Issue 18

Consumer Currents

Issues driving consumer organizations

KPMG
cutting through complexity

ASEAN dawn

What does Asia's new economic community mean for brands and retailers?

Winston Churchill once wrote: "To improve is to change, to be perfect is to change often." That sounds like useful advice for leaders of the consumer goods industry as they contemplate a world of uncertainty in which the short-term present is an increasingly imperfect guide to the long-term future.

Change in all its guises underpins this edition of *Consumer Currents*. In an industry being revolutionized by technology, tectonic shifts in the global economy, a growing consumer base – primarily in emerging markets – and changing demographics, the challenges and opportunities are immense. Yet the manufacturers and retailers that create an enduring competitive advantage will be those who have the courage to think and act anew, and embrace change and transformation, while drawing on the best of what they know.

New approaches are certainly called for when it comes to pricing, a complex issue we explore on page 10. This might seem paradoxical – pricing is, after all, as old as the retail industry. Yet globalization, e-commerce and consumer behavior have challenged tried-and-trusted practices. There is much that retailers and manufacturers can learn from airlines, fast-food giants and new taxi services. Yet for me the key lesson is that if companies are to break out of a self-destructive cycle of discounting, they need to think much more strategically about pricing.

When we talk of changes in consumer behavior, we are not just referring to what they spend and how they spend it, but also about new kinds of consumers. For decades, the biggest global stores and brands have fundamentally focused on selling to customers who live in developed Western economies. Yet these major players know that, if they are to generate sustained long-term growth, they must engage with consumers in the emerging markets.

Next year, a massive new single market will be created as the ASEAN nations of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam officially begin integrating their economies. This will create an economic bloc with a GDP of $US2.23 trillion. By 2025, the number of ASEAN households in the world's consuming class is forecast to soar to 125 million. On page 16, we explore a dynamic market where consumers are very optimistic about the future.

So what else is new? The success of beauty discovery channel and e-tailer Birchbox shows how quickly businesses can grow if they have an innovative new business model, understand their customers and work constructively with the right partners. We talk to the company's joint CEO Katia Beauchamp on page 20.

The rise of Birchbox demonstrates how new business concepts can create real competition for traditional consumer companies. Yet for some companies, their biggest rival may not be a legitimate business at all, but a company counterfeiting their goods. On page 14, we explore this growing problem that could be costing the industry as much as US$950bn in annual revenue, and does untold damage to brand reputations, and we investigate how the industry should react. As with pricing, effective measures to counter the counterfeiters start with companies taking a more serious, strategic view of this threat.

The UK grocery and retail group John Lewis Partnership (JLP) is not new, but it is, as Chairman Sir Charlie Mayfield discusses in the interview on page 6, reinventing itself to flourish in a world where 'click and collect' services, new retail formats and its employee-ownership model are helping it outperform the market. JLP's success proves that the challenges posed by change are also rewarding opportunities.

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Off the shelf

Winning ugly: misshapen fruit and veg are proving a hit with European shoppers

Waste not, want not

With consumers and regulators exerting pressure on retailers and suppliers to avoid landfills, tackling food waste could help the industry's bottom line and image

Food waste is a huge problem. The Food and Agriculture Organization (FAO) of the United Nations reports that nearly 1.3 billion metric tons of food is wasted globally each year – roughly a third of all that's produced for human consumption. The financial cost to retailers and suppliers is significant – but arguably less important than the lasting damage waste could do to the industry's reputation.

The issue is complex, as food is discarded at many points in the supply chain. Nearly 40% of fresh fruit and vegetables are destroyed globally before they reach stores, says the FAO. Yet solutions must be found, as some regulators are already taking action. In Massachusetts commercial facilities that produce a lot of food waste are required to divert all such material from landfill.

In developing nations, food waste is primarily caused by storage problems. It's estimated that 80% of rice in Vietnam never makes it to market. Such figures prompted the International Rice Research Institute to develop a 'super bag' that cuts oxygen levels to 5%, making it hard for insects to survive and seeds to germinate.

In Europe, a change in legislation has helped reduce food waste. The repeal in 2009 of EU marketing standards governing the shape and size of 26 fruits and vegetables has enabled stores to sell misshapen products. Last year, French supermarket Intermarché sold 'inglorious fruits and vegetables' at a 30% discount, and used them to create fresh juices and soups. In the first two days, its stores each sold an average of 1.2 metric tons of malformed fruit and vegetables, and enjoyed a 24% increase in traffic.

In Austria, Billa is following suit with its private-label Wunderlinge products. Alfred Dean, Director of Central Purchasing Fresh at parent company REWE International AG, says: "The consumer is pleased with cheaper fruit and vegetables, and suppliers can sell additional goods. Previously, they were left in the field or fed to animals."

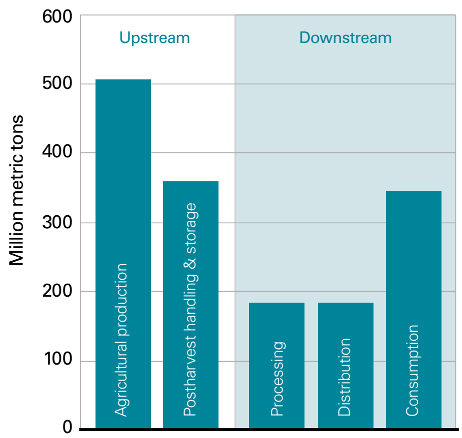
Other retailers are striving to make better use of products nearing the end of their shelf lives. In Germany, technology start-up FoodLoop connects frugal shoppers with stores by sending smartphone alerts about new discounts and available products. In pilot stores, the initiative has halved food waste.

In the US, Food Cowboy pairs food producers and transporters with nearby food banks and charities. The charities receive big discounts on the food, while donors get tax deductions. Since 2012, the service has delivered hundreds of thousands of tons of fresh food to around 60 east coast charities.

"In a world where 870 million people go hungry, food waste could undermine the credibility of corporate social responsibility programs," says **Patrick Dolan**, National Line of Business Leader, Consumer Markets at KPMG in the US. "That's why reducing waste and disposing of surplus product responsibly needs to be at the very top of the agenda."

Food wastage volumes, at world level by phase of the food supply chain

Source: UNFAO 2013



Nexttech

Nutrigenomics

Imagine waking in the morning and instead of having to whip up breakfast yourself, a machine in your kitchen automatically cooks a bespoke meal that contains the right balance of essential nutrients – those that can only be obtained via food – for your DNA make-up. This might sound like science fiction, but a revolution in the field of nutrigenomics means that disease-combating, personalized foods might be a reality within 10 years.

In the past, nutritional science has focused on the vitamins and minerals human beings need for survival, and the foods that best provide these essential elements. Now, nutrigenomics – along with the related field of nutrigenetics, which aims to offer personalized and gene-specific disease-prevention advice – is looking to combat the broader topic of diet-related diseases, such as the epidemics of obesity and Type 2 diabetes, by finding out how individual nutrients affect the thousands of genes that make up the human genome.

Nestlé's Institute of Health Science is already developing tools to measure and analyze people's levels of essential nutrients. Code-named 'Iron Man', the project could lead to the creation of capsule foods.

"Until recently, food was just food. This is a completely new direction that could transform the way we create, distribute, sell and eat food," says **Adam Bates**, Head of Creative Thinking at KPMG in the UK.

Meet the zombie brands

Why are famous names rising profitably from the dead?

Classic brands die in many ways. On-demand video streaming and digital TV movie channels caused Blockbuster to fold in many markets in 2013. Yet the brand and the business model remained viable in Mexico where only 31% of households have internet access. Last year, Blockbuster Mexico rented more than five million movies and games, generating almost US$117m in revenue in the first nine months of 2013. It has since been acquired by Grupo Elektra SAB, a retail and financial company controlled by billionaire Ricardo Salinas. The deal adds 300 outlets in 108 cities to Elektra's network, through which the company plans to sell electronics and financial services.

"A brand that has faded in its home market – such as Blockbuster – can thrive elsewhere, where the benefit the brand offers consumers is still relevant," says Lou Ellerton, Senior Consultant at brand specialist The Value Engineers. "Many companies have found that in emerging markets, brands can be 10-15 years behind those in developed markets."

In some countries, a brand may keep resonating because of its American aura. Founded in 1956 in the US, restaurant brand Mister Donut was acquired by Allied Lyons subsidiary Dunkin' Donuts (later to form part of Dunkin' Brands). There is now only one Mister Donut store in the US, but there are 10,000 worldwide: Duskin Co.'s foods division has built Mister Donut into a chain with 1,100 outlets in Japan, while Ramcar, one the Philippines' largest multinationals, has built a network of 700 franchised stores.

As launching brands is costlier than ever, a judicious relaunch can make sense. "Creating a compelling brand is time-consuming, risky, and requires substantial investment," says Ellerton. "Reviving a brand is a lot cheaper than creating one from scratch."

In 2007, Cadbury UK heeded demands from 93 Facebook groups to temporarily revive Wispa, the chocolate bar discontinued in 2003. Seven years after its revival, the brand is still selling strongly. But, says Ellerton, there's more to a relaunch than dusting down a product and sticking it back on the shelves. "You can't assume consumers have the same needs and reactions as your original target market."

