opened physical stores that now generate as much as 60 percent of sales. And a handful of retailers are reshaping their store network to consist of a few flagship stores—which essentially become a marketing and service channel for the online business—supported by numerous smaller outlets that offer convenience and a curated product offering. British retailer Argos, for one, is experimenting with a hub-and-spoke distribution system in London, with products being delivered from large stores to smaller-format "digitally

enabled" stores—allowing all Argos stores in the area to guarantee same-day or next-day fulfillment on some 20,000 products.

In light of rapidly evolving technology and consumer behavior, we believe retailers that take a forward-looking view and heed the following five imperatives can position themselves for multichannel success.

Start by redefining the role of the store

The first question that retailers should ask themselves at the beginning of their store-network-transformation journey is, "What role will my brick-and-mortar stores play in a multichannel world?" To answer the question, retailers must find out what their customers truly care about. Which aspects of a store matter most to customers? What purpose does a store serve for them?

- *Convenience and proximity.* Do they appreciate the ease and speed of being able to visit a store and get what they need?

- *Efficiency.* Do they see the store as a place that helps them make better use of their time—for example, by enabling them to make faster decisions or by serving as a pickup location for something they ordered online?

- *Inspiration.* Are they looking to discover—and be surprised by—new ideas and products?

- *Instant gratification.* Do they look forward to store visits as a chance to make impulse purchases and get things they want immediately?

- *Finding a solution, information, or service.* Are they seeking knowledge and expertise above and beyond what they can find via an Internet search?

- *Entertainment and social interaction.* Do they see stores as places where they can be entertained and have fun with family and friends?

- *Experiencing brands and products.* Do they visit stores for a chance to touch, feel, and be won over by products and brands?

Economic considerations are important as well. For each of the purposes above, retailers should ask, "How can stores do this profitably?" There may be more than one answer, and therefore more than one winning store format. In any case, the agreed-upon role (or roles) of the store should dictate every decision about the store operating model: location, assortment, staffing, supplier funding, employee training, and so on.

A supermarket chain, for example, had been investing in costly service-led formats in which store staff provided expert in-person advice to shoppers. Customer research revealed, however, that service was a priority to a subset of customers in only one-tenth of its stores. Based on these findings, in the other 90 percent of its stores the retailer shifted its emphasis away from service and toward efficiency (with fewer service counters and more automated features such as self-checkout) and instant gratification (for example, by heavily promoting new impulse-buy bargains), which were higher priorities for customers in those stores. The retailer was thus able to materially reduce operating costs while better meeting customers' needs.

Tailor categories accordingly

Customer priorities and store economics should then become critical inputs into ongoing category reviews, to ensure that assortments and space allocation are continually optimized for a multichannel world.

For example, with niche products—the so-called long tail—becoming searchable and available to consumers online, retailers can capture tremendous savings by stocking such products only in central warehouses rather than in stores. That said, some slow-moving products should remain available in stores, such as emergency items (for instance, home-improvement retailers should stock tools and spare parts for fixing a leaky sink) and products that are part of a bigger basket (because customers buying paint or wallpaper in the store to complete a home-decorating project will be frustrated if they have to buy a ladder separately online).

Through customer research, an electronics retailer found that the frequency and purpose of customer visits, as well as average driving times, varied significantly by category. Only half of customers were willing to drive more than ten minutes to buy kitchen appliances in person, compared with almost 100 percent of customers buying a TV. Indeed, half of customers said they would never buy a TV without first seeing it, testing it, or comparing it with other models in a store. These insights suggested that the retailer needed different assortments in its in-town and out-of-town stores, as well as different space and service levels for each category.

Optimize the portfolio using forward-looking analytics

The next step is to reevaluate the store portfolio through a multichannel lens. Leading retailers regularly analyze correlations between sales performance and catchment data to identify promising locations for new stores and to figure out the winning formula for top-performing stores; they examine factors such as population density, income, competitor presence, and average tenure of the sales staff. This is a valuable exercise,

Cosmetic changes alone won't result in lasting impact. A multichannel mind-set must be embedded in the store design and in employees' new ways of working.

but in a fast-changing business environment it's not enough. Retailers must look ahead: they must extrapolate the impact of macro and industry-wide trends on the store network's economics and operating model. And they must understand the impact that channels have on one another. One retailer that already had 100 unprofitable stores in its network found that another 100 would be in the red within three years given competitor trends and the shift to e-commerce.

The most forward-thinking retailers use analytical tools and techniques to reshape their entire store network. They use financial and geospatial modeling to highlight not only where stores should be opened but also which should be closed, resized, or reformatted. Using geospatial modeling, a grocery chain made the counterintuitive discovery that a critical mass of stores in certain regions was highly correlated with a boost in online sales. The company therefore took a renewed interest in a number of locations that it had previously rejected. Analysis also showed that the grocer's target customer groups were growing rapidly in neighborhoods near those sites, suggesting further upside.

Geospatial analysis is useful for creating a "blank sheet" optimal mix of store formats by location type. In a populous city, for instance, the optimal mix for an apparel retailer might include one or more flagship stores with a long drive time, high-footfall destinations (such as stores in malls or on suburban main streets) with a medium drive time, and "in-fills" (such as seasonal shops or pop-up stores) to cater to small catchment populations. Through geospatial analysis, a big-box retailer discovered significant overlaps in its stores' catchment areas; its flagship stores were attracting customers from far-flung neighborhoods in which it also had smaller stores. It thus realized that it could reduce both the number and size of its smaller stores while still serving the same population.

Retailers can choose which specific stores to keep or close based on a forecast of future performance, lease profile, and expected customer retention. For problematic stores with longer leases, retailers may need to make creative moves—such as subletting part or all of the store, or closing more-profitable nearby

stores with shorter leases and switching customers over to the remaining stores.

Reinvent the in-store shopping experience

Creating the store of the future will mean overhauling the in-store customer journey, in part by using new technology to make the shopping experience as seamless and easy as possible. Some retailers simply copy the in-store moves of multichannel champions such as Burberry and Apple, or equip sales staff with iPads to give their stores an updated, high-tech look. But cosmetic changes alone won't result in lasting impact. A multichannel mind-set must be embedded in the store design and in employees' new ways of working. Retailers could, for instance, give store staff easy access to detailed and up-to-date product information so that they can provide knowledgeable customer service without needing to memorize too many specifics. Mobile devices that tell store employees where exactly in the store an item is located and how many units are in stock could enable them to better assist customers. Handheld payment points would allow customers to avoid long checkout lines.

Retailers should prioritize the basics: again, focusing on what matters most to their customers and enabling multichannel shopping (for instance, by establishing fast-pickup counters for online orders) while being ruthless about taking cost out of the things that customers don't care about.

That said, even as retailers work on the basics, they should constantly test and tinker with digital innovations. They should rapidly conduct systematic experiments, ideally cofunded with technology providers or product partners, to confirm the game-changing potential of a particular technology—for example, by measuring its effect on overall conversion or customer loyalty—before making big capital investments to roll it out across the network.

Execute systematically across channels

Change of this scale is not easy and affects many functions across the organization. Some retailers make the mistake of developing a store-network-transformation plan that extends past 2020, by which time parts of the plan will likely be obsolete, or else they embark on a massive change program that will take so long to roll out that it will be out of date before it is halfway done. Retailers are typically better served by developing a detailed plan for the next 12 months and a high-level road map for the next three years.

Pace and flexibility are critical. "Gold plating" an entire store takes too long and tends to be expensive. Retailers should instead test new ideas quickly, and they should pilot individual aspects of store design to figure out what specifically is working and what isn't.

Given the scale of a network redesign, taking a lean approach can significantly reduce capital

expenditures and increase return on investment. By using cost-saving levers such as offsite prefabrication, relaxing fixture specifications to widen the supplier pool, applying principles such as design to value and total cost of ownership, and ensuring disciplined project management, a global big-box retailer completed a major store-transformation program 25 percent faster and with 21 percent lower capital expenditures than similar previous programs.

And of course, capabilities and the organizational design, both at headquarters and in individual stores, must evolve as the network evolves. Retailers should ask themselves: Does the organizational structure support the new network size and role? What would it take to shift the mind-sets of the property team away from a focus on opening new stores and toward making better use of existing space, introducing and refreshing store concepts quickly, and even scaling back on real estate? How can the online team—which, at some retailers, still has a cottage-industry status—become fully integrated with the stores? This integration is crucial: the store of the future should allow shoppers to move seamlessly across channels. The logistics and store teams, for example, should work hand in glove with the online team to ensure that orders are fulfilled efficiently and to maintain high customer-service levels. Store staff should be well trained and comfortable in directing customers to the right products, both offline and online. The technology

and systems they use should be connected to or aligned with the retailer's website, so that they won't have to spend precious time trying to reconcile different information.

•   •   •

Even as they reassess and revamp their store network, retailers shouldn't focus exclusively on the stores. The only way a store-network transformation will have the desired impact is if the online channel is at fighting strength. For retailers whose online presence is already robust, it is simply a matter of ensuring a dual focus on both channels. For other retailers, getting the requisite multichannel capabilities and mind-sets in place will require a full transformation. Either way, the online channel must not be neglected in the face of the daunting changes required in the physical store network. The future of retail will belong to retailers that can satisfy the customer, wherever he or she decides to shop.ᵒ

Keiko Morimoto

Lost in translation: The challenge of global channel and customer management

Our research points to five practices that have helped consumer-goods companies outperform their peers.

Cristina Del Molino,
Alejandro Diaz,
and Dennis Martinis

Over the past few years, consumer-packaged-goods (CPG) companies worldwide have faced obstacles to growth—but some companies have fared much better than their competitors. What are the outperformers doing differently from the rest? One answer, according to our recent research, is that winning companies are managing their distribution channels and key retail accounts much more effectively. Across the globe, excellence in channel and customer management appears to be a critical contributor to superior performance.

In this article, we summarize the results of our latest global research on customer and channel management, which includes a survey of 141 of the world's leading CPG manufacturers (see sidebar, "About the research"). We highlight five imperatives that, taken together, present a potential road map for companies that want to extend their channel- and customer-management capabilities to achieve sales excellence globally.

Disparities in performance

Our analysis shows that companies with best-in-class capabilities in customer and channel management grew net sales three to six percentage points faster than relevant peers. Furthermore, these outperformers achieved almost double the return on their

trade investment. This disparity in perfor-mance exists in each of the three regions we studied: Europe, Latin America, and the United States.

Our research also reveals that in spite of growing global connectivity and the emergence of global retail, regional CPG players are consistently doing better than the "global giants"—companies with more than $25 billion in net sales and operations in multiple regions—even though the giants boast advantages of scale, reach, and resources (Exhibit 1).

The divergence in performance underscores the fact that building excellent customer-management capabilities across regions is extremely difficult. Within our sample of 141 companies representing all major CPG product categories, only 24 percent demon-strated excellence across all three of the core capability areas in customer management: sales strategy, pricing, and trade promotion. Moreover, only 7 percent of multinational companies in our survey excelled in all three geographies being studied. For instance, one multinational has best-in-class trade-management practices in Europe but not in Latin America or the

Exhibit 1

Regional champions are outperforming 'global giants.'

Likelihood of outperforming,
proportion of winners to total, indexed[1]

■ Less likely (global giants)[2]
■ More likely (regional companies)

Europe

United States

Latin America
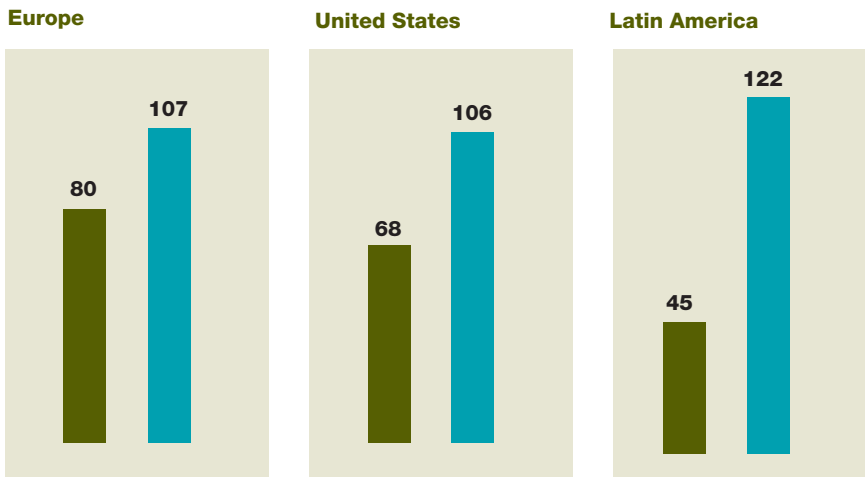
[1]Values greater than 100 indicate greater likelihood to outperform.
[2]Companies with more than $25 billion in net sales and operations in multiple regions.

Source: 2012 McKinsey Customer and Channel Management Survey

Exhibit 2   **Creating customer-management capabilities globally is difficult.**

Companies succeeding across capability areas[1]

Only 24% of winners are successful in all 3 capability areas

141 total participants, including 14 global participants

53 winners
in at least 1 core capability area in any region

28 winners
in 2 core capability areas[2]

13 winners
in 3 core capability areas

12 global participants
won in 1 region

4 participants
won in 2 regions[3]

1 participant
won in all regions

Companies translating their success across regions

Only 7% of the global participants won in all regions

[1]Core capabilities include sales, pricing, and trade promotion.
[2]May be the same capability in multiple regions.
[3]May be the same or different capabilities.

Source: 2012 McKinsey Customer and Channel Management Survey

United States, and thus has not been able to amplify the impact of its success in this core capability area (Exhibit 2).

Five imperatives
Our research points to five imperatives that address the core elements of customer and channel management. CPG companies should assess how well they are executing these imperatives in each region and then establish a program for addressing any capability gaps.

Identify pockets of growth and align resources against them. Compared with their category peers, outperforming CPG companies allocate a disproportionate amount of their resources to high-growth channels, customers, and geographies. For instance, convenience is one of the fastest-growing channels in Europe, and the most successful CPG companies in Europe are investing more of their trade dollars (11 percent of net sales) in the convenience channel than their category peers are (7 percent). Meanwhile,

dollar stores and drugstores are the fastest-growing channels for consumables in the United States, and the outperforming US companies in our study allocate 15 to 25 percent more full-time staff to the account teams handling these channels than relevant peers do. Furthermore, outperformers invest time and resources in customizing account plans, not only for large, high-priority trade customers but also for high-potential independent stores in fragmented retail markets.

Overinvest in collaborative relationships with most important customers. Outperforming CPG companies collaborate with high-priority customers more broadly than category peers do. Top European companies, for instance, engage with customers to jointly strategize on an average of seven topics, including category management, in-store promotions, merchandising, and innovation. By contrast, category peers typically collaborate with retailers on only three to five such topics. Similarly, successful CPG companies in the United States are almost twice as likely as category peers to share new product concepts with their top retail partners at least a year prior to launch. Eighty percent of winners, compared with only 45 percent of nonwinners, communicate with retailers about new products 12 to 24 months in advance. In doing so, they generate strong retailer support (in the form of broader distribution, prioritized shelf placement, and preferential merchandising) and, in some cases, a more compelling product.

Use deep insights and analytics to realize greater returns from pricing and promotion activities. The outperforming companies in our research consistently use revenue-management and trade-promotion optimization tools to improve their pricing and promotion results, as well as their return on trade investment. Successful CPG companies in Europe, for instance, are more likely than category peers to have invested in analytical capabilities that allow them to boost the effectiveness of their pricing and promotional activities. Furthermore, outperformers in Europe tap into more sources and types of data—including data from loyalty cards, point-of-sale transactions, third-party providers, and virtual store environments—when assessing pricing and promotion effectiveness.

Translate distinctive consumer insights into in-store advantages. Compared with category peers, high-performing CPG companies across all three geographies are more regularly collecting unique shopper insights and applying those insights more broadly. Outperformers in the United States, for instance, are 50 percent more likely than category peers to experiment with in-store shopper-interaction tools and technologies for collecting behavioral data. These companies are using the insights they glean to inform their in-store marketing, promotion, and assortment strategies, and innovating accordingly. Similarly, winning CPG companies in Europe are 50 percent more likely than their category peers to use shopper data to better understand product interactions and to shape trade-promotion strategy and tactics. (For examples of how companies are

translating shopper data into in-store advantages, see "Market Map: Finding pockets of growth in mature markets," page 70.)

Increase sales using optimized route-to-market models. Outperforming companies have a disciplined process for optimizing their route-to-market models based on economics and strategic priorities. In Latin America, 90 percent of outperforming companies review their route-to-market strategies—across direct store delivery, wholesalers, and distributors—at least annually. In every region we studied, the outperforming companies evaluate their route-to-market partners at least quarterly. They also tend to have fewer, deeper third-party relationships. Outperformers in Europe, for instance, work with three times fewer distributors than their category peers (Exhibit 3). Additionally, outperforming companies consistently invest in

Exhibit 3

EU outperformers carefully select the best distributors to become true partners.

