

# THE COLLAPSING VALUE CHAIN

Managing core competencies to better understand and react to consumer demand



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We are in the midst of a changing and extremely challenging world for consumer goods companies. Executives must manage an increasingly complex value chain, a fragile manufacturer/retailer relationship and a consumer who is harder to reach and understand. This month, Thomas Bornemann, Managing Partner, Consumer Products, Clarkston Consulting, shares his perspectives on these topics and his vision for the industry.

**With pressures to lower costs, reach new markets, bring new products to market faster and personalize the customer experience, value chains are also becoming more complex. How do companies manage this complexity?**

**BORNEMANN:** Ultimately, the answer lies in redefining and rebuilding your company's core competencies. And one of the most fundamental core competencies needed in tomorrow's world will be the ability to make choices about what level of complexity to build and manage in various parts of your company's value chain. Over the past 25 years, the consumer packaged goods (CPG) industry has adopted technologies and processes that resulted in more efficient operations. Much emphasis has correctly been placed on focusing the business on what really matters, leading to divestitures of non-core parts of the business, brands and product lines. But amazingly, simplification and productivity improvement brought one drawback — lack of agility. For example, the ability to react to consumer insights, and launch new products quickly and concurrently, has been lost. Today, few companies could simultaneously launch six new products in 12 consecutive test configurations and then rapidly commercialize on the products and markets that work best — in a matter of weeks. This increase in new products launches would necessitate increased numbers of SKUs, not SKU rationalization. However, the answer is not to “turn back the clock” and once again increase complexity in CPG companies to gain agility. The answer lies in developing the capabilities needed to not have a “one size fits all” mentality. This could mean combining DSD and warehouse distribution for the same SKU depending on customer or store segmentation, even for companies that traditionally do not do DSD at all. Extremely good choices and decisions need to be made as to where some increases in complexity are warranted versus the continued focus on simplification for the base business. CPG companies are going to have to be good at multiple types of execution all the way across their value chains simultaneously.

**With the increased size and strength of retailers, private label and store-by-store differentiation, how does the changing retailer/manufacturer relationship impact the value chain?**

**BORNEMANN:** The relationship between manufacturers and retailers is a delicate balance of power. For example, the recent announcement of Publix's intent to combine national brand and private label in BOGO promotions should have the entire industry's attention. Taking this Publix concept even further, it would be a greater shift of power if a major retailer were to buy an existing brand and launch it as a private label brand. The answer for the CPG companies is to develop true consumer and shopper intimacy. A direct line of communication with those people selecting, buying and using the products created is the best way to influence this balance of power. An old rule still applies — when a product is a commodity with little differentiation for the end-user, the retailer has the stronger hand in driving price, promotions and shelf position. When a product has end-user differentiation and is a “hot commodity” the manufacturer has the upper hand. With more and more retail space building on the concept of three brands at shelf (No. 1, No. 2 and private label), having a compelling product differentiation based on meeting consumers needs will only continue to grow in importance.

It is surprising to see how few CPG manufacturers have direct links to their consumers. Much emphasis has been placed on customer relationships, but consumer relationships are more important in influencing this balance of power. At Clarkston, we believe the final answer includes a win for both parties based on the concept that if more CPG companies would really understand their shoppers and consumers, more compelling new products would emerge that would boost both the CPG and retailer sales.

**The collapsing value chain has caused the store shelf to become a battle ground. In light of this change, how has TPM become a key enabler of merchandising and reaching the consumer?**

**BORNEMANN:** So many in the industry have taken up the trade promotion challenge over the past few years, yet real progress is slow and intermittent at best. The focus on managing trade promotions is only half the battle. The real answers lie in optimizing trade spending. Simply stated, robust post event analytics are needed to make optimization a real option. Very few companies can do effective trade promotion optimization today. However, some progress has been made in re-aligning trade spending from the non-controllable (pay to play) to the controllable side of the equation. As more advertising spending is converted to trade spending, having the ability to optimize trade spending will be more important than ever. Another part of the answer lies in sound segmentation of customers in regards to trade programs. What works for one customer should not be the identical trade program used for another. CPG companies should not be afraid to try new and unique things with some customers to drive trade events. They just need to be in a position to analyze the effectiveness, learn and adjust programs and then build on successes. CPG companies should not focus on benchmarking what everyone else is doing with trade promotions; they should be developing true optimization skills that have excellent post event analytic capabilities.

**How do companies incorporate insights from disparate data sources into the ideation process?**

**BORNEMANN:** This question boils down to customer and shopper intimacy much like question two above. If your company can operate in a “build it and they will come” model, you are indeed a rare player in this industry. Most CPG companies need to develop stronger skills in regards to segmentation and understanding of their customers and consumers. Decisions about what products and which markets to enter or exit depends on sound information and data. This data comes from many sources, some obvious, many less obvious. But the fundamental driver is ensuring a direct link between those shoppers and consumers that move the needle for your company, and making sure that information is gathered (everything from 800 product line numbers, to special events, to opt-in loyalty programs) and utilized within organizations. Often, some of this data is tucked away in pockets throughout the companies, but not actively consolidated and acted upon. Using the Internet and direct communications (email, text messaging, blogs) are all part of a well developed consumer intimate communication strategy — a strategy that yields strong insights when executed well. Every CPG company should have a database of loyal consumers (several million in size) with whom proactive and two-way communications occur. Insights will result.

**Much has been said about Demand Driven Supply Networks (DDSN) — is the concept here to stay?**

**BORNEMANN:** Yes, with a modification. DDSN was a great starting point, but the concept very much needs to become CDSN — where the “C” represents final consumers instead of customers. The following themes underpin this migration to CDSN:

- **Consumer intimacy** — direct dialogue with shoppers and consumers
- **Segmentation** — tailored execution to where it is needed most
- **Adaptability** — adding and deleting complexity intelligently

The industry needs to continue to strive for better decision-making that builds models that are not the same across the board. Developing core competencies that allow for dynamic execution for different groups of consumers, customers and products is what CDSN is all about. **CG**