"The imperative for companies considering reviving a brand is not to rush to judgment," says **José Manuel González**, Partner and Head of Retail at KPMG in Mexico. "Technology, the growing power of consumers in emerging economies and a general decline in customer loyalty have created a more complex marketplace. As manufacturers strategically review their brand portfolios, they need to think carefully about what to keep, kill or sell."

Analytics is Top of Mind

Harnessing technology to analyze the growing levels of customer data is key to consumer companies' strategies this year, and is changing business models, according to KPMG and the CGF's latest *Global Consumer Executive Top of Mind Survey*. Supply chains, corporate responsibility and global expansion also ranked as top priorities in the study, which can be downloaded at **kpmg.com/CMsurvey2014**

Trend **Spotting**

Adapting customer loyalty

Ronan Gilhawley, Lead Partner, Strategy Group at KPMG in Australia, says Asian consumer diversity and rapid market growth mean it's time for business to focus on communities

Although loyalty programs have long been a staple of food and grocery retailing in Europe and the Americas, the idea of linking them to specific business objectives is still fairly new to such companies in Asia. A new study by our Australian strategy practice, *Making the Connection: Rethinking the Role of Loyalty Management*, found 40% of them collect point-of-sale data, but fail to analyze it regularly.

Yet the need to focus on loyalty management has never been more compelling. The food and grocery segment in Asia is worth US$1.5 trillion and is growing at 4.3% compound annual growth rate. Consumers' income brackets and preferences are changing rapidly. Local markets are diverse and sensitive to the smallest changes. The range of customers and the gulf between them mean it's impossible to take even a large segment-based approach to retailing in Asia.

We found that companies need to get close to the local community. In India, for example, local communities – even those as close together as two kilometers apart – prefer to use different types of rice. If your business doesn't stock the right variety, customers will soon switch to a different chain.

Achieving this level of understanding requires a fundamental shift in how businesses view loyalty management. It's traditionally been seen as a branch of marketing and considered infrequently. But *Making the Connection* argues that food and grocery retailers in Asia need to establish a continuous feedback loop with their customers – one that permeates every part of the company – to keep up with the pace and scale of change.

> **"A continuous feedback loop with customers needs to permeate every part of the company"**

Adrian James, an Associate Director at KPMG in Australia and contributor to the study, believes "this feedback loop would affect decisions at every level; bringing science to the art of retailing, using loyalty data to gain insight into customer behavior, and using that insight to help tailor a retailer's proposition to the needs and preferences of its target customers."

Park'n'Shop, one of Hong Kong's largest supermarket chains, sparked a seismic shift in its employees' attitudes to loyalty management by launching a 'year of science'. Line managers were encouraged to showcase how they leveraged customer data in everyday processes. Healthy competition between departments prompted many innovations. Park'n'Shop made sure that every loyalty program had a sustained impact on customer lifetime value. It wasn't trying to make extra sales each week, but monitored results at segment levels and focused on driving up average customer transaction values over 12 months.

This level of detail and segmentation is vital if loyalty management is to prosper in the rapidly changing Asian retail sector. Businesses relying on a single definition of a 'loyal customer' will find they lack the deep insight that enables them to truly understand consumers. 'Dynamic segmentations' unlock the potential for immediate and future growth. The customers who are valuable to you today may not necessarily be the most valuable in the future. By implementing a continuous feedback loop, you can constantly identify which customer segments can help you achieve your goals.

John Lewis Partnership Chairman Sir Charlie Mayfield says building partnerships with suppliers leads to innovation and better products for customers

"We know we are in this business today, tomorrow and beyond, so we can take the longer-term view"

Leading an employee-owned retail giant isn't a disadvantage, says John Lewis Partnership Chairman Sir Charlie Mayfield; it helps the company make the big bets it needs to flourish

Taking over as Chairman of British high-street favorite the John Lewis Partnership in 2007, Sir Charlie Mayfield has led the firm through a period that has buffeted many of its rivals.

Despite a recession, budget-conscious consumers and fierce competition, John Lewis department stores and Waitrose grocery stores have thrived.

Sales at John Lewis rose 9.4% to £1.87bn (US$3.01bn) in the first half of 2014, with like-for-like sales up 8.2%. Meanwhile, Waitrose grew its market share in a torrid grocery sector to 5% and recorded on average 670,000 more customer transactions a week than in the comparable period in 2013.

Both retailers have significantly expanded their online service. Web orders were up 54% at Waitrose in the first half of 2014 and they account for around a third of sales at John Lewis. The Partnership is also still expanding its high-street footprint; John Lewis aims to increase its number of UK stores by more than 50% to 65 by 2023.

In a world where many brands and retailers are finding consumers increasingly fickle, the Partnership has retained the deep affection and loyalty of its customers with such popular product and service innovations as the offer of free coffee to Waitrose shoppers and the group-wide 'click and collect' service.

After joining the Partnership in 2000 as Head of Business Development, Mayfield stepped up to the Board as Development Director in 2001, and was charged with formulating the Partnership's online strategy. He then served for two years as John Lewis Managing Director prior to becoming Chairman in March 2007.

The John Lewis Partnership is owned by its 90,000 permanent staff, and comprises 43 John Lewis shops, 329 Waitrose grocery stores, an online and catalog business, a production unit and a farm.

ConsumerCurrents met Sir Charlie at the Partnership's headquarters in London's Victoria to discuss the particular challenges of leading an employee-owned business, operating in a highly competitive, ever-changing retail landscape and developing strategies to succeed in an omnichannel environment.

The grocery market is tough right now. How has Waitrose gained market share?
By consistently hammering away at shoppers' perceptions of price. People have tended to think Waitrose is more expensive than it is, but we have been progressively making headway with our [budget] Essentials range, and with Brand Price Match messages.

We have also relentlessly focused on innovation. Customers want quality, newness and innovation, and we invest a lot in them. We've also been investing in the shopping experience. Supermarkets can be functional places, but our focus has been on making the Waitrose experience special through good wine and charcuterie offers. We are putting more cafés and juice bars in stores and enhancing bakeries, and adding spaces for events such as food tasting.

We are also making good progress on being more customer-centric. We now have five million myWaitrose cards. It has proved a great success in encouraging lighter shoppers to spend more, while encouraging loyal customers to keep shopping with us.

It's all about relationship building. Simple schemes, such as offering free coffee and newspapers, have a high perceived value, and help people make their Waitrose shop a daily ritual, as well as reflecting the brand's hospitality and warmth.

Unlike other supermarkets, Waitrose has many regular, but infrequent customers, who shop lightly with us. Data from the myWaitrose program allows us to identify more accurately what would appeal most to different customers, so we can tailor promotions better than ever before.

How is the Partnership staying relevant in a fiercely competitive retail landscape?
The traditional retail market has been defined by space and the need for high sales densities, but technology is changing the way customers shop. Sales densities remain important, but they aren't the only crucial factor.

We have relatively less space than some retailers, but our 'click and collect' service makes the John Lewis brand much more accessible, as customers can collect John Lewis orders at 325 Waitrose stores. It's a brilliantly convenient way to shop and a great example of how we can use the overlap between the two brands to our advantage.

Click and collect is growing at an almost startling rate. We have recognized that convenience really matters to customers. You can no longer base a business model on the belief that someone will drive for an hour to visit your store, no matter how

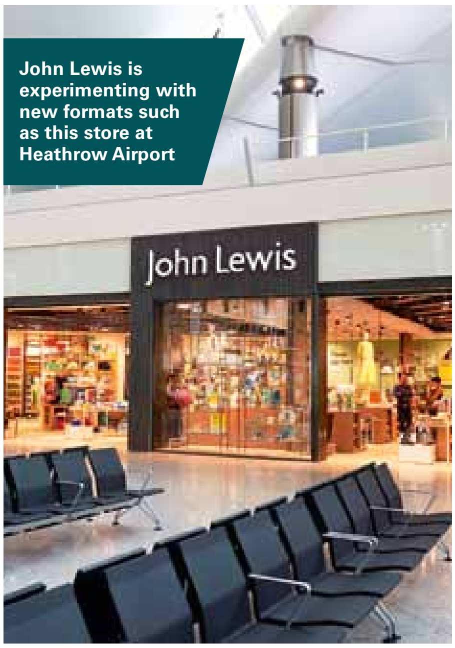
"Click and collect is growing at an almost startling rate. Convenience really matters to consumers"

fantastic it is. If there is a closer, more convenient one, they will shop there instead. Convenience is key and we have started to take the brand closer to people with our first Waitrose at Kings Cross station in London, and the 3,600sqft John Lewis at Heathrow Terminal 2.

We also need to make sure that, if the customer is making the effort to go to the shop, the visit has to deliver a value-adding experience. It has to offer inspiration, ideas and knowledge from the partners (staff).

What challenges does the omnichannel environment present for JLP?
Logistics and supply chain are absolutely mission critical, and we have developed our understanding of that partly because of our presence in both retail and groceries.

The creation of our logistics hub at Magna Park, near Milton Keynes, is one of the most important things we have done in the last 10



John Lewis is experimenting with new formats such as this store at Heathrow Airport

years. It gives us a supply chain with the agility to deliver to shops flexibly, frequently, accurately – and therefore cost effectively.

Having the supply chain capability to pick orders in hours for next-day delivery is difficult and expensive, but it's enormously worthwhile and gives us an important competitive advantage, one we are continuously investing in. We are building another 600,000sqft facility at Magna Park and adding a Waitrose national distribution center. This will be supported by investment in systems, which is essential for the businesses' improvement.