Number of distributors a company works with[1]
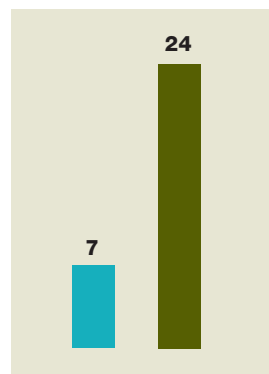
Share of the top distributors[2]
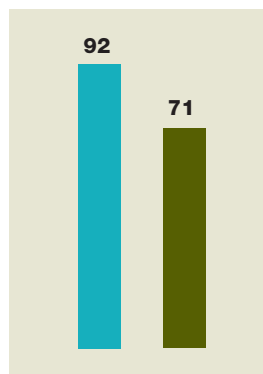
■ Outperformers
■ Others

[1]Considering companies using distributors.
[2]Companies with more than 200 distributors not considered for averages.

Source: 2012 McKinsey Customer and Channel Management Survey

A small set of companies is capturing the advantages of global customer-management excellence; a much larger group is wrestling with how to do so.

improving field sales-force effectiveness (in the form of training and technology), both for themselves and their distribution partners.

Building global customer-management excellence

As our findings suggest, a small set of CPG companies is capturing the advantages of global customer-management excellence; a much larger group is wrestling with the challenges of how to do so. There are multiple approaches that companies can take to achieve sales excellence worldwide.

Capitalizing on a strong global commercial function. A global sales organization sets the capability-building agenda and marshals the resources (talent and budgets) and influence (performance evaluations and compensation schemes) to deliver results. This approach is effective when the company's operating model

emphasizes global rather than regional categories, and when the organization emphasizes and enforces global processes.

Establishing strong regional accountability. Each market or region is responsible for building its own capabilities; the sales organization may boast a global capability-building agenda but there is limited global infrastructure to support it. This approach is effective when the company's operating model is oriented toward regional rather than global categories, when there is a strong performance-management culture embedded in all regions, and when there is even distribution of sales talent across regions.

Building centers of excellence as well as local accountability. The capability-building agenda is created through regional consensus and collaboration. A lean global sales infrastructure

About the research

Since 1978, McKinsey has been studying and benchmarking the channel- and customer-management practices of leading consumer-packaged-goods (CPG) companies in the United States. (For the latest US survey results, see *Winning where it matters: A focused approach to capturing growth—2012 Customer and Channel Management Survey*, on mckinsey.com). In 2012, we expanded the research to include Latin America and Europe; future surveys will include data from Asia. This multiregional focus has allowed us to develop a more global perspective on the practices that differentiate performance.

Our research links in-market results with reported channel- and customer-management practices to identify the winning practices that matter most. A survey is administered to heads of sales and their teams; it seeks information on their capabilities in core areas such as sales strategy, pricing and trade investment, and organizational and financial benchmarking. Our most recent survey, conducted between 2011 and 2013, included 141 companies across the United States, Latin America, and Europe, representing about $900 billion in net sales globally and eight of the top ten CPG companies. The research base included a cross-section of industry players from all major CPG product categories.

develops processes and tools for all to use and promotes the sharing of best practices. This approach is effective when the company's operating model balances power across businesses and regions; when it has strong functional networks, in which the cross-pollination of ideas by function and geographies occurs; and when there is an even distribution of sales talent across regions.

In any of these models, leaders seeking to develop channel- and customer-management excellence on a global scale must take certain steps:

- *Know where you stand.* Build a fact-based perspective on your commercial capabilities across geographies.

- *Pick your battles.* Prioritize your market-level capabilities based on the potential effects of your activities and the size of the prize; factor in both your company's starting point in the market and the local dynamics of the market.

- *Play to your strengths.* Conduct an honest assessment of your company's operating model and your sales organization's culture and composition. Consider what that assessment implies about the choice of capability-building approach.

- *Manage for impact.* Invest in and establish processes for creating transparency across your global operations; this includes instituting a performance-management program that measures outcomes and facilitates the sharing of best practices.

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Competition in the CPG industry continues to intensify. Our findings show that both faster-than-average growth and higher returns on commercial investment are functions of best-in-class channel and customer management. Clearly, the time for CPG companies to build global capabilities in these areas is now.○

Cristina Del Molino is a consumer-packaged-goods specialist in McKinsey's London office, **Alejandro Diaz** is a director in the Dallas office, and **Dennis Martinis** is a director in the Geneva office.

Toko Ohmori

'The business of creating desire': An interview with the CEO of LVMH Fashion Group

Since 2006, Pierre-Yves Roussel has been in charge of some of the fashion industry's best-known luxury brands. Here, he shares his views on creativity and inspiration, the evolution of brands, and how the Internet is—and isn't—changing the industry.

Olivier Sibony and Thomas Tochtermann

Makers of luxury goods grapple with many of the same challenges as other companies in the consumer-products and retail sectors: keeping customers happy, offering the right products through the right channels, and finding and nurturing the best talent. LVMH Moët Hennessy Louis Vuitton, the multinational conglomerate that owns some of the world's most successful luxury brands, is no exception. Pierre-Yves Roussel knows this well. As chairman and CEO of the LVMH Fashion Group, he oversees a growing stable of brands including Céline, Givenchy, Kenzo, Loewe, Marc Jacobs, Donna Karan, Pucci, Nicholas Kirkwood, and J.W. Anderson.

In a recent interview with McKinsey's Olivier Sibony and Thomas Tochtermann in Paris,

Roussel talked about some of the decisions he's made and what he's learned since becoming a fashion-industry executive a decade ago.

McKinsey: *You were new to the fashion world when you first went to work for LVMH. What surprised you most about the company and the industry?*

Pierre-Yves Roussel: When I joined LVMH Group, I knew only what most people knew about it: it has a portfolio of prestigious brands, some of them had been around for 150 or even 200 years, it's a global company, and so on. But what struck me is how central creativity and innovation are to everything we do. For [LVMH chairman and CEO] Bernard Arnault, creativity is the lifeblood of what

we do across the entire organization, whether it's in the traditional fashion houses that are known for their craftsmanship, or in wine and spirits, watches and jewelry, or fragrance. It doesn't mean we're frantically changing our products all the time—we have iconic products that have been in our stores for decades—but we apply creativity to always make them relevant. We create special versions, special colors, small adjustments that consumers might not even notice but that are actually quite innovative.

We know that if we stop being creative and innovative, it's all over—even for the powerful fashion houses that have been here for years—because, in a way, we are in the business of creating desire and happiness. Most of our customers are people who feel they have worked hard and want to treat themselves well, they want to buy something they really enjoy, they want to be seduced. So we have to constantly surprise our customers. We have to come up with exceptional products that make them say, "Wow, this is new, it's interesting, it's beautiful. I really want it." If we don't do that, they will not come to our stores.

McKinsey: *How do you do it? How does a large company like LVMH stay innovative and creative?*

Pierre-Yves Roussel: It starts with having a real culture of creativity. We hire people who are, broadly speaking, interested in creativity. They don't necessarily have to be into fashion. And some people are not creative themselves, but they are fundamentally people who are very curious and open minded, and who like to discover new things.

Bernard Arnault talks about the LVMH management team as people who are "inspired"—meaning they are inspired by the brands. They are inspired and genuinely interested in the work that the creative team does. The creative people we work with—the designers, architects, photographers, winemakers, and perfumers, or "nez"—have to be surrounded by people who look at what they do in a positive way.

Of course, we also have creativity in our ateliers. Whenever we bring in a new designer, our artisans and craftsmen are asked to implement a new vision. But if the designer is respectful of the craftsmanship—and the great designers always are—the craftsmen are thrilled, because they have a passion for learning and for trying new ways of doing things. When a new designer comes in, they get to really challenge themselves and push their skills to a new level.

McKinsey: *Where do you find these creative, innovative people?*

Pierre-Yves Roussel: We find them through multiple sources. Our talent scouting also involves the creative director of each brand, because great creative leaders have lots of connections and are usually well known, and everybody wants to work with them. A lot of talented designers want to work with [Céline's creative director] Phoebe Philo or [Givenchy's creative director] Riccardo Tisci or Marc Jacobs. They are like magnets. People want to work with the best—that's as true in the creative fields as it is in business.

We also work with design schools. We have many trainees. And many young designers who have their own brands also collaborate with us. So, we have different sources of talent. Just like creativity is a nonlinear process, the recruitment of creative people is a nonlinear process. This

year, [Louis Vuitton executive vice president] Delphine Arnault launched, with incredible success, the LVMH Fashion Prize, to help new emerging creative talent from all over the world.

McKinsey: *You have more than 200 designers working on a variety of LVMH brands. How do you establish each brand's unique identity?*

Pierre-Yves Roussel: First of all, each fashion house is located in a different place—usually a place that ties into its history. We didn't relocate them all to one big building on Avenue Montaigne in Paris! For example, Givenchy is still in its historic building on Avenue George V; Pucci is in its historic palazzo in Florence. Being in different places helps them keep their brand identity.

We "frame" each brand by defining what we call its DNA. We've been popularizing this concept of DNA, which I think is sometimes misunderstood; it gives the impression of a scientific and very analytical process. But it doesn't happen like that. I think it's more about capturing the essence and personality of the brand, the emotion, the aspects that are not necessarily rational, the intangible things that need to be understood about a brand.

To frame a brand, we start with a few "bricks": visuals, iconic products, places, and a few words. Those bricks are just the beginning of a journey: we have lots of discussions, we work with our creative teams, they propose a direction and a vision. In my first few years at LVMH, I tried to hire designers who I felt perfectly fit the brand—almost as if I was looking to be reassured about their work. But we found that the ideas they came up with were too obvious, and we ran out of steam quite quickly. So now we are more interested in

hiring and having a dialogue with someone who we know will take us in a new direction, beyond the obvious, with a strong vision.

McKinsey: *So it's not just the products that evolve; the brands do so as well.*

Pierre-Yves Roussel: Yes. Our brands have been around for a long time, and they are very rich. We use different facets of the brand at different times. We take what resonates in today's environment. Five years or seven years later, we might emphasize another facet of the brand. If you look at the archives of Dior or Givenchy, you will see how many different expressions a single brand can take over time.

McKinsey: *There's a big debate in the industry about how far you can stretch a brand. Some of your brands have expanded into fragrance and jewelry; a few of your competitors now have hotels and cafés. What's your strategy for brand extensions?*

Pierre-Yves Roussel: I think some brands have more potential for expansion than others. At LVMH we do things organically—we expand when we feel it's the right time for the brand, when there is a sense of excitement about doing it. So we never feel it is forced, or that we have to do it for business reasons.

I look at brands as books, and we write chapters. Each chapter has to connect to the larger story, but it has to be new and interesting. The Marc Jacobs brand is almost 20 years old. We tried to launch a fragrance ten years ago, but it was too early. The brand hadn't matured enough. We needed the brand to mature over several collections and seasons, because a fragrance crystallizes a chapter of your brand. We tried again four years ago, and it clicked. It's a massive success.

Pierre-Yves Roussel

Vital statistics
Born in 1965 in Paris, France

Has 3 children

Education
Holds an MBA from the Wharton School of the University of Pennsylvania

Holds a postgraduate degree from Brussels University

Career highlights
LVMH Fashion Group
Chairman and CEO (2006–present)

Group executive vice president, strategy and operations (2004–06)

McKinsey & Company
Director (2004)

Principal (1998–2004)

Consultant (1990–98)

Crédit Commercial de France (now HSBC France)
Financial analyst (1988–90)

Fast facts
Member of the board of the Fédération Française de la Couture, du Prêt-à-Porter des Couturiers et des Créateurs de Mode

Member of several prestigious fashion juries including ANDAM (France), LVMH Fashion Prize, and CFDA Fashion Incubator

Member of the board of directors of the Business of Fashion, an industry website

McKinsey: *Let's talk about the Internet. How has it changed the fashion industry in general and LVMH's strategy in particular?*

Pierre-Yves Roussel: The Internet has increased the visibility of fashion, but I think the fundamentals of the industry haven't changed. People have talked about and written about fashion for centuries; now it happens through the Internet and social media, but it's nothing new. Television, fashion magazines, and other media were already global before the Internet.

What was not global was pricing: consumers couldn't compare prices, so prices were much higher in Japan than in Europe, for example. Some of that was because of differences in taxes and operating costs among countries, of course, but part of it was due to differences in people's appetite and willingness to pay for luxury goods. Now there are pretty much no real price differentials—that has been one major impact of the Internet. But otherwise the Internet has just amplified and accelerated what had already been taking place.

McKinsey: *But half of luxury consumers research products online before buying. How has that aspect of the Internet affected your marketing strategy?*

Pierre-Yves Roussel: The Internet is often a consumer's first window into our brands, so if someone goes online we want to be sure they are actually experiencing our brand, not a counterfeit store. In the nondigital world, nobody but Céline could put an ad

in *Vogue* claiming to be Céline, but on the Internet you can buy keywords or search terms and post something that pretends to be Céline. We've invested a tremendous amount of money in owning and protecting our brands, so when you search for Céline, the first thing we want you to see is our trademarked Céline brand—the real one. Just as important, we make sure that no matter where a visitor goes on our site, they get a consistent experience; the entire site has to reflect what the brand is about.

Then there is the question of whether or not we want to sell on the Internet. People certainly buy very expensive things on the Internet, and we do sell some of our brands there. We even offer some services such as customization and monogramming. But we decided that Céline, for example, would not sell any products on the Internet, either directly or through third parties. There isn't a single Céline product that you can buy online. We made that decision five years ago, and we've stuck to it. We have invested so much in creating the best-quality products that we just want people to experience it. So if some people want to buy a Céline bag at midnight on a Sunday, sorry, they cannot. They have to wait until the store opens on Monday. By the way, this bag—they're going to keep it for 20 years. So it's worth the wait.

At the end of the day, we don't sell service—we sell products. We're a very physical business. You have to smell a fragrance, and you cannot smell it on the Internet. You cannot try on a pair of shoes or a dress on the Internet; you cannot touch the fabrics.

I don't know whether the Internet will eventually be 10, 20, 30 percent of sales or more—but for sure, 60 or 70 percent of people are doing research online now. So it's a major window into our brands, and that's the way we are treating it.

McKinsey: *Has the Internet affected the way you think about your physical store network?*

Pierre-Yves Roussel: Our customers do their research on the Internet, so by the time they enter the store, they know the collection very well—sizes, colors, everything. They also know what our competitors offer. That means our in-store staff has to be extremely well trained; they have to know everything about our products and our competitors' products.

The job of the store is to magnify the product and create the most enjoyable experience for the consumer. That's the essence of retail. It's not about having a luxury store that has marble everywhere and looks expensive; that's not the point. People don't come to buy the store—they come to buy the product. And some people will be in the store for three hours and try on 15 pairs of shoes, while others just want to come in, buy something, and get out. We have to be totally flexible, so that both types of consumers can feel they are in a great environment. We're obsessed with giving people the best in-store experience.

McKinsey: *Aside from this obsession with the customer experience, what do you think are other factors that have led to LVMH's growth and longevity?*

Pierre-Yves Roussel: Bernard Arnault is a unique combination of an incredible entrepreneur who is willing to take risks and an amazing leader with exceptional intuition for all the things we've just talked about. He has surrounded himself with people who are

experienced, independent, and opinionated, and he gives them full freedom, but he is also able to keep things under tight control. I think our organizational structure is perfectly suited to our industry. We're able to adjust amazingly fast because we're not run by consensus; we never put people around a table and say, "Let's all agree on this or that." So we can be very agile.

Agility makes a big difference in a fast-changing business. Take travel retail: it used to be a Japanese business, and in the span of about seven years, it became an entirely Chinese business. I don't know any other business where you lose your entire customer base and get a new one in seven or eight years. We look at the facts, we talk about what works and what doesn't work, we fix what's not working, and we adjust quickly. Whatever happens, we're able to adjust fast.

McKinsey: *On a personal level, what motivates you? What are your own sources of inspiration?*

Pierre-Yves Roussel: Honestly, I get inspired by coming to the office every day. I work with many brands, and the diversity of projects and people is extremely interesting. I am as passionate about exploring and discovering what our creative people are doing as I am about making a business out of it.

My role involves creative problem solving. The creative people come to me with their vision, and I problem solve with our management teams to figure out whether it fits with what we want to do, whether it's the right time, and how to make it happen. And we're constantly reorganizing and restructuring our teams. So there's the excitement of daily change, but there's also the fulfilling sense of building something for the very long term—something that will last.○

Luxury shopping in the digital age

The "right" digital strategy differs for every luxury brand, but the essential elements are the same: a strong mobile presence, a selective approach to social media, and a tight focus on carefully chosen metrics.