The group is famous for being an employee-owned Partnership. What are the benefits of running the business on this basis?
The employee-ownership model is overwhelmingly beneficial, because the partners' engagement with the business is so much greater. They are invested in the company financially, professionally and socially. Our AGM takes place with 70 partners who are elected from the business who work in it every single day, and they know what's going on. Their engagement is greater than that of most shareholders.

Our focus on innovation and on investing in our partners' capability stem directly from our ownership model. One of the things I most enjoy about my job is seeing our partners build up this capability over time, like the amazingly knowledgeable people in our large electrical departments. The food technologists at our research and development (R&D) center don't just wake up one morning being great at what they do, they have continuously developed their capabilities throughout their careers.

The Partnership model also allows us to focus on the long term; we can invest more money in our pricing strategy, even though it may not be the best thing for profits this year.

How does JLP's 'partner first' attitude affect decision-making?
It means that big decisions can sometimes take longer to make, but the fact that we will get there together makes us stronger.

Our pensions review is a good example. I am hoping we will get agreement next year to halve the rate of accrual for our final salary scheme and replace it with a defined contribution (DC) scheme. That's a pretty radical change, but if we carry on as we are, in perhaps 20 to 30 years' time the Partnership may be under threat from an overhang of risk, or we may have to mitigate that to such an extent that the bonus will eventually dwindle.

So there is a choice between the short term and the long term, and you must decide how to strike the right balance between them. This is fundamentally different to other organizations, where a pound that does not go to the employees goes to the shareholders. A partnership creates a completely different construct around that type of decision making.

How does the democratic nature of the Partnership affect the way you manage the business?

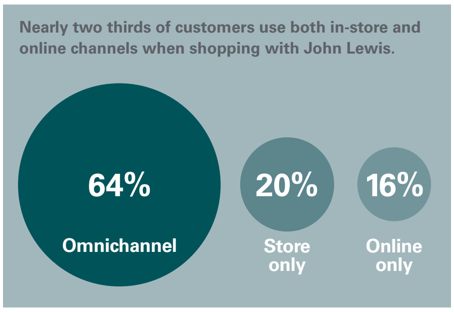
It changes how we approach problems. For example, we are changing the way we do personnel, administration and systems, and it has not worked as well as we had hoped.

In July, the Partnership Council was forthright in its unhappiness about this, so I commissioned a report that validated some of those concerns. My executive team will report back to the Council on what they are going to do about it.

That's a very tangible sign of the Partnership Council effectively raising its opinion up through the business, for messages to be heard and acted upon. It does a very good job of holding management to account.

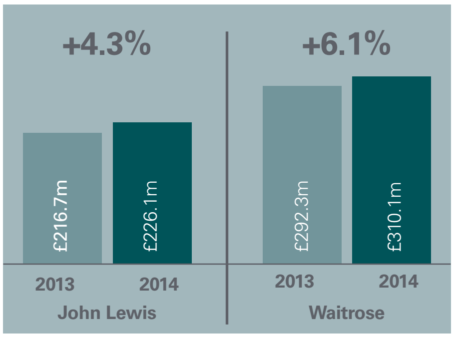
We also have a Partnership Board, and its elected directors are absolutely integral to our big strategic conversations. The Board's character is enhanced enormously by having elected directors who care passionately about the Partnership.

JLP customer shopping habits



Source: John Lewis Partnership annual report 2014

JLP operating profit 2013/14



Source: John Lewis Partnership annual report 2014

Does the Partnership model lead to a different kind of relationship with suppliers?

We look to develop long-term relationships with suppliers which we think leads to innovation and better products. For example, we've worked with one bedding company for 30 years. They have come up with better, much lighter versions of synthetic duvets for us with similar characteristics to down equivalents. Because they have long-term confidence in their relationship with us, they are not afraid to invest in R&D. It's very difficult to get this if you just have a transactional relationship with your suppliers.

Pork is another great example. Most pigs are farmed indoors so they can be protected from the sow rolling over them. One of our suppliers, a Danish farming co-operative, has bred sows with lower mortality rates for their piglets. The result is better husbandry, better productivity and better pork. You don't get these kind of innovations when you are haggling with your suppliers over pennies.

JLP is one of the UK's leading multichannel retailers. How do you plan to stay competitive in this respect?

Logistics and systems are key. We have to make a significant investment in systems now. It's difficult to achieve, because you have to do it in flight and it's a complex architecture due to the range of products we sell. Even though the numbers are painful, we have to make that investment to make sure we have a systems architecture that is fit for the future.

From an ownership standpoint this is not profit maximizing. Depreciation for systems is over five to 10 years, compared to 30 years for a store, which creates a drag on your profit and loss on top of the actual cost.

If you are in a business driven by executive remuneration or short-term profits, you have a disincentive in taking those big bets. But we know we are in this business today, tomorrow, next year and beyond, which enables us to take the longer-term view.

It's also vital to understand the different cost and profit dynamics of the online and offline models. Shops are a fixed-cost business, whereas online is a variable cost model, and if you do both you have to figure out the blend between the two.

DEFINING THE RIGHT STRATEGY

Retailers and manufacturers need to stop seeing price as a tactical lever and move from constant discounting to improve long-term profitability

During the economic downturn, companies competed for market share and volume, which meant frequent price promotions and markdowns. While many markets have since recovered from the recession, corporations still find themselves stuck in a cycle of recession-driven discounting.

Robert Browne, Partner, Strategy Group at KPMG in the UK, says that companies need to now rethink their pricing strategy. The high-low model – marking products up, only to discount them later – not only lowers margins, but damages and devalues brands over time.

"It isn't a strategy that helps improve the perceived worth of the product in the eyes of consumers," Browne says. Constant discounting essentially telegraphs to consumers that products aren't worth the regular price – the sale price is the true price – and he warns that the model can reset prices to a lower level permanently. "For a number of products, customers will now buy only if certain promotions are on."

Some retailers, he notes, have been making a push away from the high-low model. In the US, electronics chain Best Buy has adopted an everyday low price model. However, it doesn't always work. JCPenney tried to adopt the same model in 2012 but – showing how difficult it is to break out of such a cycle – retreated to price promotions. "While our prices continue to represent a tremendous value every day, we now understand that customers are motivated by promotions and prefer to receive discounts through sales and coupons applied at the register," the company said in a statement.

George Svinos, Partner and Head of Retail, Asia Pacific at KPMG in Australia, says retailers are now pressing manufacturers to think more strategically about prices, and to focus on long-term profits rather than quick sales. "Retailers have a lot of precise data about the cause and effect of pricing promotions because of their loyalty card schemes," he says. "They are finding that sometimes the promotion of a branded product actually cannibalizes their

What happens when the price isn't right? Constant promotions can lower consumer perceptions of a product's true value private-label sales rather than creating a halo effect on other products.

"This means retailers are pushing back on branded-product suppliers and saying: 'We don't want to do those promotions any more.'"

Browne says the working relationship between suppliers and retailers is right at the heart of the issue. "Suppliers have to get smarter about dealing with retailers and work with them to understand which promotions do and don't work. If they don't, they will continue to be at the mercy of retailers."

Last year KPMG conducted a wide-ranging study of pricing with companies in the UK and the unanimous response is that they all have significant room for improvement. To illustrate this point, over 70% of companies said they could increase profits by at least 5% if they were able to price products and services more effectively, while 40% believed they could generate at least a 10% improvement in profits.

But to do so, brands need to treat pricing as a strategic rather than tactical capability. This is especially important now as companies are having to contend with growing competition, increasing price transparency, new consumer-led buying models and technological advances in traditional pricing models.

"Companies are realizing pricing can no longer be overlooked as a capability," says Browne, who led the KPMG study. "It reminds me of the shift a decade ago with procurement, which transformed from an operating function to a core strategic capability for most businesses. Organizations now understand that to stay relevant and competitive, they need to examine different pricing models, ensure their chosen model aligns with their business goals, and that the strategy drives long-term profitability."

Consumer-led models

Browne says there are two new pricing models emerging: "One that is beneficial to the consumer, and another that works more in the seller's favor."

The former includes competitiive pricing, driven by increased price transparency and online retailing. Consumers are using mobile devices to check and compare prices between multiple retailers. This is particularly evident in the travel sector, where a slew of new websites – such as Trivago and Kayak – claim to do the comparing for millions of consumers who have neither the time nor inclination to visit multiple sites. These capabilities are now also ubiquitous in retail.

"New technology now enables shoppers to scan bar codes using a smartphone app and see the price at other retailers," says Browne. Some apps even forecast what the price might be in the near future – potentially delaying or spurring the decision to purchase. "We're seeing a lot of new technology concepts, such as what mySupermarket is doing with Morrisons in the UK, that will help consumers comparison-shop between retailers."

E-commerce across borders is also contributing to the challenges of competitive pricing. Competition previously resided within geographic borders; now domestic and foreign brands are going head-to-head online.

In Australia, for example, where goods are typically more expensive than in most other parts of the world, residents can make overseas online purchases of up to AUD$1,000 (US$867) without paying duty, goods and services tax (GST) and import processing fees.

To ensure that its prices remain competitive with global e-commerce sites, Australian department store chain David Jones, purchased by South Africa-based Woolworths earlier this year, embarked on "price harmonization" as part of its turnaround plan. To date, David Jones has negotiated with 250 international brands that it identified as being in need of harmonization.

"We've been working and will continue to work with our brand partners to reduce prices across the store," the company said in an announcement. "Right now, the prices on hundreds of products from international brands have been reduced by up to 50%. Not temporary savings, but lower everyday prices."

Other consumer-led models have emerged including collective buying, where shoppers use their combined purchasing power to get deals. Groupon is a well-known enterprise-led example, but there have been more community-driven efforts, too: in the UK, energy suppliers found themselves bidding in a reverse auction for the business of 36,000 customers. The households had signed up to a campaign called The Big Switch, orchestrated by activist group 38 Degrees and the Consumers' Association, that aimed to secure them cheaper gas and electricity services.

There are also websites that put a twist on the name-your-price model made popular by travel website Priceline and Humble Bundle, a purveyor of digital assets such as games, e-books and music. Users of online marketplace Higgle, for instance, can name their price if they have enough people buying together. Typically, users of these marketplaces rely on social media to find like-minded buyers.

"Expect to see more examples of groups of customers coming together to use their buying power as one," says Browne. "This will open up new opportunities for enterprising brands that are willing to be innovative in their approach to pricing and promotions."

Seller-led models

Consumers may have access to more information than ever before about the prices of goods and services across various sellers – but retailers have more information about their customers than ever before. "There is a

> **"Organizations need to examine different pricing models, ensure their model aligns with their business goals, and that the strategy drives long-term profitability"**

George Svinos

Partner and Head of Retail, Asia Pacific, KPMG in Australia

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1. Move responsibility to strategic function

Think of pricing as central to your long-term strategic plans; not as part of your short-term, tactical actions. When reassigning responsibility for pricing, ask yourself: how does the pricing reinforce the brand value of your product or service? How do prices affect supply and demand? And, ultimately, how does your pricing strategy help to drive profit for your company?

2. Retailers are in the driver's seat

Manufacturers must acknowledge that retailers are in prime position to understand and determine pricing strategies. Their ability to capture and analyze transaction and loyalty-card data gives them the insight needed to define the prices and promotions that drive the most profit. Online retailers are also able to optimize prices using sophisticated algorithms that consider multiple variables that manufacturers may not be able to see. It's essential for manufacturers to work closely with their retailer partners to develop promotions that are mutually beneficial.

3. Consider the role of value

Do you know what value consumers place on your brand, and why? Once you do, you can explore how value can be protected and enhanced by your pricing strategy. Understanding how consumers define the value of your product or service brings you much closer to identifying a pricing strategy that works.

4. Big data is still king

Making use of the wealth of customer data available is crucial for shaping your pricing strategy. Use it to gain insights into price performance and identify which segments of consumers are willing to pay more for your products and services.

lot of data available in the retail environment through point-of-sale systems, loyalty cards, competitive price checkers and social media," explains Browne. "It's a matter of retailers analyzing that data and gleaning insights they can put into action."

More and more brands are using data to set prices on an increasingly dynamic basis, where prices can change by month, week or day, depending on supply, demand and a multitude of other variables factored in by the algorithm.

It is a model that has driven the success of online giant Amazon and is now being replicated by similar retailers across the globe such as Jumia, the largest e-commerce provider in Africa.

Jumia, which was set up by AIG and is funded by Millicom, MTN and Rocket Internet, has seen double-digit growth month-over-month since its 2012 inception. As well as serving its home market, Jumia also sells general merchandise in Kenya, Morocco, Ivory Coast, Egypt, Ghana, Cameroon and Uganda.

"It is the Amazon way of doing business," says Nicolas Martin, Chief Executive Officer of Jumia. "You develop a pricing algorithm so sophisticated that no one can emulate it. This enables you to always have the most relevant price, and to optimize your price and margin based on the price and availability of competitors' products."

The old pricing model, says Martin, lacks the flexibility needed to balance inventory and the inherent depreciation of products. He notes, for instance, the price of a new computer drops about six weeks after going on sale. "No matter what you do, the only way to succeed in online retail is to have the right product, at the right price, delivered conveniently," he says. "Nothing else matters. If you are not relevant in terms of price, you have no business."

> **"The only way to succeed in online retail is the right product, at the right price, delivered conveniently. If you are not relevant in terms of price, you have no business"**

In markets such as Africa, consumers can be very wary of online payments. Martin says earning consumer trust is an important way for brands to ensure they don't compete purely on price. It explains why Jumia offers pay-on-delivery (through a fleet comprising mostly motorbikes, which make it easier for drivers to navigate congested roads) and free returns on most product categories.

"Trust has limited impact when it comes to actual price, but it does as part of a consumer's consideration list: 'If I don't trust you, I don't care about your assortment or your prices'," notes Martin. "Trust also allows you to charge more for services." For example, a company's shipping fees can be higher than the average if people trust and enjoy the quality of the service.

Browne says airlines are a great example of a sector that uses data-driven dynamic pricing in combination with an innovative value proposition. They've pioneered a concept he calls "disaggregating value".

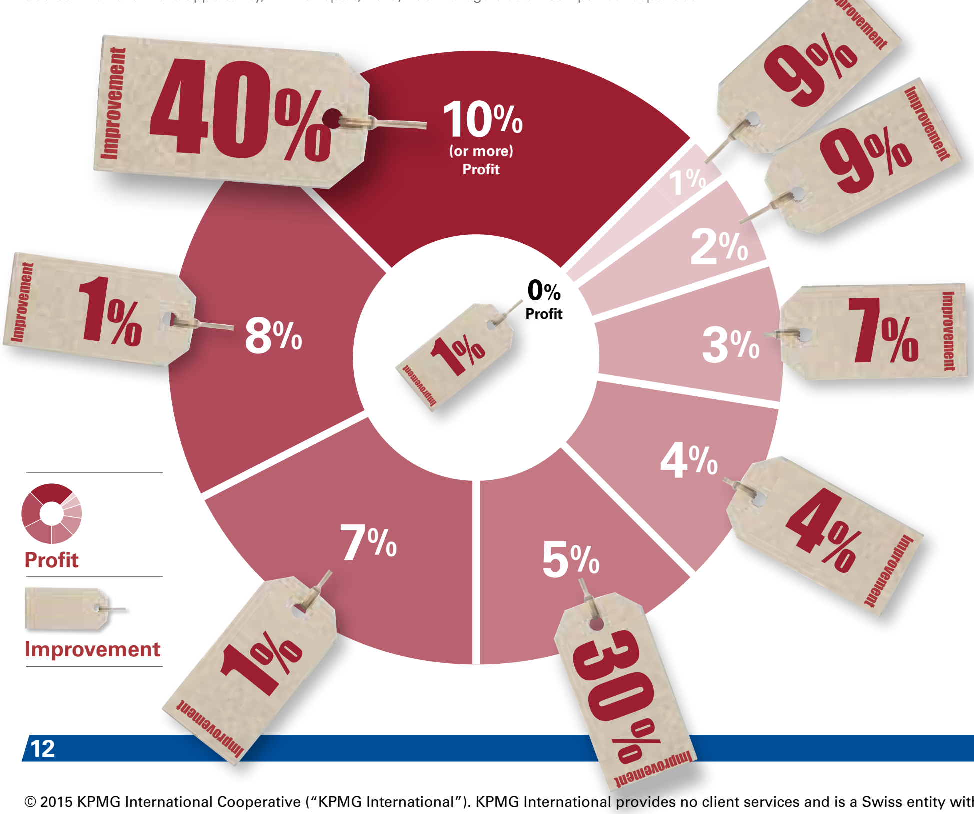
By breaking down the offer into individual components that drive value for customers – such as the ability to check baggage, change flights or reserve seat locations – airlines can charge for them on a per-use basis, since they are separated from the 'seat price' on a flight. "For 40 years airlines couldn't figure out how to make money until they started disaggregating how value is created," explains Browne. "They figured out their value proposition and said: 'Let's price for all these bits and pieces of value.' They really pioneered 'smart' pricing."

Dynamic pricing is nothing new at retail – restaurants' 'early bird' specials and shoe store end-of-season clearance sales, for example, demonstrate dynamic pricing in its simplest form. But can these bricks-and-mortar retailers learn to better leverage technological advances?

"Does that really apply in the real world of the retail consumer? It sort of does now," says Browne. "There are lesser versions of dynamic pricing creeping into lots of places that retailers need to be aware of. Trials of electronic price tags that update prices based on inventory, for example, are already under way. If you contrast that to someone coming along with a price gun to change a price on

In the current market conditions, what profit improvement would you estimate your company could generate with more effective pricing?

Source: The 10% Profit Opportunity, KPMG report, 2013; 200 managers at UK companies responded



End-of-season retail sales represent dynamic pricing in its simplest form

a shelf, you can see how we're moving light years away from that."

Uber, a ride-sharing service founded in San Francisco, has hit the headlines because of its pricing model: rates fluctuate due to an algorithm that takes into account the number of taxis on the road and taxis taken with passengers. When demand is low, Uber's rates are generally cheaper than other cab services, but when demand is high, rates can be several times above normal levels.