Linda Dauriz,
Nathalie Remy,
and Nicola Sandri

Among luxury companies, conventional wisdom used to be that participation in e-commerce—and, in particular, selling through multibrand retail websites—was only for the lower and middle range of products. The pervasive belief was that luxury shoppers, with their discriminating taste and preference for high-priced goods, wouldn't buy expensive things online; they would always opt for the personalized customer service and tactile shopping experience that monobrand brick-and-mortar stores provide.

That thinking has evolved in recent years. The success of ventures such as Net-A-Porter has shown that consumers are indeed willing to buy luxury products online, and at undiscounted prices. Our latest luxury-industry research, conducted in collaboration with Italian industry group Altagamma Foundation, indicates that luxury companies are recognizing—and, in some cases, successfully capitalizing on—the increasingly important role that the Internet plays in luxury shoppers' purchasing decisions (see sidebar, "About the research"). One telling statistic: while overall sales of luxury goods grew by a mere 2 percent in 2013, online luxury sales increased by 20 percent to an estimated €9 billion. We believe this growth will continue; we project that sales of luxury goods online will more than double to approximately €20 billion in the next five years.

Today e-commerce represents a scant 4 percent of luxury sales—but e-commerce is only one aspect of the digital opportunity. Our research found that an additional 40 percent of luxury purchases are in some way influenced by consumers' digital experience—for example, through online research of an item that is subsequently bought offline, or social-media "buzz" that leads to an in-store purchase.

Given the undeniable and growing power of the digital universe, all luxury brands must think hard about their digital presence. The "right" digital strategy differs for every brand, but what's certain is that it's no longer just about a beautifully designed and user-friendly website or effective banner ads. The most successful luxury brands will be those that build a compelling mobile presence, engage and influence consumers through targeted use of social media, and focus on a carefully chosen set of digital-performance metrics.

Going mobile, being social

Three out of four luxury shoppers own a smartphone and about half own a tablet, according to our interviews with more than 3,000 luxury customers in six major luxury markets. Not surprisingly, while they're at work they rely mostly on desktop or laptop computers, but while commuting, dining, or shopping, they're more likely to use smartphones, especially to search for products and store locations. Indeed, more than half of luxury shoppers' searches are mobile, and more than one in five of the shoppers in our sample said they often or always do some research on a mobile device before making a luxury purchase.

Luxury brands with informative, easy-to-navigate sites optimized for mobile devices—as opposed to just standard websites designed for full-size computer screens—are therefore more likely to drive store traffic. But brands shouldn't rely exclusively on their own sites to promote their products to potential customers. Luxury shoppers are increasingly turning to product-oriented sources of information, such as the websites or mobile sites of multibrand retailers and department stores, so that they can easily compare products and prices (Exhibit 1).

Indeed, many luxury brands—in efforts to engage and influence customers in every stage of the "customer decision journey"—are partnering with multibrand retailers online. However, these brands must make sure that their presence on multibrand sites plays a strategic role and reinforces their brand positioning. An ultraluxury brand that seeks to convey an image of peerlessness and exclusivity, for instance, might choose to be absent from any multibrand sites, whereas a brand that wants to play in the "affordable luxury" segment may decide to feature a few lower-priced items on the web and mobile sites of high-end department stores.

What about mobile applications? Our findings suggest that investing in mobile apps doesn't yield the best returns and therefore should not be a high priority for luxury brands: only about 4 percent of the shoppers we surveyed reported downloading a luxury-brand app. Indeed, only about a quarter had downloaded any mobile apps at all. We found that luxury consumers are interested only in apps that offer detailed, up-to-date information or useful services—for

Exhibit 1

Luxury customers are increasingly researching products on multibrand sites.

Luxury customers who do online research before buying,
% of respondents

United Kingdom	54
United States	52
France	51
Japan	48
Italy	45
China	33
Global average	48
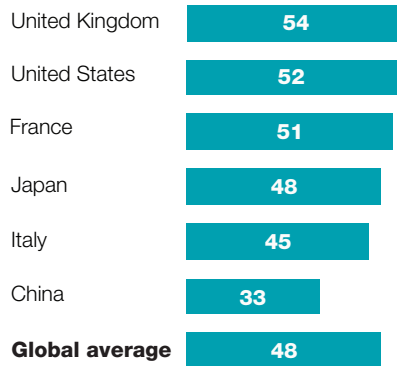
Preferred sources for online research,
% of respondents

Multibrand full price	39	+1% vs 2012
Multibrand off-price	34	
Department store	34	
Official brand sites	31	−12% vs 2012
Luxury forum	29	
Multibrand event	26	
Luxury blogs	21	
Facebook	15	
Twitter	13	
Other social media	12	
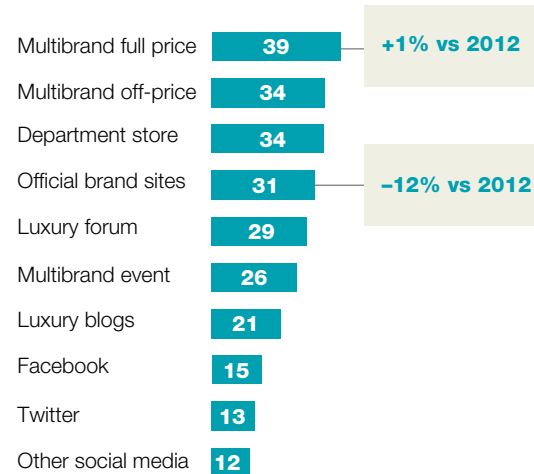
Source: China Internet Network Information Center; International Telecommunications Union; Pew Research Center; McKinsey analysis

instance, an app that features an easy-to-browse product catalog or that delivers exclusive offers to loyal customers. Luxury brands interested in developing apps should keep these criteria in mind.

As for social networks, luxury shoppers use them—but mostly to do research or retweet other people's posts, not so much to post their own comments. Thirty percent of the luxury shoppers in our sample had commented on luxury products via social media, but at an infrequent rate: less than one post per month on average, with the majority of the posts taking a neutral position on a luxury product (for example, posting pictures of leather handbags) rather than expressing either a positive or

negative opinion about a particular luxury brand or company. The luxury category with by far the most social-media buzz: cars, which are mentioned in about 2,000 tweets per day. Ready-to-wear apparel comes in at a distant second place, followed by fashion accessories.

Our analysis of the content of social-media posts revealed that luxury shoppers use different social networks for different reasons. For example, they use Twitter primarily as a way to learn about or comment on live events in real time, whereas they look to Facebook mostly for information on promotions or discount coupons. On blogs and forums on media websites, most user comments are about in-store experiences or specific products.

ory

About the research

Digital Luxury Experience 2013, available at digitalluxuryexperience.it, is a collaborative effort between McKinsey and the Altagamma Foundation. The research for this report encompassed more than 300 luxury and "affordable luxury" brands in the following 12 categories: fashion apparel and accessories, jewelry, food and beverage, furniture and design, watches, cosmetics and fragrances, automotive, hospitality, wine and spirits, yachts, fine china, and other (including fine art and electronics).

To understand the preferences and behavior of luxury shoppers—defined as high-income consumers who purchased at least one item from a luxury brand in the preceding year—the team scoured 13 million public online comments, surveyed 300 online respondents, and conducted in-person interviews with more than 3,000 luxury shoppers in six major luxury markets: France, Germany, Italy, Japan, the United Kingdom, and the United States. The research team also tracked a set of 70 performance metrics across more than 700 luxury websites.

The research methodology was developed and refined by the Digital Luxury Experience Advisory Board, comprising senior executives from 15 leading global luxury brands across a range of categories.

Almost every luxury brand falls into one of these categories, dictated primarily by its brand positioning, its channel strategy, and the level of retail control it wants to exert. A brand's digital archetype will therefore remain fairly constant, unless the company decides to fundamentally reposition the brand.

Once it has determined its digital archetype, a brand should compare its key performance indicators (KPIs) against competitors within the same archetype. Through this benchmarking exercise, it can identify which digital KPIs are most closely correlated with either sales or earnings. To illustrate, a brand might decide that one of its financial objectives is to increase online sales. It would then gather data on each digital KPI (for example, average number of unique visits per day or the number of Facebook followers), compare its performance with that of competitors of the same archetype, and pinpoint the KPIs that appear to be correlated with online sales—recognizing, of course, that changes in performance in one KPI will almost certainly have an impact on other KPIs.

The most forward-looking companies are testing digital opportunities across their entire organization, monitoring impact closely, and scaling up effective approaches quickly.

Having identified the most relevant KPIs, the brand must then take tactical action to boost its performance in those KPIs. If, for instance, it aims to increase its average number of page views per visit, one possible action would be to tweak elements of its website design—such as the layout of pages, the placing or naming of links, the size of images, and so on. If the number of Twitter mentions is one of the priority KPIs, then images could be added to the brand's tweets to increase the likelihood that they will be retweeted. The brand should track key metrics on a weekly basis and test a variety of approaches to see which ones actually move the needle.

• • •

Digital tools and technologies are revolutionizing the luxury-goods industry, and no luxury brand can afford to ignore them. Online sales—as well as the influence of mobile and social media on offline sales—will continue to grow rapidly, in both developed and emerging markets. The most forward-looking companies are testing digital opportunities across their entire organization, monitoring impact closely, and scaling up effective approaches quickly. All other luxury companies should follow their example or else risk falling far behind.o

Keiko Morimoto

The hidden value of organizational health– and how to capture it

New research suggests that the performance payoff from organizational health is unexpectedly large and that companies have four distinct "recipes" for achieving it.

Aaron De Smet, Bill Schaninger, and Matthew Smith

[1] Scott Keller and Colin Price, *Beyond Performance: How Great Organizations Build Ultimate Competitive Advantage*, first edition, Hoboken, NJ: John Wiley & Sons, 2011. See also Scott Keller and Colin Price, "Organizational health: The ultimate competitive advantage", *McKinsey Quarterly*, June 2011, mckinsey.com.

For the past decade, we've been conducting research, writing, and working with companies on the topic of organizational health. Our work indicates that the health of an organization is based on the ability to align around a clear vision, strategy, and culture; to execute with excellence; and to renew the organization's focus over time by responding to market trends. Health also has a hard edge: indeed, we've come to define it as the capacity to deliver—over the long term—superior financial and operating performance.

In previous articles and books, such as *Beyond Performance*,[1] we (and others) have shown that when companies manage with an equal eye to performance and health, they more than double the probability of outperforming their competitors. Our latest research, at more than 800 organizations around the world, revealed several new twists:

- We found that the linkage between health and performance, at both the corporate and subunit level, is much clearer and much larger than we had previously thought. With the benefit of more data and a finer lens, we discovered that from 2003 (when we began collecting data on health) to 2011, healthy companies generated total returns to

shareholders three times higher than those of unhealthy ones.

- We further discovered that companies consistently outperforming their peers generally conformed to the pattern of one of four distinct organizational "recipes." We had already recognized these patterns but hadn't understood their strong correlation with health, operational success, and financial performance.

- We also uncovered a practical alternative to the common (but too often disappointing) approach of seeking to improve corporate health by closing every best-practice gap. More tailored initiatives that combine efforts to stamp out "broken" practices while building signature strengths not only are more realistic but also increase the probability of building a healthy organization by a factor of five to ten.

In short, we're more convinced than ever that sustained organizational health is one of the most powerful assets a company can build. We're also clearer on how to achieve it, including the pitfalls to avoid on the road. We hope this is welcome news to leaders worried about the long term, who frequently complain to us that the benefits of their one-off reorganization initiatives are ephemeral.[2]

How we track health

For the past ten years, we have measured and tracked organizational health in hundreds of companies, business units, and factories around the world. We ask employees (more than 1.5 million and counting) about their perceptions of the health of their organizations and what management practices they do or don't see in them. We then produce a single health score, or index, reflecting the extent to which employees say that their organizations are "great" in each of nine dimensions (or outcomes) of organizational health. To establish more precisely what each organization looks like, as well as its strengths and weaknesses, we also ask employees how frequently they observe[3] four to five specific management practices that drive those nine outcomes. Exhibit 1 provides some flavor of how the management practices, 37 in all, line up against the outcomes.

When we have done this with similar units—such as factories, processing units, and regions—in a given company, we have frequently found a strong correlation between organizational health (as measured by our survey) and the unit's financial or operating performance. And when we compared the health metrics of more than 270 publicly traded companies[4] with their financial-performance metrics, we found that the healthiest generated total returns to shareholders that were three times higher than those of companies in the bottom quartile, and over 60 percent higher than those of companies with "middle of the road" health profiles.

Management practices matter

The most interesting findings, though, came when we looked more closely at the healthiest organizations in our database. Obviously, all had high health scores as measured by the nine outcomes of health. But when we delved deeper and looked at the 37 practices that management teams focus on to deliver those outcomes, we discovered that four combinations of practices,

[2]These were the fortunate ones. Our global survey shows that only one-third achieve their change goals.
[3]On a scale ranging from "never or almost never" to "always or almost always."
[4]The full database includes many nonpublic companies and government organizations that were excluded for this analysis.

Exhibit 1

The organizational-health index tracks nine dimensions of organizational health, along with their related management practices.

In all, the index covers 37 related management practices. Here are selected examples of practices for 3 of the dimensions.

Role clarity
Performance contracts
Consequence management
Personal ownership

Shared vision
Strategic clarity
Employee involvement

Direction

Accountability

Coordination and control

External orientation

Leadership

Innovation and learning

Capabilities

Motivation

Culture and climate

Meaningful values
Inspirational leaders
Career opportunities
Financial incentives
Rewards and recognition

or recipes, were associated with sustained success. Indeed, further analysis showed that companies strongly aligned with any of these four organizational recipes were five times more likely to be healthy and to deliver strong, sustained performance than companies with mixed (or random) recipes.

Each of the four clusters we identified from the data reflects a distinct underlying approach to managing, including core beliefs about value creation and what drives organizational success. Each can be described by the specific set of management practices prioritized by companies that follow it (Exhibit 2).

The hallmark of the first, or *leader-driven*, recipe is the presence, at all of an organization's levels, of talented, high-potential leaders who are set free to figure out how to deliver results and are held accountable for doing so. This open and trusting culture is typical of highly decentralized organizations or of new businesses, where the resolve of strong leaders, effectively multiplied by their peers across the organization, is essential to create something from nothing. While most organizations use career opportunities to motivate employees, companies in this cluster use career opportunities as a leadership-development practice. Role modeling and real experience is more important than passing along sage lessons.

Exhibit 2

Each of the four clusters identified from the data reflects a distinct approach to managing and can be described by a specific set of management practices.

Top 5 out of 37 management practices prioritized by companies that follow given approach

Leader driven	Market focused	Execution edge	Talent and knowledge core
Career opportunities	Customer focus	Knowledge sharing	Rewards and recognition
Inspirational leaders	Competitor insights	Employee involvement	Talent acquisition
Open and trusting	Business partnerships	Creative and entrepreneurial	Financial incentives
Financial incentives	Financial management	Bottom-up innovation	Career opportunities
Risk management	Government/community relationships	Talent development	Personal ownership

Organizations following the second, or *market-focused*, recipe tend to have a strong external orientation toward not only customers but also toward competitors, business partners, regulators, and the community. These companies strive to be product innovators, shape market trends, and build a portfolio of solid, innovative brands to stay ahead of the competition. The best ones both respond to demand and develop products that help shape it (a strong recent example would be Apple as it reshaped several consumer-technology markets). They have a shared vision and the strategic clarity to ensure that employees explore the right market opportunities, as well

as strong financial management to provide individual accountability and to ensure that responses to market trends are in fact profitable.

The third recipe, which we call *execution edge*, includes companies that stress continuous improvement on the front line, allowing them to raise quality and productivity constantly while eliminating waste and inefficiency. These companies place a heavy emphasis on sharing knowledge across employees and sites—not just as a way to foster innovation but, paradoxically, also as the primary way to drive standardization. Knowledge sharing helps to manage the frequent trade-offs between the top-down need for

Successful companies match their organizations
to their aspirations; misalignment can often
undermine both performance and health.

networkwide consistency and bottom-up
encouragement of employees; without it, the
best ideas might not get disseminated across
different units of an organization. Such
companies are unlike market-focused ones,
which push alignment and consistency more
strongly from the top down by analyzing
external trends and developing a clear strategy
for where the market is going.

The fourth and final recipe, *talent and
knowledge core*, is found frequently among
successful professional-services firms,
professional sports teams, and entertainment
businesses. Such organizations emphasize
building competitive advantage by assembling
and managing a high-quality talent and
knowledge base. They typically focus on
creating the right mix of financial and
nonfinancial incentives to acquire the best
talent, and then on motivating employees and
giving them opportunities. In contrast to
companies in the leader-driven group (whose

value is created through teams directed by a
strong leader), talent and knowledge-core
organizations succeed thanks to highly skilled
individual performers. (For more on how our
findings translate in a narrower industry
context, see sidebar, "Organizational health
in consumer-goods companies.")