The model generated some negative publicity for Uber after journeys during a New York City snowstorm cost some passengers more than eight times the standard price. The company has since said it will cap how much it can raise rates during emergencies.

While Browne says that consumers are becoming more used to paying for goods and services on a dynamic basis, he warns that they don't want to feel that a business is deliberately profiting when they are at their most vulnerable.

"There is a profound psychological issue that is fundamental to all pricing models: no one wants to feel like they are getting ripped off," he says. "There was an experiment done by a soft drinks manufacturer in which the price of its drinks in vending machines changed based on the temperature outside. It would be logical to think if the temperature rises so would the price, because of greater demand. But customers completely rejected this pricing model, because it felt exploitative."

What's the next frontier of pricing? Svinos says marketers have the ability to leverage data analytics to price products on an individual basis. "We're not there yet," he says. "At the moment, many retailers are just trying to make certain customers aware of promotions based on their purchasing histories. But once you know someone's triggers, you can target prices individually without necessarily doing it across the board."

Demand-led pricing

One market segment that rarely discounts is luxury goods and services. Svinos says they are the best example of the proactive, value-based model, in which pricing is determined based on how much a consumer values the product or service. To maintain its value, luxury brands such as Rolex and high-end fashion labels always keep prices at a high level.

"Louis Vuitton doesn't have sales. It doesn't discount because it doesn't want to disenfranchise customers by causing some to buy goods at full price and enabling others to buy at a discount," says Svinos. "It is the ultimate in brand protection and pricing."

Non-luxury brands have embraced the value-based model partly by shifting from mass production to a made-to-order or made-to-build model. "The car industry used to produce as many vehicles as it could to capitalize on production efficiencies," Svinos continues. "But now the thinking is: 'Why do I need to build so much stock that I will then have to discount?' Because typically the only mechanism to move inventory is to reduce the price. Now they are moving to a built just-in-time basis."

However, marketers still have to find the right price point that will attract buyers, and ensure stock doesn't pile up. Svinos says this demands that companies also better understand how production and pricing can work together strategically; too often pricing is a reactionary response to inventory levels.

Svinos credits Apple for implementing the just-in-time model, achieved through lean manufacturing and smart supply chain management, which helps maintain prices as demand is always greater than supply.

He says the value-based model can also work for a brand such as McDonald's, which has found the right value price point for its meal products. "It introduces new products every month – this innovation brings customers to the restaurants and generates demand. It's not actually price-driven at all," he says. "McDonald's recognizes that price is not the only lever to move product."

Spanish fast-fashion retailer Zara is cited as another successful example: it has developed a highly centralized manufacturing and distribution model, which results in new clothes being delivered to stores twice a week. "Zara has adopted a replenishment model that results in not overstocking a store," says Svinos.

"It doesn't mean that everything Zara delivers to store is a best seller, simply that if the item doesn't sell, the retailer doesn't deliver any more, thereby minimising discounts in store," he says. "When Zara does occasionally discount goods, consumers don't really notice the sales – that's not the reason why they visit the company's stores."

Zara's model compels the shopper to buy at full price rather than wait for a markdown that might not come, says Svinos. "It has created demand: people say: 'If I don't buy it today, it won't be there tomorrow. I can't wait.' It is a demand-led model, not a supply-led one."

Adapt or be left behind

Both Svinos and Browne believe that retailers and suppliers need to become more sophisticated about pricing strategies – because if they don't they will continue to execute reactionary, low-margin responses to competition and consumer behavior even during times of growth. "There is a real opportunity to get more strategic about it now," says Browne. "Strong pricing capabilities are now a requirement to be competitive."

THE MYSTERIOUS SCIENCE OF PRICING

As retailers search for the 'secret' to perfect pricing, **Robert Browne** finds researchers have been delving into the subconscious factors that influence how consumers perceive prices

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Feeling warm and fuzzy

Warm temperatures can increase the perceived value a shopper has of a product, say Israeli researchers at the Hebrew University of Jerusalem. "Physical warmth activates the concept of emotional warmth (e.g. intimacy, belonging). This, in turn, increases valuation of the product," say the researchers, who dub it the 'temperature-premium effect'.

Retail rejection

Conventional wisdom suggests that friendly salespeople yield more sales. Yet a 2014 study from the University of British Columbia's Sauder School of Business suggests rejection can sometimes be positive. "We are attuned to social threats and are driven to buy from the very people who are disrespectful to us," says the report.

Seeing red

Researchers at Virginia Tech and the University of Virginia analyzed data from eBay auctions and replicated them. They found buyers placed higher bids when the screen had a red background (rather than blue). "The red induces aggression through a feeling of arousal," says the report.

Say what you see

A study published by the *Journal of Consumer Psychology* in 2012 discovered that prices that had more syllables when spoken aloud – such as using the number seven or zeros after the decimal point – were perceived by consumers to be higher than those with fewer syllables. The same effect was observed when values were written, rather than spoken – so consider carefully how prices are displayed on shelves.

Pleasurable pricing

Researchers at the Stanford Graduate School of Business and the California Institute of Technology have discovered that because people expect expensive wines to be high quality, their brains are 'tricked' into enjoying a more pleasurable experience than when drinking cheaper wine. Expecting a high-quality product triggers activity in the brain's medial orbital cortex, which registers pleasure. Taste is unaffected.

Not the genuine article? Today's illicit goods can be so sophisticated they deceive even expert examiners

Fighting the fakes

Counterfeiters can be companies' biggest competitors. Now new technologies offer a cost-effective defense

"A more pernicious kind of counterfeiting is now flourishing, as fakes enter legitimate supply chains and are sold without the manufacturer, retailer or consumer realizing"

Counterfeiting isn't what it used to be. Years ago, a customer buying, say, a fake Rolex watch probably knew it wasn't the genuine article. Today, some counterfeit goods are so convincing that even seasoned brand protection officers are tested. As Philippe Amon, Chief Executive Officer of SICPA, a Swiss company that creates track and trace and authentication systems to fight this problem, says: "In the past, it was easier to tell the difference between real, licit, and false, illicit products. Now it is increasingly hard to identify which is which."

Counterfeiting is big business. Estimates of how much revenue is lost vary wildly. The Organization for Economic Co-operation and Development (OECD) puts losses at around US$250bn. However, in the security industry, some companies say product-related crime could be worth as much as US$915bn.

The range of fake products varies from cigarettes to luxury goods, toys to fine wine, and smartphones to automotive parts. David Weatherby, a consultant at GS1, an organization that develops and maintains standards for supply chains, says: "Any market where you have high margins or high taxes is vulnerable to counterfeiting. The counterfeiters' costs are so low – they don't have any R&D, they don't have to produce to a particular standard, worry about health and safety or pay decent wages – and the rewards are so high."

The added incentive for those who run these businesses is that they are very unlikely to get caught and, if apprehended, even less likely to go to jail. All of which may explain why, GS1 estimates, the counterfeiting industry is 100 times as large as it was in 1984.

Faking products has long been a lucrative business but a more pernicious kind of counterfeiting is now flourishing, in which counterfeit goods enter legitimate supply chains and are sold in store without the manufacturer, retailer or consumer realizing they are not the genuine article.

Amon believes three main factors have driven the growth in counterfeiting. "Sophisticated technologies are more freely available and criminal groups are now so well equipped they can counterfeit designs in days. The internet has given counterfeiters outlets to sell their goods and there is poor protection of the consumer on the web. These challenges have been exacerbated by outsourcing or offshoring production, often

HOW TO FIGHT BACK

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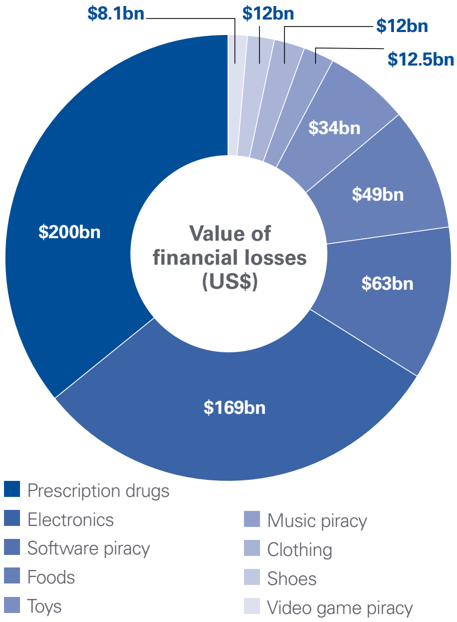
1. Think strategically
Countering counterfeiting isn't just about technology – it requires a strategic commitment from the C-suite. Companies like Louis Vuitton (LVMH) spend millions on investigations, finding criminals and undertaking legal battles. Whatever technological solution you choose, you need to invest in enforcement.

2. Identify a solution
Counterfeiting is now so sophisticated, you need to ensure that your technology can look back – so it works with your legacy systems – and look forward, being flexible enough to develop as the threat changes.

3. Maintain open standards
Learn from the timber industry. Track and trace technology was not as effective there because each company sought their own solution. By adhering to open standards, companies can encourage adoption, ensure greater coverage of the supply chain and lower their costs.

4. Manage your costs
You need to balance the cost of protection with the cost of attack from counterfeiters. You don't want to spend too much money per product or end up passing costs on to the customer. Yet in some sectors, the return on investment can be significant.