Building a healthier organization

What can be learned from the four healthy
organizational clusters our latest research
identified? How can companies adapt
accordingly? We certainly wouldn't suggest that
they blindly seek to replicate one of the cluster
recipes, ingredient by ingredient or practice by
practice. Just like great chefs don't copy and
paste the recipes of others, companies must
take these general archetypes as inspiration
and identify a pattern of healthy practices that
best fits their own organizations and strategies.
In their continuing search for a better-
functioning organization, companies should
consider the following issues.

Organizational health in consumer-goods companies

Sorcha McKenna

For companies in the consumer-goods industry, organizational health is an asset that can help sustain a competitive edge in mature markets and capture growth in emerging markets. In our experience, healthy consumer-goods companies are able to respond faster and more flexibly to the challenges they typically face in mature markets, such as stagnant growth, intense competition, and rising raw-material costs. Branded-goods manufacturers with a consistent approach to organizational health can make tougher choices faster and execute radical changes more successfully. In emerging markets, healthy companies are able to grow more quickly than their less healthy counterparts, in part by maintaining a strong and effective talent pipeline, leveraging their platforms and systems across markets, and developing innovations that differentiate them from competitors.

The four recipes my colleagues identified can help consumer-goods manufacturers achieve higher levels of organizational health and simultaneously drive better financial and operational performance.

Leader driven. Several consumer-goods companies used to follow this recipe. However, in many companies, the emergence of global brands has resulted in a lessening of local leaders' degrees of freedom. While local leaders are still accountable for results, they now rarely make big choices that will have an impact on a brand's overall strategy. At such companies, few local leaders have the opportunity to develop the skills that global leadership roles require.

Market focused. Most consumer-goods companies follow this recipe. They have a customer-centric approach to management. Many of the most successful consumer-product innovations of the 20th century—disposable diapers being one example—are a direct result of this strong customer focus.

Execution edge. Some consumer-goods companies, particularly those that operate in many small local markets, have used certain ingredients from this recipe—for example, they have developed centers of expertise in marketing and innovation that liaise closely with staff in local markets to facilitate the sharing of knowledge and best practices. Such an arrangement allows these companies to learn from local improvements and spread them quickly across the global network to deliver a real execution edge over competitors.

Talent and knowledge core. Although they certainly use some of the management practices strongly associated with a talent and knowledge core, this recipe in its pure form is rare among consumer-goods companies.

Sorcha McKenna is a principal in McKinsey's Dublin office.

The imperative of alignment between strategy and health

Successful companies match their organizations to their aspirations. Once a company has identified the most appropriate organizational recipe for the chosen strategy, it should align the organization as far as possible with that mix of practices. If its most important day-to-day practices do not support its strategy, or are not consistent with the direction communicated by its leadership, the misalignment can often undermine both overall performance and health.

Such misalignments often happen in strategic shifts. A large company we know changed its product and service mix and rapidly accelerated its globalization strategy. It then realized that what it really needed was a new focus on developing high-potential leaders who could direct next-generation businesses and operate with a global mind-set. Such moves would bring the company closer to the leader-driven recipe. Its old execution focus was no longer a powerful competitive weapon.

This company developed what it called "critical paths" for a ladder of opportunities available to high-potential leaders. These paths culminated in an important role, such as general manager for a large region, and promoted to prominence leaders who were visibly inspirational. When the company's own research showed that trust accounted for 90 percent of its employees' perceptions of how effective their managers were, it focused its development efforts accordingly. (Coincidentally, trust was one of its three core cultural values.)

The company ultimately avoided the "commodity hell" it feared. It reliably increases its margins every year, leads its industry in segments where it elects to compete, and is recognized by respected analysts as a leading "talent factory."

The importance of selection

Our earlier research had already shown that to be in the top group of healthy organizations, companies must do better than bottom-quartile ones across the full suite of 37 management practices. But a better-than-bottom score is generally enough for practices that are not essential to a company's recipe. The trick is to be truly great in a handful of practices—and not to worry a lot about the rest, which is just as well, because no company has the capacity, resources, or management time to be great at all 37. The power of the four recipes our research unearthed is that they provide an indication of where to concentrate improvement efforts.

We discovered that 73 percent of the companies that strongly or very strongly follow one of the four recipes *and* are not in the bottom quartile for any practice enjoy top-quartile health. By contrast, only 7 percent of companies that have at least one broken practice *and* a less-than-strong embrace of any of the recipes are in the top quartile. Taken together, this represents a better than 10:1 ratio of effectiveness. It also

suggests that the right course is to fix all broken practices (by improving them enough so that a company escapes the bottom quartile) and to turn a targeted handful of practices into true strengths. Trying to exceed the median benchmark on a large number of practices is not effective.

The danger of recipe killers

Our research also identified recipe killers—the management equivalent of baking a beautiful chocolate soufflé but then adding too much salt and rendering the dish inedible. The new data suggest that, just as concentrating on too many practices diminishes an organization's odds of achieving top health and success, adding the wrong practices to the recipe can be extremely harmful.

One example of this is the overemphasis on command-and-control leadership styles in companies trying to follow the execution-edge recipe. Most people think execution requires that approach. Actually, execution requires

tremendous on-the-ground energy, so the best execution-driven organizations employ internal competition and bottom-up innovation to empower the front line to excel. Overuse of top-down processes would kill that dynamic—and, indeed, in our data set the least healthy execution-edge organizations are those that have the authoritative-leadership practice in their top ten.

•   •   •

Building organizational health can be a powerful lever for improving the long-term performance of companies. Leaders can't ignore this lever, given the accelerating pace of change in most industries.

Companies can achieve organizational health in any of the four ways we have discussed here. But gratifying simplicity masks hidden risks. Choose your recipes and ingredients carefully, as the wrong mix may leave a bad taste in the mouths of employees, executives, and investors alike.○

Insight-driven sales transformation

By embedding consumer insights into their merchandising processes, retailers can boost both like-for-like sales and profitability while creating smarter merchants.

Florian Bressand, Peter Breuer, and Nedim Suruliz

Over the past five years, traditional large retailers—such as supermarket chains, drugstores, and big-box specialty retailers— have found growth elusive. In most major markets they are facing intensified competition, particularly from discounters, as recession-era shopping habits have become entrenched. Opening new stores is no longer a surefire way to grow, in light of market saturation and the boom in e-commerce (see "Making stores matter in a multichannel world," page 4). Same-store sales growth, or "like for like" growth, has been flat or declining for most large players across all major European markets, and margins are under pressure.

Amid this punishing environment, how have a handful of retailers outperformed the competition and achieved substantial like-for-like sales growth? In our experience, they have succeeded primarily by developing a deeper understanding of consumer and shopper behavior and embedding these insights into the way they manage every product category. In other words, they have implemented an insight-driven sales transformation.

In this article, we describe an approach that has helped leading retailers kick-start such a transformation. We call it the "category accelerator": it is simultaneously a thorough,

data-driven category-planning process and an intensive capability-building program for category managers. Retailers in the grocery, drug, and do-it-yourself sectors that have used the approach have achieved a sales uplift of 3 to 5 percent and a net margin improvement of one to four percentage points in 6 to 18 months.

Three steps to transformation

As they seek to increase like-for-like sales, retailers encounter a number of common challenges. One is wide variability in performance and execution among product categories, in part because each category manager does his or her job independently of and differently from others. They use different tools and techniques, and some rely on data and insights more than others. Another common challenge is a lack of coordination of improvement initiatives; pricing actions, for example, are often disconnected from visual-merchandising changes. In such cases, retailers miss out on capturing the full potential of an integrated category-wide (not to mention store-wide) transformation.

The category accelerator addresses all these problems in a systematic, sustainable fashion. In a nutshell, it is a program for creating insight-driven category plans for all of a retailer's product categories, using a standardized process supported by a dedicated team of experts. The three main steps of the approach involve building the core team, creating best-practice content, and developing insight-driven category plans.

Set up a cross-functional team of 'navigators' and analysts

The first step is to establish a cross-functional core team focused on delivering quick wins. The team should combine category-management expertise (in the form of high-profile, experienced merchants) and analytics expertise (data analysts, often hired through targeted external-recruitment efforts). Retail leaders may initially balk at the idea of pulling top merchants from their day-to-day tasks, but it is an essential sacrifice for both perception and impact.

The team, which initially will have approximately four to eight members, should be situated in a dedicated space—an environment designed to encourage new thinking, foster creativity, and facilitate rapid implementation. Having a separate room for the team may seem trivial, but it is a fundamental success factor. It helps the team get away from a business-as-usual mind-set.

The merchants play the role of navigators who coach and challenge category managers throughout the process, while the analysts are responsible for mining transaction and loyalty-card data and translating those data into useful insights for category managers (see sidebar, "A sampling of opportunities in big data"). This arrangement sidesteps a common pitfall of sales transformations: having an analytics team that works in isolation from the commercial team and thus generates unusable or irrelevant insights. Instead, the analysts work with category managers to make sure that decision-support tools are intuitive and accepted by end users, and that the insights are accessible to everyone who needs them—not just to a select group of "superusers."

Retailers should resist the temptation to incorporate the team back into the business. Once it has built buy-in and momentum

Exhibit 1 **The modules of the category accelerator cover all commercial levers.**

Module 1: Customer-decision tree

Objective: Build customer-decision tree, which will guide category analysis

Module 2: Clustering

Objective: Check relevance of store clusters and provide guidelines for creating cluster-specific assortments

Module 3: Category overview

Objective: Understand the category's performance across all channels and identify main areas for improvement

Module 4: Assortment health check

Objective: Refine assortment using customer-decision trees, category performance, and competitive insights to highlight potential SKU additions and deletions

Module 5: Value

Objective: Set pricing and promotional action plan to optimize customer value perception and profit

Module 6: Own brands

Objective: Develop action plan for own brands, including new-product requirements and margin improvement

Module 7: Inventory management

Objective: Optimize inventory by setting up-front targets, evaluating performance, and building action plans (eg, exit strategy)

Module 8: COGS[1]

Objective: Set a COGS goal and create action plan to improve negotiations with key vendors in the short and medium term

Module 9: Merchandising/operations

Objective: Create customer-centric planograms for each store cluster

Integrated category plan

Objective: Develop an integrated category plan, including an estimate of sales and margin impact and action plans with critical milestones/owners

[1]Cost of goods sold.

through quick wins, the team should broaden its focus, bring in more navigators and analysts, and become a permanent unit. For a large grocery retailer, this core team would typically consist of 10 to 20 people, split evenly between navigators and analysts.

Create a comprehensive series of modules
Among the core team's initial responsibilities is to develop a series of modules, covering all commercial levers, to serve as the main content for sessions with category managers

(Exhibit 1). The integration of levers—in contrast to the typical siloed approach whereby each initiative is managed independently of others—is part of what makes the category accelerator a powerful force.

Each module should contain standardized, best-in-class tools and methods that will help category managers perform consistently high-quality analyses of commercial decisions, manuals that explain how to use the tools, and sample outputs and templates. The materials

should make clear the overall objective of each session, actions to be completed for each session, and core concepts and terminology definitions. Crucially, each module should incorporate consumer and shopper insights, generated primarily through analysis of transaction and loyalty-card data.

If a retailer has some category-management teams that are consistently high performing, it can build the modules simply by identifying and codifying internal best practices—an exercise that usually takes a few weeks. Another option is to assemble external best practices and tools, customize them to the company, pilot them for a subset of categories and suppliers, and then refine and codify them. This option obviously takes more time: two weeks to three months, depending on the starting point and the topic.

Develop insight-driven category plans

With the core team in place and the content ready, sessions with category managers can begin. A retailer typically starts by having two to four category managers go through the sessions over a two-week cycle. Each category manager runs through the entire set of modules with the core team, spending one or two days on each module. Relevant specialists participate as appropriate—a pricing specialist for the pricing module or a space planner for the visual-merchandising module. In each session, the analysts provide a fact base for the navigators to use as a basis for challenging the category managers' conventional assumptions and for pushing them to develop ambitious category plans. The goal is to create uniformly high-quality category plans powered by consumer insights.

As a category manager at a large South African retailer said, "For the first time, we built integrated category plans covering all levers, and we made bold moves that went beyond the typical knee-jerk pricing and promotions actions." She and her colleagues set—and met—ambitious targets equivalent to 3 percent of sales and two percentage points of margin.

After working out any glitches in the first few cycles, the accelerator should be able to accommodate ten categories per cycle. A rigorous follow-up calendar—with quarterly or biannual check-ins—ensures that decisions are executed, that progress is measured, and that errors are corrected.

A large grocery retailer built a team of 25 navigators and ran all 300 of its product categories through the category accelerator over a two-year period. In one category, for example, it captured a 2 percent incremental sales increase within six months by making a series of pricing changes and expanding the distribution of select regional product lines.

How to make it stick

The approach might not appear complicated, but in practice it can be rife with pitfalls. To capture the full potential, retailers must adhere to the following success factors.

Start with targeted commercial changes that drive rapid impact

Retailers must pick their battles along the sales-transformation journey: they should initially focus on a carefully chosen set of two or three improvements in core commercial processes. These should be initiatives that will pay off right away, which will build buy-in and momentum for the broader transformation.

A sampling of opportunities in big data

Big data and advanced analytics can benefit retailers in almost all areas of the business. Examples include the following.

Optimizing assortments. Loyalty analysis—for instance, measuring purchase frequency or penetration among high-priority customer segments—allows retailers to understand product categories from a customer perspective. By measuring customer "switching" behavior, retailers can also identify which SKUs play a unique role and which are redundant. Such analyses helped a European retailer reduce its assortment by 10 percent across 100 categories while improving margin by one percentage point.

Improving pricing and promotions. Using market-basket analysis, retailers can measure price elasticity and identify key value items by customer segment. They can thus set prices based on consumer demand and competitor moves. In addition, by analyzing the impact of past promotions and linking it to current customer behavior, retailers can reliably estimate the success of planned promotions. A European retailer was able to increase returns on promoted sales by 3 to 5 percent after analyzing its historical promotions across marketing vehicles.

Customizing marketing offers and activating the online customer base. Retailers can tailor offers and promotions to customers based on their past behaviors, thereby increasing spending and loyalty. Big data also enables retailers to activate their online base with targeted content and offers. An Asian retailer used big data to send customized coupons to millions of customers based on their profile (taking into account metrics such as total spending by category). This effort helped the retailer reduce its reliance on the above-the-line couponing that made it easy for competitors to quickly duplicate the offers. The result: a three-percentage-point lift in same-store sales.

Conducting negotiations. By measuring vendor-performance fundamentals (such as penetration rate and repurchase rate), retailers can develop compelling arguments to improve their bargaining power during supplier negotiations. A grocery retailer in the Asia–Pacific region trained buyers on how to use data and insights in supplier discussions—an effort that yielded $300 million in savings within the year.

One retailer had seen its value perception among customers fall by more than ten points over a six-year period despite having the lowest prices in the market. Through analysis of transaction data, the retailer found that the decline in value perception was due to a large share of its baskets being more expensive than competitors'. While it took approximately a year to put in place new pricing processes, in just a few weeks, the retailer reduced prices on some of its best-selling items, consequently reducing the share of more expensive baskets while tactically increasing prices on background items. Customer value perception improved, and the retailer was able to achieve an increase in like-for-like sales from 2 to 5 percent, while also recouping one percentage point of margin.

A European grocery retailer chose supplier negotiations as one of its priority areas for quick wins. It held two-day workshops for all buyers, and its core project team wrote a one-page negotiation playbook that quantified and justified the "asks" it would make of each supplier. In only six weeks, this initiative generated a 1 percent reduction in cost of goods sold.

Invest in big data talent and systems

Retailers know that their transaction data and loyalty-card data are a treasure trove that they could mine to find new pockets of growth. The most sophisticated retailers also use big data and advanced analytics beyond commercial applications—for example, instead of relying exclusively on traditional sales and margin indicators, they use more data and analytics (such as household-penetration metrics or market-basket analysis) to generate more insightful and nuanced performance evaluations of category managers.

There are a number of reasons that retailers fail to embed insights from big data into their daily decision making. One is a lack of technical

Exhibit 2

A heat map can highlight priorities for investment in big data.

Application areas

Use case	Price	Promotion	Ranging	Space	Availability	Purchasing	Media	
Data	1	2	2	2	3	2	1	1
Analytics	4	3	3	5	3	3	4	
Software	1	2	3	2	3	2	3	2
People	3	2	3	2	3	4	3	
Process	3	3	1	4	3	4	3	
Strategy	2	2	2	2	3	3	4	
Overall score[1]	1	2	1	2	3	2	1	
	3		4					

Initiative priority ● | Basic 1 2 3 4 5 Insight driven

[1] Takes into account the weakest link in each application area and is therefore always equal to the lowest score in the column.

capabilities. Indeed, the category accelerator won't work unless skilled data analysts are a core part of the team, collaborating closely with category managers. Another reason is poor systems and infrastructure. Investment in the right data infrastructure is a key enabler for delivering insights in a timely manner. One retailer, by changing its data middleware, accelerated its insight-generation process from days to minutes.

A North American nonfood specialty retailer used a heat map to assess its strengths and weaknesses in using big data across all functional areas (Exhibit 2). The heat map helped the company identify and prioritize opportunities for investment. The resulting initiatives included targeted efforts to improve data quality and management, technology and software updates, and the introduction of a new pricing model.

Use multiple levers to shift mind-sets across the organization

Making any change stick beyond the specific project or intervention requires the use of

several levers, one of the most important being highly visible role modeling by senior leaders. For instance, top management should serve as faculty and coaches for some of the modules.

Performance management is another important lever. Handing out "category manager of the month" awards or special prizes for the "best negotiation team" can be surprisingly effective in spurring performance.

And to make sure that the new ways of working stay embedded in the organization, companies should choose the two or three capabilities that will make the most difference and invest in those capabilities, either through additional training or new hires. The category accelerator gives retailers a clear path for developing and honing their category-management and merchandising skills; it serves as a training ground for future commercial directors and buyers. But hiring new people, particularly data analysts or customer-insights managers, is often also necessary. Retailers should try to upgrade existing capabilities—for example, by

reassigning employees to new roles or by providing training—but such moves are typically not enough to make a difference.

A retailer that chose pricing as its priority battle put in place a new offshore team tasked with analyzing competitive pricing data on a weekly basis, working hand in hand with the onshore category-management team. The new global pricing team delivered one percentage point of margin uplift, with very limited additional overhead.

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As retailers strive to boost like-for-like sales, an insight-driven approach can increase their chances of success tremendously. The category accelerator's distinctive elements— particularly the combination of quick wins with longer-term capability building and the translation of consumer data into actionable commercial insights—have helped large retailers across the globe capture growth in spite of fierce competition.○

Is your supply-chain operating model right for you?

Too many consumer-goods companies decide how to run their supply chain without first defining what it's supposed to deliver. Here's a methodology they can follow instead.

**Søren Fritzen,
Cédric Losdat,
and Frank Sänger**

Most consumer-packaged-goods (CPG) companies know that a thoughtfully designed, high-functioning supply chain plays a crucial role in overcoming today's business challenges. It can, for example, drive innovation and reduce time to market—critical capabilities in light of slowed growth in developed countries. It enables shorter lead times and better customer service, helping CPG companies cope with a fiercely competitive retail landscape and heightened retailer expectations. And a well-run supply chain yields significant savings, which can then be reinvested in growth initiatives.

But as companies expand globally, designing a supply-chain operating model—which

encompasses the supply chain's organizational structure, governance, and processes—becomes an increasingly complex undertaking. It requires finding the best answers to tricky questions such as, "Should my supply chain be organized primarily by product categories, functions, or regions?" and "To what degree should each function be centralized?" Companies tend to make their decisions based on gut feeling, resort to trial and error, or simply mimic the operating models of more successful competitors. The result, too frequently, is an arbitrary operating model that fails to deliver on the company's strategic goals.

Drawing on our research and experience working with leading CPG companies worldwide, we have

developed a methodology that takes the guesswork out of the design process and helps companies implement a supply-chain operating model aligned with their aspirations.[1] Our methodology begins with a definition of the strategic vision. In our experience, only after a company has articulated its specific ambitions can it intelligently move on to the next steps: agreeing on operating principles, undertaking a detailed design of the supply-chain operating model, and implementing the new operating model as part of a broader supply-chain transformation.

Such an initiative can have tremendous impact. We've seen companies reduce materials costs by 5 percent, manufacturing and logistics costs by 10 percent, and inventory by as much as 30 percent, while improving service levels and shortening time to market.

Defining the strategic vision

The design of the operating model should be dictated largely by what will deliver the most value. An important starting point, therefore, is the company's definition of value. What are the company's sources of competitive advantage? What are its strategic ambitions? What are its desired commercial outcomes, and what will internal and external stakeholders require from the supply chain in order to bring about those outcomes?

One manufacturer's strategy, for example, might be to win in the marketplace through premium products and brands. This manufacturer would therefore strive for an operating model that boosts joint innovation with suppliers, accelerates time to market, and incorporates the agility to respond to sudden changes in demand. Another company's strategy, on the other hand, might be to compete purely on cost with a small portfolio of

basic products. For this manufacturer, commercial performance will depend on a different set of supply-chain levers: it would focus on refining its production technology, building scale, and implementing lean techniques to increase efficiency.

Although defining the strategic vision and articulating commercial objectives may seem like an obvious first step, it's one that many CPG companies skip entirely. Designing the supply-chain organization thus becomes a pure "boxes and lines" exercise, with little connection to internal requirements or marketplace realities. At such companies, it's not uncommon for supply-chain operations to do a pendulum swing from centralized to decentralized and back again.

Agreeing on the operating principles

Once it has defined its strategic vision, a company can begin debating the operating principles that will guide its design decisions. These principles will inform choices such as at what level—global, regional, local, or by business unit—each activity should be managed, and how activities should be grouped together. In particular, the four principles discussed below have helped CPG companies agree on difficult decisions about their supply-chain operating model.

Build—and scale up—functional skills. The company should seek to consolidate functional excellence at the level where the most synergies can be created. At many CPG companies, for example, planners and logistics managers are dispersed throughout the organization; they work independently of each other and use different tools and techniques—resulting in wide variability in planning and logistics performance across the company. Instead, companies could consider establishing virtual or physical supply-planning

[1] The methodology is backed by a fact base that includes a menu of design options, analyses of the benefits and drawbacks of each design option, sample organization charts for each supply-chain function, process-flow maps, lists of key performance indicators for major supply-chain activities, and detailed job descriptions.

hubs in which all planners are collocated. Such hubs would create a single point of accountability for supply planning, ensure that well-trained individuals use the latest tools and techniques, and facilitate the sharing of best practices.

Allocate resources across markets. Companies should optimize the allocation of assets, capital, and other resources by spreading them out across markets and categories, thereby reducing overall spending while increasing the return on investment. Businesses that face extreme capacity constraints, for instance, could choose to run a global sales-and-operations-planning process so that they can more flexibly allocate capacity to certain parts of their supply chain.

Integrate end-to-end supply chains. Our operations research in recent years has shown that integration of functions across the entire supply chain—from procurement all the way to distribution—is a strong driver of value. End-to-end integration links the traditional operations organization (manufacturing and supply) to the commercial organization, thus creating operational and financial transparency for better decision making. The order-to-cash process and delivery to retail stores, for instance, are two activities that can benefit from being closely integrated with the commercial organization. Indeed, in recent years a number of CPG companies have moved toward a more integrated model. At a leading CPG company, for instance,

the supply-chain leadership team is directly responsible for several activities that supply-chain executives don't typically lead, such as capacity management, production planning, inventory management, distribution, and the order-to-cash process.

Recognize differences among regions and businesses. The operating model should be able to accommodate the unique attributes of each region and business—not just the major differences between emerging and mature markets but also more subtle differences that require a different channel or approach to customers. For example, the logistics organization in charge of delivery to retail stores should probably have a more local (either province-based or country-based) setup in Asia given the fragmentation of the retail market and the specificities of each Asian country, whereas it can be set up at a more regional level in Europe.

Creating a detailed model

Some companies establish sound operating principles but then don't stick to those principles during the detailed design phase. The same principles can lead to very different operating models at different companies, depending on business context and company characteristics. Factors that should come into play include the size and homogeneity of a company's product categories, the structure of its commercial organization, and its manufacturing footprint.
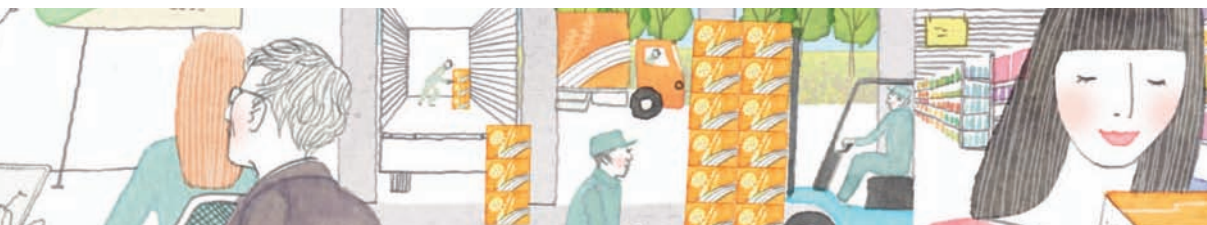
Exhibit 1 shows how a CPG company thought through six activities in one part of the supply chain. In this case, the company determined that both capital-expenditures management and technology management would generate the most value through the consolidation of functional skills and through cross-market resource allocation. The optimal level at which to conduct those activities, therefore, would be the global level.

For manufacturing management, the fifth activity listed on the exhibit, the company asked itself: Should its plants be organized by country or geographic region (for example, appointing a head of manufacturing for plants in the United States, another for plants in France, and so on), by product category (detergents versus personal care, or snacks versus ready-made meals), or by technology type (solids such as soap versus liquids

Exhibit 1

The design principles apply differently to each supply-chain activity.

□ Does not apply
■ Applies fully

	Design principles to capture the value				Proposed option
	Drive scale, skills	Steer cross-market	Integrate E2E[1]	Tailor to BU[2]	
Capital-expenditures management	■	■	□	□	Global Capital-expenditures portfolio best optimized at group level to align with strategic priorities
Technology management	■	■	□	■	Global Knowledge of technology shared among business units; relevant technology cascaded down to market level
Continuous improvement	■	■	◧	◧	Global Best-practice sharing in global lean function
Manufacturing network optimization	■	■	◧	□	Global Most value capture coming from sites that span multiple business units
Manufacturing management	■	◧	◧	■	Business unit Provides scale advantage while ensuring manageable spans of control, P&L accountability
Plant management and scheduling	□	□	◧	◧	Market Knowledge of local plant specifications (eg, scheduling optimization) critical

[1]End to end.
[2]Business unit.

Exhibit 2

A supply-chain transformation requires broad changes across the company.

Organization structure and governance
- Structure (options with pros and cons)
- Roles and responsibilities
- Job descriptions
- Detailed RACI[1] matrix

Processes
- Functional processes
- Cross-functional processes (S&OP,[2] NPI/NPD,[3] yearly and monthly financial processes)

Performance management
- Structure and definition of key performance indicators
- Benchmarks and targets
- Incentives and consequences

Capabilities
- Requirements
- Gaps
- Implementation plan

IT systems
- Requirements
- Gaps
- Implementation plan

Financial governance
- Profit-and-loss accountability
- Standard costing
- Transfer pricing
- Tax guidelines (if applicable)

[1]Responsible, accountable, consulted, informed.
[2]Sales and operations planning.
[3]New-product introduction/new-product development.

such as shampoo)? Company leaders agreed that the operating model should provide a scale advantage across markets while also ensuring manageable spans of control and reinforcing accountability of profit-and-loss performance. The company decided to organize its 60-plus manufacturing plants into four groups by product category—a grouping that aligned with the company's business-unit structure.

The end result of this exercise should be a target operating model that groups each major supply-chain function and activity at the level that maximizes its potential for benefit. It is important to build consensus around the target model among a broad set of stakeholders, both within and outside the supply-chain organization. In particular, operations leaders must collaborate

closely with the commercial organization to understand and address its concerns. One such concern might be potential changes in roles and perceived demotions (for instance, in the event that the new operating model takes some responsibilities away from country-level managing directors). Widespread support from across the company will create momentum and facilitate implementation.

Implementing the new model
Companies should avoid introducing a new operating model in isolation, as it generally won't stick and will deliver minimal impact. Instead, the new model should be just one component of a comprehensive supply-chain transformation that includes efforts in capability building and performance management (Exhibit 2).

In other words, implementation of a new organizational structure should happen in parallel with other changes—for example, changes to cross-functional processes (such as the new-product-introduction process or monthly and yearly financial processes)—in order to ensure value capture. We estimate that half of companies that transform their operating model don't capture the full value, in part because company leaders become too focused on particular organizational changes and get caught up in office politics, and therefore lose track of the value at stake and the initial objectives of the transformation. One of the success factors we have observed is to formally and immediately hold new leaders and managers accountable for value delivery; they must see it as part of their new roles.

Companies should not underestimate the complexity of a supply-chain transformation. It is typically an 18- to 24-month undertaking that requires a group of motivated leaders, including the CEO and a highly capable change team. Careful sequencing of initiatives and over-investment in change-management efforts will be critical to success, as hundreds of people will have new roles and will need to be trained in best-practice processes and adapt to a new way of working. To sustain impact, all along the change journey the company must constantly communicate progress and issues, as well as celebrate victories across the organization.

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There is no one-size-fits-all supply-chain operating model. Every CPG company would do well to follow a thoughtful and systematic process to design and implement a customized model, with the company's strategic vision as a starting point. Done right, the reward will be a supply chain that enables the company to win, even in a challenging marketplace.○

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Secrets to successful manufacturer-retailer collaboration

More companies can reap the benefits of supply-chain collaboration if they pay attention to six success factors.

Andreas Brinkhoff and Jochen Großpietsch

A growing number of consumer-goods manufacturers and retailers are working together to improve their performance. Such collaboration—partnering on initiatives that extend beyond day-to-day business and that aim to deliver significant long-term value for both parties—is a welcome alternative to price-driven (and at times antagonistic) supplier-retailer relationships. In a 2012 survey of 140 companies, conducted by ECR Europe and McKinsey, all respondents said they collaborate in at least one area of their business; more than half said they collaborate in at least six areas.[1]

Traditionally, retailers and manufacturers' collaborative efforts have focused on commercial areas such as in-store programs and merchandising. The survey indicates this is changing: recognizing that supply-chain performance will be critical to controlling costs and improving service in the coming years, survey participants ranked "supply-chain flows and processes" and "demand planning and fulfillment" as the two most important topics for future collaboration.

The rewards for supply-chain collaboration can be substantial. A recent study by the Grocery Manufacturers Association estimated the total opportunity (in cost savings and margin) for the US consumer sector at $10 billion; in Europe, which has a more fragmented consumer industry, the number would probably be even higher. The ECR–McKinsey survey respondents reported that successful collaboration, on average, resulted in a 4.4 percent decrease in out of stocks and a cost reduction of 5.4 percent (exhibit). The research firm Advantage, in its 2013 review of retailer-manufacturer collaboration in the US market, found that the most collaborative companies increased revenues by 3.7 percent more than the average company. The magnitude of these improvements is backed up by our analysis of more than 100 cases of successful supply-chain collaboration over the years.

[1] *Collaboration today and tomorrow—taking the right steps on the path to impact,* ECR Europe and McKinsey & Company, May 2012, mckinsey.com.

Exhibit

Successful collaboration offers many benefits.

Most important collaboration areas for coming years[1]		Average impact reported by respondents[1]
Supply chain	1 Supply-chain flows and processes	**4.4%** decrease in out of stocks
	2 Demand planning and fulfillment	**5.4%** decrease in costs
Commercial	3 Category product assortment	
	4 Promotion strategy and calendar	**6.3%** increase in sales
	5 In-store layout/visual merchandising	**3.9%** increase in profits

[1] As reported by 140 survey respondents from 13 countries.

Source: *Collaboration today and tomorrow—taking the right steps on the path to impact*, ECR Europe and McKinsey & Company, May 2012, mckinsey.com

We've found that some of the largest companies are among the most active collaborators, and increasingly these organizations are scaling up collaboration initiatives from small, local pilot projects to solutions that are deeply anchored in core processes. For instance, retailers such as Tesco and Wal-Mart have collaborated with suppliers to establish clear logistics standards. Market leaders, as well as midsize retailers like the German drugstore dm, are giving suppliers access to important data, such as SKU-level order forecasts. Some suppliers are working more closely with retailers to reduce out-of-stock rates (as Coca-Cola is doing) or to continuously refine delivery processes (as Unilever is doing). To improve planning, Nestlé piloted a new role—the customer-based coordinator, who works exclusively with a specific retailer—in its supply-chain teams in Spain and the United Kingdom and has since rolled it out across Europe.

Yet, despite the cost and effort invested by both parties, 40 percent of collaboration efforts fail to

deliver sustained impact. One reason is that benefits still tend to be distributed inequitably: according to our survey respondents, retailers typically gain more from collaboration efforts (about 8 percent in cost reduction) than their manufacturing partners do (2 percent). Respondents further cite insufficient resources, lack of leadership support, and reluctance by one or both parties to share information as the primary reasons collaborations don't last.

Based on the survey results and our industry experience, we have identified six steps that can make the difference between a productive collaboration and a frustrating one. (In any collaboration effort, parties should ensure they are in compliance with local laws and requirements.)

1. Collaborate in areas where you have solid footing. The most successful collaborations build on strengths rather than compensate for weaknesses. A manufacturer seeking to collaborate with a retailer in the hopes of improving its forecasting performance, for instance, will have little to gain from access to the retailer's point-of-sale data unless it has the in-house analytical capabilities to make effective use of those data.