5. Educate the consumer
Counterfeiting is not a victimless crime. Fake medicines, alcohol and food can harm and even kill consumers. Despite the label, counterfeiters do not uphold quality. And the people making money from counterfeiting are almost certainly doing things customers won't approve of.



Source: Havoscope

to distant countries with less regulated economies, with manufacturers having less control. Globalization has been good for us but it has created opportunities to bring illicit goods into the supply chain."

Traditionally, some manufacturers have taken the view that counterfeiting is an unavoidable evil and focused their time and money on more glamorous areas of the business – such as product launches or acquisitions – but **Robin Cartwright**, Strategy Partner at KPMG in the UK, says this attitude is no longer tenable: "In some markets, we tell our clients that their biggest competitors are counterfeiters."

The best case scenario for businesses that become victims of this crime is that they only lose revenue. In other instances, where a counterfeit product puts consumers at risk, a company's reputation can be irretrievably damaged. In the Czech Republic in 2012, 19 people died drinking fake branded vodka laced with methanol.

Such incidents underline the seriousness of the problem but SICPA, GS1 and KPMG all believe that businesses are not thinking strategically enough about how they can counter the counterfeiters. Amon can understand why: "It's not simple, the solutions can be deeply complex and, because the damage can be hard to quantify, many companies don't want to invest in something that they fear may not work. Yet the cost of a good protection system can be only a fraction of what some companies spend on advertising."

Part of the problem, Cartwright says, is that counterfeiting affects so many parts of a business: "Fighting the counterfeiters can involve marketing, manufacturing, the legal department and intellectual property. And companies can't define a return on

"The cost of a good protection system can be only a fraction of what some companies spend on advertising"

investment in anti-counterfeiting if they don't know how much they're investing." Yet the financial incentive is real. In one of a number of projects in China, SICPA helped devise a system providing real-time authenticity checks by using an invisible code that could be read by a device connected to a smartphone for a food manufacturer that was worried about counterfeiting. After locating the crime, the company changed its systems and raised revenues by around 20%.

So what can manufacturers do to fight back? Something as simple as giving every product a unique, checkable serial number can identify fakes. Tamper-proof packaging can make a difference. Nokia has started making batteries that contain holographic images and 20-digit identification codes that can be scanned online. RFID tags are proving popular. As GS1 notes, RFID tags can be checked quickly, easily, without line of sight and carry a unique factory-programmed code that, once written on the tag, cannot be changed. Combining both digital and material (physical) technology makes for a more robust deterrent.

Many brands want to go further. For them, the fight against counterfeiting starts with securing their supply chain, so they can track where the products are in their distribution system and where they are going, and trace back to see where goods have been and come from. By analyzing such data, companies can map codes, locations and custodians and, by following the lifecycle of a product, discover whether and where illicit goods enter the system. Fine wine company Opus One has, for the first time in its history, had no complaints about fakes after investing in multilayered authentication technology with SICPA.

Every company has a different supply chain and its approach to product security will vary accordingly but, however bespoke the technology they invest in, it needs to be based on an open standard and work with other companies' systems. And by the time the product gets to the store, Weatherby says, the simpler and clearer the advice on how to check for authenticity the better.

One of the challenges brands face is that many consumers see buying, say, a fake handbag or watch as a victimless crime. As Cartwright says, that is not true: "If you're buying a fake, you're probably funding some very bad people."

ASEAN TIGERS

In 2015, 10 Southeast Asian nations will form a single market with 625 million people, a GDP of US$2.4 trn and growth of 6% a year. What do Western brands and retailers need to know about this opportunity?

When WHSmith was launching a new store in the ASEAN region, at Kuala Lumpur airport in 2012, the company's International Director had his own view on which books should be stocked. "We need some Joseph Conrad," Louis de Bourgoing told Bison, WHSmith's local joint-venture partner. "He wrote a lot about Malaysia."

For De Bourgoing, Conrad's novels set in the Malay Archipelago would be perennial sellers, much as Wilfred Thesiger's *Arabian Sands* was the company's most popular book in Oman. That granular attention to detail is one of the keystones of success in the ASEAN region.

Ten countries comprise the Association of Southeast Asian Nations (ASEAN) – Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. By the end of 2015, ASEAN aims to have created a single economic market, to be known as the AEC, built on a collective population of around 625 million and a GDP worth about US$2.4trn.

It's easy to be dazzled by the figures. By 2020, Nielsen estimates, 400 million people in ASEAN will belong to the middle class, more than in Brazil, France, Germany, the UK and the US combined. GDP in the region is expected to rise by 6% per annum between 2011 and 2016. The demographics favor ASEAN, too: in the coming decades, it will have more prime-age adults (between 25 and 54) than ever before. Add in the optimism that pervades consumers in many of these

ASEAN

In October 2014 the World Bank rated Singapore top of 189 nations for ease of doing business

KEY LEARNINGS

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1. Western brands are seen as superior in quality to local ones, but the customer will balance that against price. Consider smaller sizes to make your products more affordable. You need to study the variations in consumer demand.

2. Don't assume that because a single market is being created, conditions in each country will be the same. There will be a lot of things (customs, climate) you don't understand, so think about a joint venture with a local company or franchise partner who has local knowledge.

3. Don't rush in. Current buoyant market conditions have sent local costs soaring in some areas, so it may be better to wait until things cool down. Look at establishing a firm foothold in one country, then expansion into another market when the time is right.

4. Don't rely on e-commerce. You may have a good product but internet penetration and e-commerce levels can be much lower in some ASEAN countries, where shopping is often seen as a pleasure and malls as places to socialize.

5. Corporate responsibility is important. Don't just think about your own profits. Responsible business conduct and working with partners and NGOs to improve the local community's quality of life will be important in how you are perceived and received.

countries and you can see why some companies might overlook the very real challenge posed by the region's cultural, legal, political, and economic diversity.

The 10 ASEAN countries harbor vast differences in wealth (Singapore, the richest, is more than 50 times wealthier than the poorest, Myanmar); in population (Indonesia's 248 million dwarfs Brunei's 420,000); in religion (Myanmar is predominantly Buddhist, Indonesia is mainly Muslim, the Philippines largely Roman Catholic); and in political and economic systems (democracies and dictatorships, communism and capitalism are in close proximity). Understanding these differences is important to any business operating in the region.

Nuanced strategy

The old-school approach for multinationals looking to tap into the ASEAN market was to set up an HQ in Singapore and assume the challenge was sorted. Yet **Ian Thornhill**, Advisory Director at KPMG in Thailand and Myanmar, says that brands need a much more nuanced strategy if they are to flourish across the region. "Companies need to study the subtleties of consumer demand. Some international brands will acquire, or work with, a local partner to understand different markets and grasp the balance of quality and price the customer is looking for.

"For example, they need to consider prices and the size of the products they're selling. In some poorer markets, they might be better off selling sachets."

One advantage for Western brands, according to Thornhill, is that they are perceived as being of higher quality than local ones, "yet they still need to be affordable. For example, one globally famous premium ice-cream brand effectively withdrew from the Philippines market after 12 years."

As critical as price points can be in ASEAN, they aren't the only conundrum that consumer goods companies must face. "Distribution and access to market can be a challenge," says **Yasuhide Fujii**, Managing Partner at KPMG in Myanmar. "Local supply chains can be quite complex and it can be difficult to access certain parts of the country."

Some markets are more open than others, which is why WHSmith has opted for a joint venture in Malaysia and appointed IDP as a franchise partner in Indonesia. "Many people like to think that going direct is the best answer in the long term," says De Bourgoing, "and they may be right. But running a joint venture can be effective because there are always things you don't understand and it is an interesting challenge to have to agree – and align – with a partner. You provide the expertise and the best practice and they have the local knowledge to help you make fewer mistakes."

One mistake Western brands can make is to extrapolate the factors that drive their developed markets to the ASEAN region. Omnichannel is a troubling reality in most Western retail markets, yet it is not so important in Southeast Asia, according to Terry O'Connor, CEO of the furniture, electrical and IT retail giant Courts Asia. "In some countries, shopping is seen as an irritation; in ASEAN it is a pastime," he says. "In Singapore, the mall is a social anchor, with food courts, cinemas and kids' theaters. E-commerce accounts for [only] around 1.1% of retail in Singapore, less in Malaysia and Indonesia."

O'Connor is not arguing that the ASEAN consumer market is protected by some kind of exceptionalism. The group has just revamped its online offering, eCourts, and he believes e-commerce can help the company move into new territories.

> **"Indonesia is a very exciting market. The consumer segment has seen a very strong emergence"**

But he is convinced that the region's shopping culture gives retailers such as Courts longer to adapt than equivalent companies in the West.

On its homepage, Courts makes much play of its promise to the community. Corporate social responsibility statements are familiar in the West but have particular resonance for Western brands looking to move into ASEAN.

"It is important that companies show that it's not entirely about their own business," says Fujii. "American companies investing in Myanmar, for example, have set a high standard for responsible business conduct, working with partners and NGOs to improve the quality of life for the Myanmar people."

Gold rush mentality

Western brands would also be foolish to overlook the political uncertainties that affect such key markets as Myanmar and Thailand. Even so, the opening up of Myanmar has been spectacular, with 15 US companies, including Gap, investing there in the past year. Most recently, Colgate-Palmolive acquired a local toothpaste maker. But what some analysts see as a gold rush mentality has sent real estate costs rocketing and prompted some potential entrants to wait for the market to cool down. "The growth is coming, but Myanmar is a long-term play," says Fujii. "In the short term, you may see better growth from other ASEAN countries that are starting from a higher base."