2. Agree on benefit-sharing models. Rather than shying away from seemingly unbalanced collaborations, companies can make them work by recognizing the potential imbalance, identifying the benefits of collaboration, and developing ways to share the benefits more fairly—for example,

through discounts or price increases. Some companies have established joint benefit pools, using the savings to fund cost-reduction efforts or sales-improvement programs.

3. Select partners based on capabilities, strategic goals, and value potential. Many companies aim to collaborate with their largest suppliers or customers—but the largest partner may not be the best one. A smaller partner may invest more in a collaboration effort than a large partner who is already juggling similar efforts. A better approach is to assess potential partners across three dimensions. First, is there enough potential value in collaborating with this partner? Second, do both parties have sufficiently common strategic interests? Third, does the partner have the infrastructure and processes in place to provide a strong foundation for the collaboration?

4. Dedicate cross-functional resources and ensure senior-leadership involvement. A successful collaboration begins at the top, with a steering committee of senior leaders who not only set the defining vision for the effort, but also have the power to allocate the necessary resources to support it. A cross-functional team consisting of representatives from both organizations designs the initiative and carefully considers its operational implications. For example, the team for a demand-planning effort should include representatives from the manufacturer's sales, finance, and supply-chain functions and the retailer's purchasing, merchandising, and store-operations functions.

5. Jointly manage performance and measure impact. Both parties should use the same metrics and performance-management system. Selecting the right metrics inevitably involves trade-offs. For example, to reduce logistics costs, the partners may have to choose between a pallet configuration suited to a retailer's restocking process, which will reduce in-store labor costs, and one optimized for truck fill, which will reduce transportation costs between the distribution center and the store. We recommend that partners select and track the smallest number of metrics required to provide a clear picture of the effort's overall performance. Partners should schedule regular problem-solving sessions to address trade-offs.

6. Collaborate for the long term. The final ingredient for a successful collaboration is stamina. Through joint planning sessions and multiyear performance metrics, both parties must define long-term objectives and develop a road map for future collaborative initiatives, while being mindful of and capturing quick wins to gain momentum for the effort.

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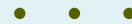
The payoff from collaborative efforts can be tremendous. Although successful collaboration is neither quick nor simple, it is certainly achievable—and definitely worthwhile.○

Toko Ohmori

What's next in apparel sourcing?

Chief procurement officers at the world's largest apparel companies are facing higher costs, tackling knotty compliance issues, and exploring new sourcing markets.

Achim Berg and Saskia Hedrich

A lot has been written lately about rising labor costs in China, where much of the world's clothing is made. In Bangladesh, home to thousands of garment factories, a series of tragic industrial accidents has made consumers and the media pay closer attention to where, by whom, and under what conditions clothing is manufactured. How have these developments affected the purchasing function at apparel companies? What has—and hasn't—changed in apparel sourcing? From where will apparel companies source their products in the future?

To find answers to these and other questions, in late 2013 we surveyed 29 chief procurement

officers (CPOs) at leading apparel companies, responsible for a combined €28 billion in purchasing volume. This was our second such survey; we conducted the first in 2011. To deepen our findings, we also conducted lengthy interviews with several CPOs and hosted a roundtable for sourcing executives in March 2014. (For more on the roundtable, see sidebar, "What the sourcing industry needs now: New capabilities, more cooperation.")

Our research shows that most apparel players expect long-term increases in labor and energy costs and are looking to move a portion of their manufacturing out of China and into some

surprising new sourcing markets. We also found that Bangladesh remains at the top of the list of apparel-sourcing markets expected to grow in importance in the next few years. More apparel companies are taking a proactive approach to ensuring that suppliers, in Bangladesh and elsewhere, comply with regulations on worker safety and environmental protection.

Costs rising steadily

Three out of four survey respondents expect sourcing costs to rise in the near term. The average expected cost increase is 1.7 percent, with the largest fashion retail chains expecting a 3.5 percent increase. And unlike past cost increases, this time the trend is expected to last—even with cyclical dips in raw-material prices—due in large part to structural factors, including the steady upward trajectory of labor costs in China and rising energy costs world-wide. Almost three-fourths of sourcing executives report that they want to reduce their exposure to China (Exhibit 1).

With consumers unlikely to tolerate higher apparel prices, companies are forced to find other solutions to relieve margin pressure. On this front, two trends are emerging: some companies are seeking to reduce costs further by sourcing from largely untapped low-cost countries in Southeast Asia and sub-Saharan Africa, while others are looking for ways to boost the productivity of their current suppliers. Apparel buyers are working closely with suppliers, for example, to implement lean techniques in factories.

Compliance increasing in importance

In engaging more deeply with suppliers, apparel companies are aiming to improve not only productivity but also compliance—particularly with rules on building and fire safety. More than 150 clothing companies from 20 countries have signed the Accord on Fire and Building Safety in Bangladesh, which was initiated in Europe. Pursuant to this agreement, more than 1,700 suppliers will be inspected in the coming

Exhibit 1

Chief purchasing officers plan to move some of their sourcing out of China over the next 5 years.

Expected change in sourcing share (value) from China in next 5 years,
% of respondents, n = 29

Strongly decrease	17
Decrease	55
Stay same	21
Increase	7

Average expected reduction in China: 5.7%

Exhibit 2

Bangladesh remains at the top of the list of sourcing markets expected to grow in importance in the next 5 years.

Expected top sourcing markets over the next 5 years,
% of respondents ranking countries among top 3, n = 29

Country	Value
Bangladesh	52
Vietnam	48
India	31
Myanmar	31
Cambodia	28
China	17
Indonesia	14
Pakistan	14

In 2011, >80% of respondents ranked Bangladesh within top 3
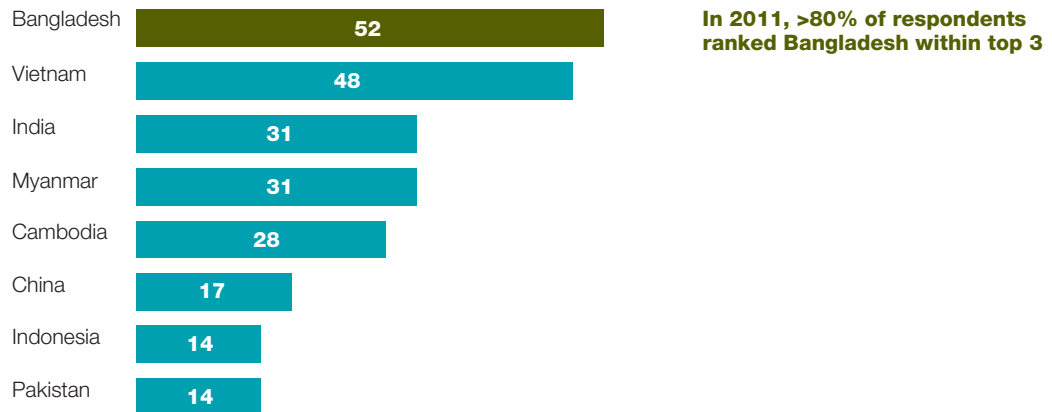
months. In addition, a group of North American companies formed the Alliance for Bangladesh Worker Safety. These two initiatives have brought apparel companies together to develop industry standards and ensure transparency and compliance.

In evaluating new sourcing markets and new suppliers, compliance is now a top criterion for CPOs, along with cost and capacity. With these prerequisites in mind, half of the survey respondents—down significantly from more than 80 percent in the 2011 survey—ranked Bangladesh among the three markets expected to grow in importance over the next five years. Also on the list are Vietnam, India, Myanmar, and Cambodia (Exhibit 2).

A new entrant to this list is Myanmar, a country located in the heart of Asia that has just begun reintegrating with the global community.[1] It remains to be seen how Myanmar will develop. Several other industries are also interested in investing in the country, and Myanmar may decide to focus on industries other than apparel manufacturing.

Looking to new sourcing markets
Myanmar is only one of the low-cost countries piquing the interest of apparel buyers. Others include countries in sub-Saharan Africa and regions in close proximity to Western Europe and the United States.

[1] For an in-depth perspective on Myanmar, see *Myanmar's moment: Unique opportunities, major challenges*, McKinsey Global Institute, June 2013, on mckinsey.com.

Seventy percent of the sourcing executives we surveyed said they would like to move more of their manufacturing closer to Europe.

One-fourth of the CPOs we surveyed expect sub-Saharan Africa to become a much more important sourcing market in the next five years. Swedish retailer H&M is already testing the waters by placing a small order with a supplier in Ethiopia. However, we expect that it will take some time for countries in the region to make the investments necessary to fulfill large-volume orders.

Seventy percent of the sourcing executives we surveyed said they would like to move more of their manufacturing closer to Europe, making the Mediterranean and Eastern Europe appealing options. Similarly, US-based

companies, in a quest for closer-to-home suppliers, are increasingly looking to US and Latin American manufacturers. In particular, CPOs are interested in "proximity sourcing" (either nearshoring or onshoring) when it comes to high-quality products and fast-fashion items. Midmarket apparel players find proximity sourcing especially attractive, but some discount retailers are joining in as well, as Wal-Mart's "Made in America" campaign demonstrates.

The optimal mix of sourcing markets differs for every apparel company. In our view, each company must first define its procurement requirements and then compare them with the

What the sourcing industry needs now: New capabilities, more cooperation

In light of the growing need to balance compliance considerations with cost and other factors, and given the rising demands of a globalized multichannel market, apparel sourcing has become more complex. Today, success in sourcing requires new ways of doing business: specifically, new skills among sourcing professionals and greater cooperation among industry players. These were the dominant topics of discussion at McKinsey's inaugural Apparel Sourcing Roundtable, held in Hong Kong in March 2014. Twenty-six sourcing executives from some of the world's largest apparel retailers and manufacturers gathered to share ideas and learn from one another. The participants are responsible for a combined €50 billion in apparel-purchasing volume.

Participants agreed that one imperative for future success is instilling a new skill set among sourcing managers and promoting what one executive called a "new breed of merchandisers"—buyers who possess not only product knowledge but also business acumen, design and engineering capabilities, and a consumer-centric omnichannel perspective. Executives cited two main hurdles to building such a cadre of sourcing professionals: the perception that the sourcing

profession is unappealing and "not sexy," and low availability of multidimensional, multiskilled talent.

They also discussed ways to make the sourcing profession more attractive, including empowering sourcing staff, providing meaningful professional-development opportunities, and even "rebranding" the profession—for instance, by introducing job titles that better reflect the sophisticated requirements of sourcing roles. As for increasing the talent pool, executives suggested cooperation with universities, global development programs, cross-pollination of staff among functional departments and regions, and an enhanced role for the HR function in talent management.

Additionally, increased coordination among industry players will be critical to overcoming these challenges. It remains to be seen whether the Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety are effective models, but participants agreed that involvement and commitment from the Bangladeshi government and local factory owners are essential to the sustained impact of the initiatives.

strengths and weaknesses of various countries, weighing the trade-offs among five main criteria: cost, quality, capacity, speed, and risk. For example, Bangladesh has very low labor costs and can handle high-volume orders, but—in addition to the high-profile problems of building and fire safety—the quality of the products it manufactures is variable, suppliers there are often set up inefficiently, access to raw materials can be difficult, it has poor infrastructure and energy supply, and the political risks are significant. Turkey, on the other hand, does not offer the lowest labor costs, but it boasts different advantages: apparel factories that have high capacity and can produce high-quality goods, the ability to make speedy deliveries to European markets

via rail or road, regional manufacturing clusters that make up an efficient and integrated textile industry, and comparatively low political risk.

•   •   •

Undeniably, apparel sourcing is becoming more challenging. CPOs, once focused primarily on cost, must now take into consideration several other important factors. Corporate social responsibility is more than a buzzword: leading apparel companies are working to improve standards throughout the value chain and adhere to sustainability strategies consistently. We firmly believe these are steps in the right direction.○

Achim Berg is a principal in McKinsey's Frankfurt office, and **Saskia Hedrich** is a senior expert in the Munich office. Copyright © 2014 McKinsey & Company. All rights reserved.

How to win in online grocery:
Advice from a pioneer

Christian Wanner, cofounder of one of Europe's first and largest online grocery stores, talks about what works, what doesn't, and what will change in food retailing as e-commerce continues to heat up.

Enrique García López,
Rémi Said,
and Khiloni Westphely

In most global markets, online grocery is just beginning to show promise. The expanding online offerings of retailers such as Tesco and Ahold in Europe, as well as FreshDirect and AmazonFresh in the United States, are making news. Services such as "click and collect" or "buy online, pick up in store" appear to be gaining traction with consumers. (For a McKinsey perspective on online grocery, see Nicolò Galante, Enrique García López, and Sarah Monroe, "The future of online grocery in Europe," *Perspectives on retail and consumer goods*, Spring 2013, mckinsey.com.)

To some, it may seem like early days for online grocery, but Christian Wanner has been at it since 1997—back when a web page could take 20 seconds or more to load, the typical household had no Internet connection, and most consumers were not yet comfortable with the idea of buying things online. That year, Wanner cofounded LeShop.ch, Switzerland's first online grocery store. LeShop is now part of the Swiss retail cooperative Migros and has been profitable since 2011.

Wanner served as LeShop's CEO from 2000 until 2013. He remains on LeShop's board and is a senior adviser to McKinsey. In January,

McKinsey's Enrique García López, along with Rémi Said and Khiloni Westphely, spoke with Wanner about his views on multichannel retail, the best operational models for online grocery, mistakes chief marketing officers make, and the power of mobile devices.

McKinsey: *LeShop is a success story, but it's one of only a few so far in online grocery. Why should grocers get into e-commerce at all?*

Christian Wanner: Food retailers can't afford not to take e-commerce seriously in the long run. The cynics will say, "Even after 15 years of e-commerce in food retailing, we're talking about at best 3 to 5 percent market share, compared with 50 percent in travel or 35 percent in electronics in mature markets." To this, I would have two replies: first, it's true that shopping habits in grocery change at a slower pace than in other categories—but, given much lower margins in grocery, if you lose 5 percent of customers to a competitor's online proposition, that makes a big difference in both your profit and loss (P&L) and your competitor's P&L. What's more, online grocery typically attracts the most profitable customers: dual-income households, customers

who prioritize convenience over price or promotions, big-spending customers—these are the type of customers you'll be making more loyal to the franchise.

Second, digital literacy is evolving at an exponential pace. It took LeShop eight years to reach its first €50 million in sales on PCs but just three years to reach €50 million in sales on mobile phones. Retailers shouldn't underestimate the "digital natives" generation. They need to begin transforming their organizations now; otherwise, they will have a rude awakening when outsiders like Amazon start entering their market.

McKinsey: *Many grocers worry that online sales will only cannibalize store sales. What are your thoughts on that?*

Christian Wanner: Two comments: first, if you don't cannibalize your own business, someone else will do it for you. If you do not serve new consumer needs, your competitor will. Second, we conducted several studies on cannibalization, which repeatedly proved that a multichannel offer increases your overall share of wallet. For example, by isolating 5,000 households new to LeShop during one year and tracing their behavior with the Migros stores in the previous year, we observed a total sales increase of 30 percent among those households. Store sales to those customers declined by around 10 percent, but that decline was more than offset by the growth in the online business—and in a flat market, the cannibalization was clearly at the expense of our competitors.

Another study, involving a very big sample group, demonstrated clearly that our customers who shop both online and in stores spend twice as much as customers who shop only in stores, indicating that our online offering attracts higher-value customers. And customers who use three

channels—traditional stores, home delivery, and Drive[1]—spend 2.3 times as much.

McKinsey: *Retailers today are experimenting with a variety of operational models for these new channels—fulfilling online orders from existing warehouses, from new dedicated warehouses, and even from stores. Will all these models continue, or will there be a convergence?*

Christian Wanner: Convergence has already taken place on the transactional side: in website and mobile navigation, how you present the offer, and recipe and recommendation features. Website ergonomics and transactional behavior are similar across geographies and cultures, so you can leverage similar systems in different countries.

But I don't yet see a strong convergence in logistics—there are just too many geographical and sociological differences, as well as business-model beliefs. In Latin America, for instance, the more affluent people are highly concentrated in certain areas of the city. In Buenos Aires, if you address those few neighborhoods, you've basically covered the relevant market for online grocery because 80 percent of the population is simply not at a socioeconomic level that will support your business. In such regions, you can go with a dedicated warehouse close to the geography you want to serve. This model will not be valid in Switzerland, for instance, where there is more of a mix of social classes geographically.

Then, you have differences in population density. Take the Netherlands versus France. The low population density in France probably explains the roaring success of the click-and-collect model versus home delivery, whereas in the Netherlands—where the population is very concentrated—the home-delivery model is viable almost nationwide. Ahold's click-and-collect service is making serious

[1] Drive is LeShop's click-and-collect service, introduced in October 2012. Customers can place their orders online and, as soon as two hours later, pick them up at a designated location.

inroads as well, because it brings extra conve-
nience to the customer versus home delivery.
Logistics choices also depend on a company's
existing assets, heritage, and capital-expenditure
capacity. There is no single best practice you
can roll out worldwide.

That said, already we see some models fading—
such as store picking (that is, fulfilling online
orders from stores). I don't think that in 2014 your
logistics strategy can sustainably be based on
store picking, unless it's a defensive strategy in a
marginal business and you are picking in a very
big hypermarket. Store picking is not industrially
efficient if you account for true costs, and it does
not fulfill the promise to the customer because it
results in many orders that have substitutes or
missing products.

McKinsey: *But couldn't a retailer start with
store picking and then gradually move to a more
capital expenditure–intensive model such as
warehouses or "dark stores"?*

Christian Wanner: First, we will need to agree
on the definition of a dark store. Tesco was the
first to coin that term, I think, and at that time it
meant a warehouse with exactly the same layout
as a traditional store but without customers.
This is certainly not a model I would advocate,
because it fails to adapt the layout and workflow
to create picking efficiency. Tesco has quickly
recognized this, and each successive version of
its warehouse integrates more automation and
workflow efficiency.

To your question of whether store picking would
be a sound starting strategy, with the intention of
learning the business and then moving to something

more sophisticated: it may have been a viable
option for a retailer back in 2000, but not today,
because your organization will be learning the
wrong things. In store picking, the energy
of the online team, the IT people, and the general
manager will be spent on avoiding out of stocks,
which means their energy will be spent on
things like substitute management and product-
supply planning.

You cannot imagine how much energy goes into
substitute management: proposing intelligent
substitutes, then having a whole logistics process
for the customer to receive the substitute. You
have to pick the substitute separately from the
rest of the items so that you can ask the customer
whether she agrees with the substitutes, and if
the customer says, "I agree with this one but not
with that one," then you need a process whereby
the rejected substitute comes back to the store,
and you need a process to manage the price
difference between what she originally ordered
and the substitute, and so on and so forth. Little
of this is useful when you scale the operation and
move to a dedicated warehouse, which can fulfill
98 or 99 percent of orders with the exact
products that the customer wanted. So I think it is
wiser to set up a dedicated infrastructure and
organization up front and then fine-tune it until it
is ready to be scaled up.

But a dedicated infrastructure isn't necessarily an
enormous and fully automated warehouse. You
still have to make important choices as to
geographical reach, assortment depth, mode of
delivery, and so on. It would be a mistake to start
with a highly automated and capital-intensive
warehouse before having gained experience in all
the above aspects first.

Christian Wanner

Vital statistics
Married, with 2 children

Citizen of Brazil and Switzerland

Lives in Sydney, Australia

Fluent in English, French, German, Portuguese, and Spanish

Education
Earned a master's degree in economics from HEC Lausanne

Participated in Stanford Executive Program at Stanford Graduate School of Business

Career highlights
LeShop.ch/Migros
Board member (2013–present)

CEO (2000–13)

Cofounder (1997)

P&G (1993–97)
Senior financial analyst and assistant brand manager

Vinci Soft (1989–93)
Cofounder

Fast facts
Adviser to the e-government board of the Swiss Federal Council (2007–12)

Chairman of the Alpine Chapter of the Young Presidents' Organization (2010–11)

Member of the advisory board for HEC Lausanne economics faculty

President of 2007 Swiss Tech Tour

McKinsey: *Companies are understandably hesitant to make big bets on online grocery because profitability is far from assured.*

Christian Wanner: It's a "chicken or egg" debate. If you don't commit yourself seriously to this business, you will simply never achieve any significant breakthrough. Online grocery is certainly a very difficult business to make profitable, but it has proved possible. LeShop's home-delivery business has been profitable since 2011, and this is in Switzerland, where we pay warehouse workers between €3,800 and €4,000 a month, including bonuses. But achieving profitability takes hard work. It requires chasing every second, chasing every source of inefficiency, chasing every mistake you make to avoid paying the cost of correcting those mistakes.

I've found that many traditional retailers are stuck in paradigms or make choices that impede profitability in their online business. Take, for example, the "long tail" obsession: I come across traditional retailers who can only envisage their online store having exactly the same assortment as their hypermarket format, thus 30,000 SKUs. This is an ideological positioning, not a pragmatic positioning to start with. You typically have the

chief marketing officer saying, "There is no way we should enter online with a smaller assortment than our biggest hypermarket, because that's what the customer expects." The problem is, your logistics complexity and costs increase exponentially with assortment depth, and the customer will hardly pay that premium. In my experience, if you have 13,000 SKUs, the last 1,300 of them will account for less than 1 percent of sales. So, you can only imagine what it means for 30,000 SKUs. It would require probably eight times the capital investment, because thousands of slow-moving SKUs will need automated instead of manual picking. It's not impossible to manage a warehouse with 30,000 SKUs or more—Ocado is doing that successfully—but you need to be aware that it has direct and heavy consequences on your capital expenditures and organization.

Another area where you need to make hard choices is your online promotional strategy. Should you have exactly the same promotional schemes as you have in your stores, or can you leverage the advantages e-commerce offers? For example, in e-commerce, you can tailor promotions based on customer behavior, which you can't really do in the traditional supermarket, except through loyalty cards. You might be losing a lot of margin points if the chief marketing officer insists on exactly the same product range and the same promotional scheme online and offline.

McKinsey: *Are you saying the online business should be completely separate from the traditional retail business?*

Christian Wanner: After 16 years in this industry, I still find it vibrant and fascinating

because there is no absolute golden rule. The right structure depends on how the parent company is organized. A centralized company would require a different structure than a decentralized cooperative.

What is clear, however, is that retailers should not regionalize e-commerce; it has to be at least national, if not transnational, meaning that you use the same website and the same technological platform in every country. It doesn't make sense to have several teams developing multiple websites and mobile platforms.

But should the web and mobile platform be developed by the corporate IT team or by a separate team? My opinion is that it has to be a separate, dedicated team. The main issue is the speed of releases: if you are just 1 percent of the business, you will hardly be a priority. You might be a priority for corporate IT when the project starts, but after version one has been delivered and you need changes, you will probably wait a long time for those changes. And in e-commerce, you'd better have a release of either bug fixes or improvements every four weeks.

I also think logistics should be driven by a dedicated team, not the central logistics team. E-commerce logistics is about picking and transporting single products, which is not a core competency of traditional retailers. Again, this competency has to be developed by the e-commerce team, with no legacy systems restraining it.

What about category management? My opinion is you need dedicated people looking at what's

happening in e-commerce and being very reactive to customers: tailoring the assortment, the promotional scheme, and so on.

McKinsey: *What changes do you foresee in online grocery in the next few years?*

Christian Wanner: Consumer behavior is evolving fast. Customers now expect to be able to interact digitally with any merchant, so a robust digital presence has become a must. When we launched our first iPhone app in 2010, we did not foresee that three years later, one-third of our orders would be coming from an iPhone or iPad. Frequency was around 20 days between two orders on the website; it accelerated to 10 days between orders on the mobile phone. Our supermarket is technically in the handbag or pocket of our customers all the time. Our app even allows them to shop when they are offline. The screen is small, but repeat customers are able to drop 60 items into their basket in less than 10 minutes—that's efficient

shopping! So is technology evolving? Yes, but, more important, consumer behavior and expectations are evolving. And we're not talking about tech freaks here—we're talking about 50 percent of our customers shifting to mobile. This is an unstoppable megatrend.

In the coming years, retailers will need to work on what we call multichannel or cross-channel or omnichannel—that is, harmonizing the channel experience for the customer. It is about combining the digital power of e-commerce with the infrastructure and service of bricks and mortar, and determining what role each will play. We will have to leverage the richness of online information in the convenience channel because that is where the battle will be won. We will need to move the battle away from "I have the cheapest stuff" to "I have the best service." At the end of the day, the winners will be those retailers that best understand the patterns of behavior of their customers and respond to those patterns intelligently.○

Market Map: Finding pockets of growth in mature markets

Jim Doucette, Felicita Holsztejn, and Dymfke Kuijpers

A new approach helps consumer companies determine where to compete, how to win, and what winning is worth.

In recent years, the European consumer-packaged-goods (CPG) market has experienced single-digit growth at best. The environment has been particularly difficult for branded-goods manufacturers, as consumers have traded down to private-label goods and discount channels. Introducing new brands or line extensions hasn't been a surefire move: the soft-drink market in the Netherlands, for example, boasted more than 125 new products or range extensions in 2013, but the total category grew by only 2 percent that year. And CPG companies are steadily shifting more of their marketing spending and other resources away from Europe and toward faster-growing emerging markets.

Against this backdrop, companies are under immense pressure to find pockets of growth and place smart bets in Europe and other mature markets. They must figure out what consumers in these markets will pay for so that they can put the right products on the right shelves. We've found, however, that many CPG companies still rely on assumptions or intuition—not data—about what consumers want and need, and about how consumers decide which products to buy.

When companies do use data to make decisions about category strategy, they tend to use only the most basic data, yielding poor decisions. For instance, as they seek to optimize their assortment, many companies simply "cut the tail," or eliminate the SKUs with the lowest sales volume. But this can be a dangerous move, as some slower-moving items have a fiercely loyal following and play a strategic role in the portfolio. Take organic soup: it may not be a top seller in the category, but if it isn't in stock, the shopper will leave the store without making a soup purchase. Absent a more data-driven and thoughtful approach to category strategy, CPG companies end up with a suboptimal portfolio that causes shopper frustration at the shelf and results in missed opportunities and lost sales.

To take a more analytical tack, companies can use Market Map, a McKinsey approach that involves crunching data on consumer's needs, attitudes, usage, and purchasing behaviors and—crucially—connecting these pieces of information to present a unified consumer view of the category. (Other approaches focus exclusively on either usage or purchase behavior, not both.) And unlike traditional market-research approaches that rely on consumers to recall past behavior, Market Map uses data on actual consumer behavior captured in real time through consumer-diary surveys and panels. The use of Market Map and the insights it generates has boosted sales growth by as much as 30 percent at a broad range of CPG companies, from manufacturers of fast-moving consumer goods to makers of consumer durables, food, and health products.

The power of data and predictive analytics
The Market Map approach has been validated in hundreds of real-life situations. The first step of the approach is the construction of a "consumer map" for a broad category, such as nonalcoholic beverages, by analyzing data on consumer usage. The consumer map shows, at a macro level, how consumers make choices in that category: What situational factors affect their choices? What needs are they trying to meet and on what occasions? The next step is the creation of a "shopper map" for a specific subcategory (such as juice or coffee), using an analysis of household-level purchase data, to show the products that households purchased over time. Integrating the consumer and shopper maps creates a visual model that explains the choices that consumers and shoppers make within a category. Specifically, it depicts the relative importance of the product benefits and attributes that consumers take into consideration when buying a product in that category.

To illustrate: when US consumers buy coffee, what is the first thing they typically look for? Is it caffeine content (that is, regular versus decaffeinated)? Is it a particular brand, type, or price tier? Is it some other attribute—perhaps flavor or package size? Exhibit 1 shows two conceivable maps for the coffee category in the United States and the implications of each on category strategy. Both of these maps are plausible, but—according to actual consumer data—only one accurately shows how US consumers make choices when buying coffee.
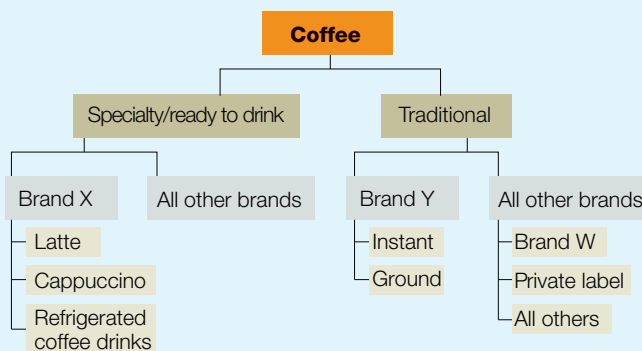
Mapping the market
With the help of Market Map, CPG companies can define the role of each brand in a portfolio based on the brand's position, relative strength in the marketplace, and

Exhibit 1

Two maps illustrate possible drivers of consumer choices in the coffee category.
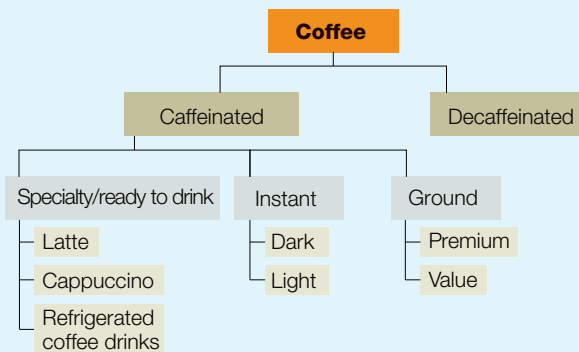
Example: brand structured

```
                    ┌──────────┐
                    │  Coffee  │
                    └────┬─────┘
            ┌────────────┴────────────┐
  ┌───────────────────────┐    ┌──────────────┐
  │ Specialty/ready to drink│   │ Traditional  │
  └───────────┬───────────┘    └──────┬───────┘
      ┌───────┴────────┐         ┌─────┴──────────┐
┌─────────┐  ┌──────────────┐ ┌────────┐  ┌──────────────┐
│ Brand X │  │All other brands│ │Brand Y │  │All other brands│
└─────────┘  └──────────────┘ └────────┘  └──────────────┘
  ├ Latte                       ├ Instant    ├ Brand W
  ├ Cappuccino                  └ Ground     ├ Private label
  └ Refrigerated                             └ All others
    coffee drinks
```

Implications

Brands carry meaningful benefits to consumers
• Consumers perceive brands X and Y as distinct; these brands have greater marketing and pricing leverage
• Other brands are perceived as more substitutable
• New types or forms of brands X and Y will add incremental volume

Retailers should organize the shelf by brand blocks within specialty and traditional categories

Example: attribute structured

```
                    ┌──────────┐
                    │  Coffee  │
                    └────┬─────┘
            ┌────────────┴────────────┐
  ┌────────────────┐            ┌──────────────┐
  │  Caffeinated   │            │ Decaffeinated│
  └───────┬────────┘            └──────────────┘
   ┌───────┼───────────┐
┌─────────────────────┐ ┌─────────┐ ┌─────────┐
│Specialty/ready to drink│ │ Instant │ │ Ground  │
└─────────────────────┘ └─────────┘ └─────────┘
  ├ Latte                 ├ Dark      ├ Premium
  ├ Cappuccino            └ Light     └ Value
  └ Refrigerated
    coffee drinks
```

Implications

Attribute (in this case, caffeine content) is the most important driver of choice

Brands are not meaningfully differentiated, suggesting several things:
• Store brands could outpace national brands in growth
• In the short term, increases in marketing spending on national brands are likely to have a poor return on investment
• National brands have limited pricing power

Retailer profitability will likely benefit from dropping redundant brands

potential for growth. They can identify "white spaces" for category growth, as well as opportunities to reposition existing brands and products. In particular, they can gain detailed insights into where to compete, how to win, and what winning is worth.

Where to compete
Most CPG companies define a product's competitive set based on where it competes today—not where it could compete. Market Map analysis gives a company a precise

definition of a product's competitive set and a detailed understanding of shoppers' switching behavior (that is, which products shoppers choose as substitutes for other products and how often they do so). Through further analysis and modeling, a CPG company can quantify "transferable demand"—the sales volume that would be transferred to other SKUs if a particular SKU were discontinued. Market Map's simulation capabilities allow companies to build credible scenarios of the shape

future competition could take and thus spot opportunities for innovation earlier.

A European beverage manufacturer sought to stem its falling market share in declining categories. The Market Map for beverages showed 20 subdomains, including "health-focused breakfast companion" and "refreshing and hydrating." Market Map analysis brought to light that in one of the subdomains, two of the company's brands were in direct competition with each other.

Having unsuccessfully invested in advertising and promotion over the years to grow each of these brands, the company now knew it should either consolidate the brands or reposition one of them.