So it may be no coincidence that these markets are the priorities both for WHSmith, a global retailer making inroads into ASEAN, and the Singapore-based Courts. The latter is already the second largest player in its sector in Malaysia but O'Connor says the company is determined to keep expanding. "We aim to grow our footprint in Malaysia by an average of six stores a year," he tells *ConsumerCurrents*. "On top of that, we have just entered the Indonesian market with our largest ever 'Big-Box' Megastore in Bekasi.

"Indonesia is a very exciting market," he adds. "The consumer segment has seen a very strong emergence as there are about 135 million middle-class consumers. We're looking forward to being a long-term player in the country. There is a lot of scope for players like us to bring something different to the market."

WHSmith has targeted the same markets in the same order, but using different models: Malaysia through a joint venture with Bison, followed by Indonesia, through franchisee IDP. Though De Bourgoing is instinctively reticent when asked strategic questions, the *modus operandi* seems clear. Get a foot in an ASEAN market, learn the right lessons, and then, when it is stable and the moment seems right, look for the next market. "The good thing about retail," he tells *ConsumerCurrents*, "is that you can test, adapt and react."

Huge achievement

Whereas Courts covers more sectors as a retailer, WHSmith is something of a specialist. In ASEAN, its focus is on travel essentials – be they neck pillows (its bestseller), soft drinks, books or magazines – yet the strategy for growth is not dissimilar. Courts, which opened its first store in Singapore 40 years ago, moved into Malaysia then Indonesia; the Philippines and Vietnam are now of particular interest.

This is also effectively the strategy noted by Fujii: "Given the differences in consumer tastes across the region – and the challenges supply chains can pose – many companies look to establish a hub and export, or move into, neighboring markets."

Conventional wisdom suggests that, for multinationals, it can take a long time to profit from emerging economies. Yet De Bourgoing says WHSmith's first store, at Kuala Lumpur airport – a photograph of which hangs on his wall in his London head office – was trading profitably from day one. The company's international division is now five years old – he previously spent a decade building up a similar business for Lagardère – and is

> **"Be organized. Be patient: there will be complexities that take time to resolve. And be optimistic"**

growing fast. This is not, he hastens to add, due to any particular genius on his part: "If you're selling travel accessories at an airport in Malaysia, where traffic is growing by 12% a year, all you have to do is get on the train."

Will the single ASEAN market help that train accelerate? O'Connor is cautiously optimistic. His company saw revenue increase by 4.6% in the year to March 2014, although profits fell by 31.6% due to increased costs, in particular the credit difficulties of some customers. "Confidence levels across the region are robust," he says. "Being realistic, 2015 is the first step on a journey but if it brings down barriers, makes the ASEAN market more open and encourages investment, it can only help the expected economic expansion."

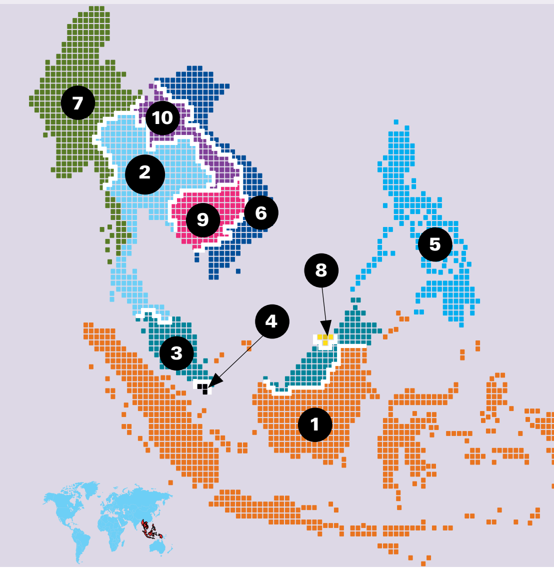
O'Connor's optimism is shared by the respondents to the Economist Corporate Network's survey in 2013. When asked whether ASEAN will build a true single

ASEAN MARKET SNAPSHOTS

BRUNEI DARUSSALAM

Population 420,000

An energy-rich sultanate comprising two separate territories within Malaysia, Brunei has the smallest population of the ASEAN region but the second highest GDP per capita, behind Singapore. The IMF forecasts growth of 5.5% in 2014 and its well-educated, mainly English-speaking population, 54% of which is under 30 and 99% of which uses the internet, supports a retail landscape dominated by food and drink. Multi-nationals operating here include Burger King (with local franchisee Sinofood Express). KFC and Starbucks are tapping into the drive-thru trend in the capital Bandar Seri Begawan. Brunei is the fifth ASEAN country to welcome a branch of seafood outlet Fish & Co.



COUNTRY	GDP PER CAPITA (US$)
1. Indonesia	3,700
2 Thailand	3,520
3 Malaysia	10,490
4 Singapore	49,790
5 Philippines	2,420
6 Vietnam	1,650
7 Myanmar	869
8 Brunei	39,600
9 Cambodia	978
10 Laos	1,470

CAMBODIA

Population 15.1m

Growth of above 7% is forecast for 2014 and 2015, and is continuing to be driven by clothing manufacture, construction, agriculture and tourism. Oil will fuel future growth, having been found in Cambodian waters in 2005. Poverty rates are declining but it still stood at 18.6% in 2012 and labor costs are low. In 2012, Cambodia received more foreign investment per head than China for the first time, and its retail market is forecast to grow by 7.5% a year from 2014-18. The US$205m Aeon shopping mall opened in Phnom Penh this year, attracting 50,000 visitors a day. Malaysian retailer Parkson will open its first store in 2015. Some foreign restaurants – notably Singapore's Asian Kitchen – have entered the market through franchises.

INDONESIA

Population 253.6m

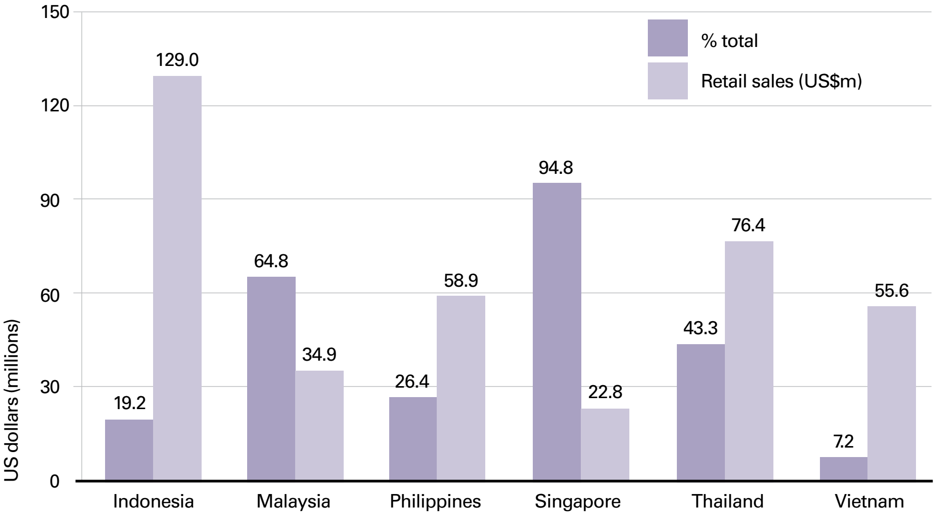
The world's third biggest democracy has enjoyed a GDP growth of around 8% for the past four years, driven by a mushrooming middle class. More than 60% of the population is of working age, with 27% under 15. Retail is one of the fastest growing segments, generally outperforming GDP. Luxury goods sales are growing by as much as 40-60% a year, albeit from a low base. Uniqlo, South Korea's Lotte Department Store, French

In ASEAN countries, shopping is seen as a pleasure; in Singapore, malls act as social anchors

market by 2015, only 6% said yes. But a further 89% expect it to be completed eventually. As Pushpanathan Sundram, Managing Director for Asia of EAS Strategic Advice, says: "Remember that the goals for the ASEAN Economic Community are very bold. Even if they only achieve 70% of their targets by 2015, that will still be a huge achievement."

If ASEAN were a country, it would be the world's fourth largest economic power. With most members expected to enjoy growth rates that would leave developed countries dollar-green with envy, ASEAN offers an opportunity that seems too good to resist for many Western brands and retailers. Yet multinationals eyeing the region could do worse than heed De Bourgoing's advice: "Be organized. Be patient: there are complexities that will take time to resolve. And be optimistic: these are dynamic markets with a lot of resources, people and potential."

Households with annual disposable income over US$10,000 amd retail sales in 2011
Source: Euromonitor



department store Galeries Lafayette, and Swedish apparel retailer H&M all plan to enter the market or expand their presence.

LAOS

Population 6.77m
Economic reforms that began in 1986 have been bearing fruit in the single-party socialist republic, with GDP growth in excess of 7%. The government is committed to attracting private investment, a stock market was created in 2011 and Laos joined the World Trade Organization in 2013. Serious challenges remain. Laos dropped 12 places in the WEF's World Competitiveness Index in 2014-15 owing to its poor macroeconomic environment, low tech-readiness/internet access, difficult access to finance, and infrastructure challenges. Natural resources account for more than half of Laos's wealth. Euromonitor reports domestic growth of around 15% a year in sales of packaged foods and alcohol.