One of the most important insights generated by the Market Map analysis was that the company was absent in subdomains that represented almost two-thirds of the volume in the marketplace. In response, the company launched R&D initiatives to develop products in those subdomains, which had previously not even been on the company's radar. All told, the company identified more than a dozen revenue-growth opportunities that put it on track to boost revenues by 8 to 14 percent in three to five years.
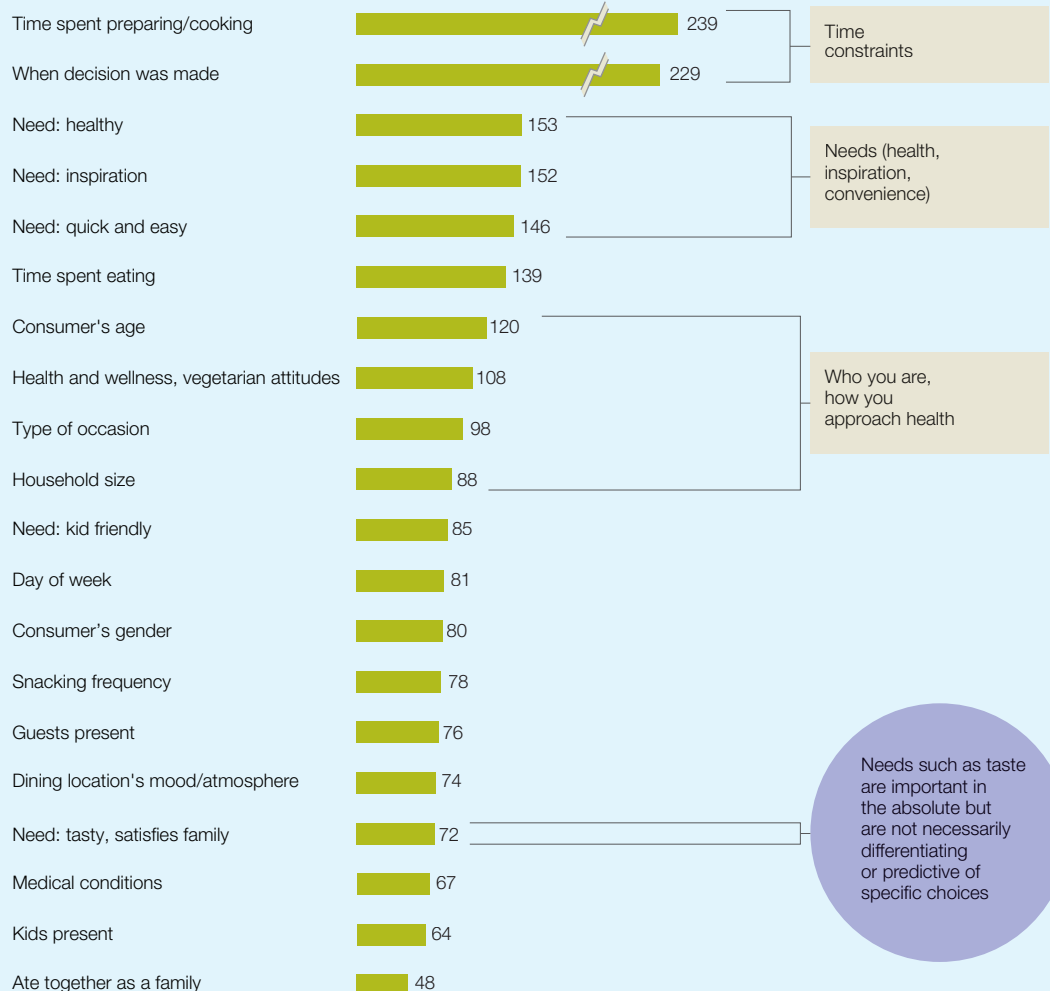
How to win

Armed with a precise definition of its competitive set, the next logical step for a company is to determine how to win in these spaces. Through Market Map analysis, companies can isolate the most important "situational drivers" behind consumption decisions (Exhibit 2).

Exhibit 2

Analysis can pinpoint the 'situational drivers' that exert the greatest influence on consumption decisions.

Hypothetical example: drivers of dinner choice, index (100 = base level)[1]

Driver	Index
Time spent preparing/cooking	239
When decision was made	229
Need: healthy	153
Need: inspiration	152
Need: quick and easy	146
Time spent eating	139
Consumer's age	120
Health and wellness, vegetarian attitudes	108
Type of occasion	98
Household size	88
Need: kid friendly	85
Day of week	81
Consumer's gender	80
Snacking frequency	78
Guests present	76
Dining location's mood/atmosphere	74
Need: tasty, satisfies family	72
Medical conditions	67
Kids present	64
Ate together as a family	48

Time constraints *(Time spent preparing/cooking; When decision was made)*

Needs (health, inspiration, convenience) *(Need: healthy; Need: inspiration; Need: quick and easy)*

Who you are, how you approach health *(Consumer's age; Health and wellness, vegetarian attitudes; Type of occasion; Household size)*

Needs such as taste are important in the absolute but are not necessarily differentiating or predictive of specific choices

[1]The index is derived through CHAID (or Chi-squared Automatic Interaction Detection) analysis, hierarchical partitioning, and other analytic techniques applied to data from a consumer usage diary.

Understanding these behavioral dynamics provides insights across the value chain, including in R&D, supply chain, marketing, and sales. Examples include the following:

Innovation or new-brand launches. Through Market Map analysis, the aforementioned beverage company learned that brand and flavor—attributes the company had long assumed were the primary drivers of consumer choice—were much less important to consumers than portability: that is, a consumer would choose a smaller, easier-to-carry bottle of her second-favorite brand or flavor over a 1.5-liter bottle of her favorite brand or flavor. Following this insight, the company shifted its focus away from new-flavor R&D and toward introducing more portable pack sizes for existing products instead.

SKU reduction. A consumer-healthcare company discovered that consumers were generally indifferent to the various easier-to-swallow forms of common medicines (capsules, caplets, and liquid gels). The company significantly reduced the number of SKUs in its portfolio, reducing costs and freeing up shelf space for products with greater incremental volume.

Portfolio strategy or tailored advertising. A mattress company repositioned its brand to focus on comfort and restfulness after discovering that technological claims carry little weight among consumers. In the six months that followed, sales rose by 57 percent over the same period in the previous year.

Merchandising strategy. A pharmaceutical company was accustomed to retailers displaying adult analgesics on the shelf based on the products' active ingredients: all ibuprofen products together, all aspirin products together, and so on. But Market Map analysis revealed that consumers shop for a pain reliever based on their symptoms

(head pain, body pain). The company worked with two of its retail customers to pilot a different shelving arrangement and introduce signage clearly distinguishing, for example, headache products from arthritis and muscle-pain products. These changes contributed to double-digit sales growth in the adult-analgesics category at the pilot stores, spurring more of the company's customers to implement the changes at their stores as well.

What winning is worth
Finally, companies can use Market Map insights as a foundation for strategic planning. Because the tool helps quantify consumer loyalties to specific products, companies can model a variety of scenarios for improving sales volume and profit and understand the potential financial impact of each action. For example, before committing a sizable investment, a company can validate the economics of introducing a new product to capture identified white spaces.

Companies can thus sequence their portfolio initiatives—whether they are investments in existing brands, new products, or potential acquisitions—based on factors such as strategic relevance, estimated impact, and time to impact, yielding a prioritized list of both quick wins and longer-term strategic investments. Quick wins typically center on brand repositioning and the introduction of close-in line extensions, whereas strategic investments are more often innovations that revolutionize the category by addressing previously unmet consumer needs.

A maker of breakfast products, for instance, used Market Map to identify a number of core-brand and innovation opportunities, prioritized by revenue potential. For quick wins, the company doubled ad spending on the core brand, introduced new snack-size options, and replicated the core brand's key advantage—its positioning as a complete

meal for people on the go—across its other products. Together, these moves resulted in an 8 percent sales increase in one year, which provided funding for additional new-product launches.

Using the Market Map approach is powerful in itself, but it can also serve as a starting point for a broader transformation of marketing and sales performance. The insights that a CPG company generates through Market Map can be applied to optimize a wide range of marketing and sales levers including pricing, promotions, and marketing-spending effectiveness. By using data and advanced analytics to formulate and refine category strategy, companies can satisfy shopper needs, maximize returns, and capture growth—even in mature markets. ∎

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Making the most of your marketing budget with Marketing Navigator

Thomas Bauer, Jesko Perrey, and Dennis Spillecke

Marketers who incorporate return-on-investment data into their daily decision making can better allocate their marketing dollars. A new analytical tool can help.

Thanks to recent advances in data and analytics, companies now have a number of ways to measure marketing return on investment (MROI). Many companies rely on a variety of tools, each of which measures only one marketing activity—say, online display advertising. But while such tools can generate interesting insights, they tend to yield narrow, short-term calculations that don't answer broader business questions—for instance, "Do the returns on our investment in online display advertising justify its 15 percent allocation in our marketing budget?" Furthermore, the tools neither measure a marketing activity's impact on long-term brand value nor do they help executives weigh trade-offs among marketing activities.

Marketing Navigator is a new solution that reflects the complexity of marketing decisions and yet is easy to use. It is a suite of customizable decision-support tools covering all aspects of marketing—from budgeting and planning all the way to execution. Marketing Navigator consists of Value Navigator, Brand Navigator, Mix Navigator, and Campaign Navigator. Crucially, the analytics behind each of the tools take into account the interactions among the various marketing activities.

In this article, we focus on one of these tools: Mix Navigator, which helps companies determine the ideal mix of marketing activities given their particular products

and objectives. Mix Navigator has four features that set it apart from standard MROI solutions: it can integrate data from different sources and perform different types of return-on-investment (ROI) analytics on those data, it tracks both short-and long-term impact to ensure that decision makers take into account the full economic value of each marketing activity, it can generate granular as well as big-picture insights, and it can be easily scaled up and embedded into marketers' daily work.

Integrating a variety of inputs and analytical techniques

Different marketing activities are typically measured and analyzed in different ways. For example, advertising in traditional media—such as television, print, or radio—is measured through econometric models that yield response curves; events and sponsorships are usually measured using rule-based methods such as the reach-cost-quality approach; and online marketing, because of the wealth of data available even at the individual-user level, lends itself to attribution modeling and other analytical techniques. Mix Navigator can accommodate data from different sources as inputs, and it can combine a range of analytical techniques—including econometric modeling, heuristics, and customer-relationship-management analytics—depending on which technique is best suited to the particular data type. The tool's flexibility enables a company to make meaningful comparisons of the impact of different marketing instruments and activities. This functionality is especially important for companies with a global footprint, which tend to see wide variations in data availability and

analytical capabilities across geographies, brands, and marketing instruments.

Using Mix Navigator, one company learned that, contrary to its hypothesis that its TV-advertising budget was too big and ought to be cut, the long-term effects of TV ads on its brands' reputation made the investment worthwhile. It also learned that majority of its events and sponsorships were a good investment, but its sports sponsorships in particular failed to deliver the expected ROI. Based on these findings, the company plans to increase its budget allocations to television and events, while reducing investments in sports-related sponsorships.
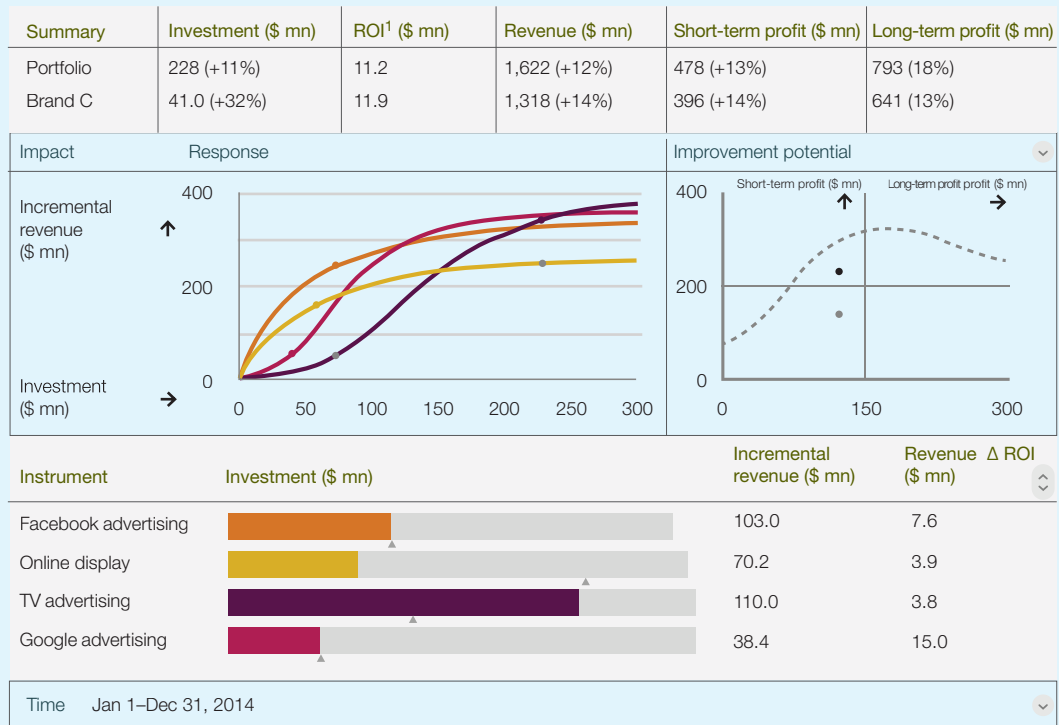
Tracking short- and long-term impact

Marketing activities can have tremendous impact on long-term brand value. For example, while image-oriented print ads or social-media mentions may not immediately increase sales, both could potentially help limit price elasticity and drive future sales. By quantifying both short- and long-term impact, Mix Navigator gives a company a complete picture of MROI.

First, the tool analyzes how much a single marketing activity—TV advertising, for example—contributes to a company's revenue base. A marketer can then use Mix Navigator's simulation capabilities to find out how an increase or decrease in the company's TV-advertising investment would affect both short-term sales and long-term brand value (exhibit). The calculation of impact on brand value is typically informed by historical data and experience; companies that lack such information can

Exhibit

Mix Navigator calculates the short- and long-term impact of specific changes in marketing investments.

Summary	Investment ($ mn)	ROI[1] ($ mn)	Revenue ($ mn)	Short-term profit ($ mn)	Long-term profit ($ mn)
Portfolio	228 (+11%)	11.2	1,622 (+12%)	478 (+13%)	793 (18%)
Brand C	41.0 (+32%)	11.9	1,318 (+14%)	396 (+14%)	641 (13%)

Impact	Response	Improvement potential

Incremental revenue ($ mn) ↑

Investment ($ mn) →

Instrument	Investment ($ mn)	Incremental revenue ($ mn)	Revenue ($ mn)	Δ ROI
Facebook advertising		103.0	7.6	
Online display		70.2	3.9	
TV advertising		110.0	3.8	
Google advertising		38.4	15.0	

Time	Jan 1–Dec 31, 2014

[1] Return on investment.

use industry benchmarks that have been preprogrammed into the tool.

Mix Navigator can thus quantify a marketing activity's ability to affect brand value over time. This functionality can help companies weigh the trade-offs between short-term measures (such as leaflets, which tend to have neutral or even negative effects) and marketing activities that can push both short- and long-term returns (such as TV advertising).

Generating big-picture and granular insights

Particularly in companies that work with multiple ad agencies, seemingly straightforward questions about total spending and ROI can be complicated to answer. A company that has different agencies handling print advertising, event planning, and social media, for instance, may have a fragmented picture of its marketing spending and performance. Mix Navigator can serve as a central repository for data from

various internal and external sources, thus providing a comprehensive view of marketing activities and campaigns. (Depending on the complexity of its marketing activities, a company may assign data-gathering and data-cleaning responsibilities to an in-house team or an outside provider.)

Mix Navigator can provide full transparency on current spending and ROI for individual activities or campaigns, but it can also give

executives a broad picture of marketing spending and effectiveness. It is therefore useful to marketing staff at all levels of the organization—from media planners to brand managers to country managers and chief marketing officers (CMOs). For instance, the CMO of a multinational company with a presence in Brazil, Germany, and the United States can view its marketing spending and ROI for each activity in each market (such as TV ad campaigns in Brazil). The CMO can also select a combination of markets and activities: for example, TV ad campaigns in Brazil and the United States over a specified time period. Such transparency enables companies to exert greater control over their campaigns and agency relationships.

Scaling up and building capabilities across the organization
Mix Navigator was designed with decision makers—not analysts—in mind. Its interfaces are intuitive and user friendly, with step-by-step instructions, predefined templates, and straightforward simulation functions. And because it is a web-based tool, it is easily scalable, even in large and geographically dispersed marketing organizations. A company can grant access to as many of its employees as appropriate, and it can define log-in rights to allow each user to review and edit his or her respective part of the budget. Brand managers can plan brand campaigns, country managers can review their annual budgets across marketing activities, and the CMO can view—and have full accountability for—global marketing spending. The use of a single database ensures that everyone in the organization is looking at the same data, with no inconsistencies.

Just as important, Mix Navigator helps build capabilities among the marketing staff because it allows them to embed MROI thinking and concepts into their daily decisions.

With Mix Navigator, companies can uncover significant improvement potential—typically a 15 to 20 percent increase in returns for every marketing dollar spent. The tool can thus play a critical role in enabling a company to make the best use of its limited marketing resources. ∎

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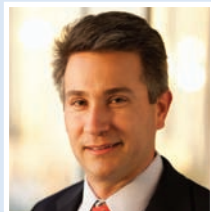Director
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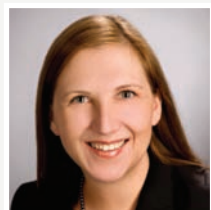Director
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