MALAYSIA

Population 30.1m
Malaysia has strong institutions, good infrastructure, a healthy financial market and a well-educated workforce but its economy is reliant on electronics and natural resources exports. Retail competition is growing, with added pressure from foreign e-tailers. Recent entrants into the market include H&M and high end accessory designer Michael Kors. The luxury goods market is already estimated to be worth around US$1.2bn.

MYANMAR

Population 61.0m
Restrictions on foreign retailers have been lifted and retail is estimated to be growing by 10% per year. Infrastructure, institutions, and education are at very low levels, but there is huge consumer optimism among the country's youth, with 48% of the population under 25. Myanmar is attracting significant foreign investment, with Colgate-Palmolive recently purchasing Laser, a local toothpaste brand.

SINGAPORE

Population 5.6m
Second (as usual) in the WEF's global competitiveness index, Singapore officially has no poor people, and its online consumers are among the world's most active. Western brands (Italian diary and journal maker Moleskine opened its first Asian store there in 2014) are common. Minimum wage policies, foreign labor restrictions, and low unemployment make staff hard to find and expensive.

THAILAND

Population 67.7m
Recent political instability has led to fluctuating GDP growth. Even so, its GDP per capita continues to outperform the regional average, and its WEF global competitiveness ranking is rising. Internet penetration is just 29%, but demand for convenience retail is growing, along with mobile device use.

PHILIPPINES

Population 107.7m
The macroeconomic environment is balmy: the country is on track to receive investment grade status, has a stable banking sector and strong stock market. Forbes forecasts the retail market will be worth US$75bn by 2017. Local food and drink manufacturer Universal Robina Corp recently bought New Zealand cookie maker Griffin's Foods to meet middle class demand for high-quality products.

VIETNAM

Population 93.4m
Around 60% of the population are young consumers, with 42% under 25. Retail growth is in double digits. At 44%, internet penetration is higher than Thailand, and online retail is growing by more than 10% per year. US convenience chain Circle K now has more than 70 stores in Vietnam.

Boxing clever

How two young women transformed the selling of beauty products with their 'discovery retail' model

Inside Birchbox's first high-street store in Soho, New York City

"This business model had to exist. It was so obvious to us," says Katia Beauchamp, co-founder and joint-CEO of beauty platform Birchbox. "There needed to be a way for consumers to touch, try and experience beauty products before buying them online."

Consumers clearly agree with her and her business partner, Hayley Barna. Each month their NYC-based business ships a bespoke 'Birchbox' of five targeted samples of beauty, grooming and lifestyle products for just US$10 for the women's Birchbox (US$20 for the men's) to 800,000 global subscribers. If the recipient likes an item, they can order full-sized versions from Birchbox's e-shop, which sells more than 6,500 products from 800 brands.

"I like the way [Birchbox] does the editing for me and gives me a non-noisy environment to shop in," said one time-pressed customer.

Beauchamp and Barna founded Birchbox just months after receiving their MBAs from Harvard Business School, where they met and first conceived their business idea. "We thought: 'Who wouldn't want someone to cut through the clutter and help them find the best beauty products?'" says Beauchamp. With that simple question, Birchbox was born.

One of Barna's friends, a beauty editor, shared her expert knowledge and spare samples with the pair. The first boxes shipped to subscribers in September 2010; four years later, the fledgling startup has grown into a global success story.

"Consumers understood right away that Birchbox was a valuable service to them," says Beauchamp. Yet even its founders were taken aback by how quickly Birchbox's discovery retail model took off.

FACT FILE
Name Birchbox
Founded 2010
Headquarters NYC, USA
Co-CEOs Katia Beauchamp and Hayley Barna
Website www.birchbox.com

Each month Birchbox subscribers receive five samples

"We had realistic expectations, that it would take some time to explain the value proposition to brands and customers alike," says Beauchamp. "But our customers embraced it, and started sharing their experiences online through social channels such as YouTube. Growth was truly viral."

The popularity of Birchbox – and the rise of competitors in the US and abroad – spurred Beachamp and Barna to work harder. "We knew we'd go global at some point, but while similar discovery retail companies were springing up, we had to focus on running our own business."

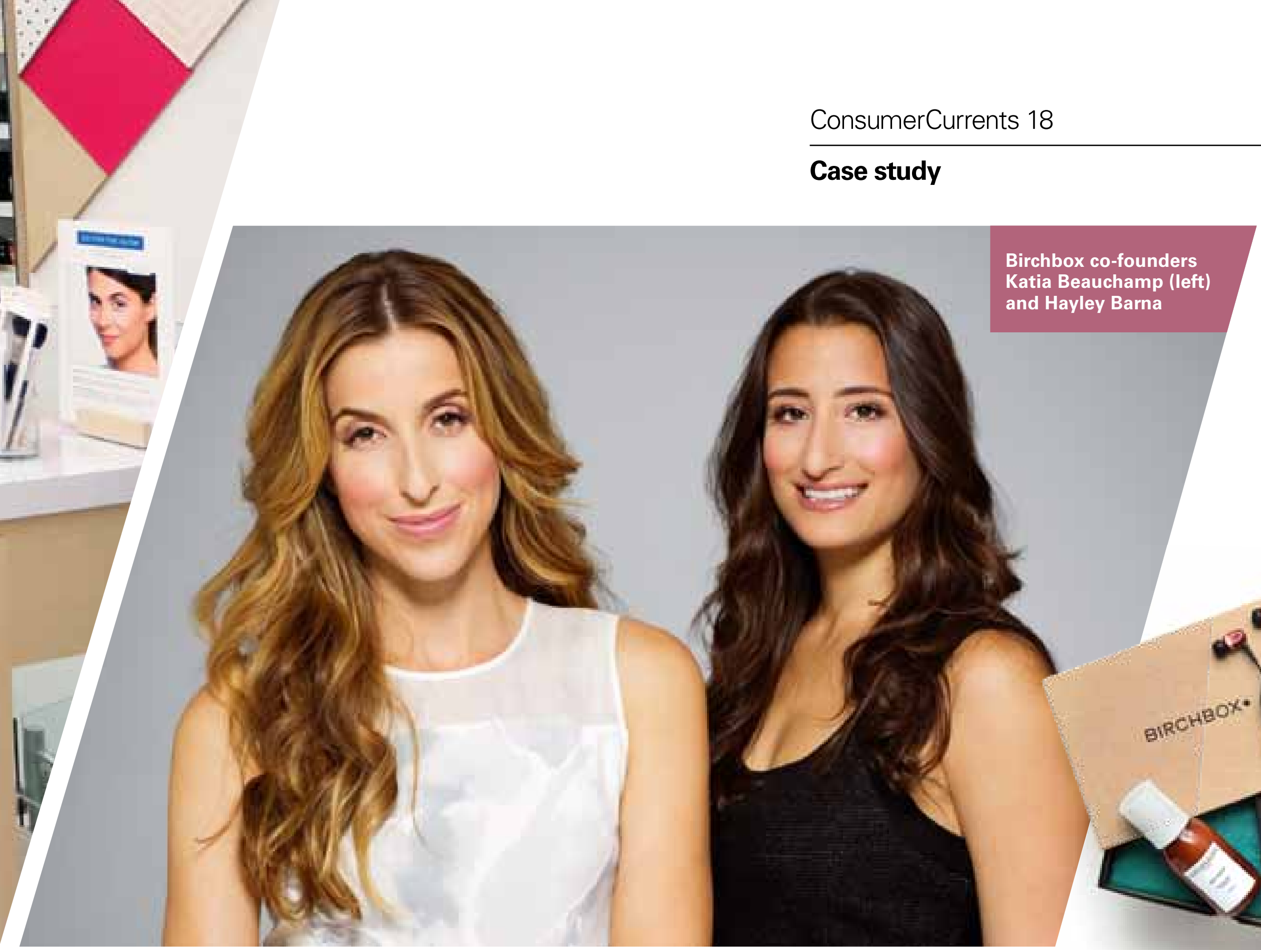
Expansion came swiftly. Having moved into men's products in April 2012, that September they acquired Joliebox, which operated in the UK, Spain and France. "It allowed us to extend our service from the US to three other markets, overnight," says Beauchamp.

"Because beauty is regulated in the same way as pharmaceuticals, overseas growth couldn't be as simple as shipping from the US to other destinations. We had to wait for the right opportunity."

One of the key reasons for Birchbox's rapid success was its founders' careful targeting of what Beauchamp describes affectionately as "the average, everyday beauty consumer".

"That choice is a critical element of what we want our brand to be," she says. "We knew that die-hard beauty experts would love to be exposed to lots of new brands that aren't easily accessible. But we also designed Birchbox for people like ourselves – the more casual beauty consumer. No other retailer was really focusing on her." Now the brand sees a "reawakening of her

Case study



Birchbox co-founders Katia Beauchamp (left) and Hayley Barna

Both men and women's Birchboxes are available

[the average consumer's] love for beauty". Subscribers – who also have access to 'how to' videos, insider knowledege and loyalty points – post thousands of product reviews on Birchbox's site, and many regularly share 'unboxing' videos through social media channels when their boxes arrive through the mail. It's this close connection with a community of consumers that beauty manufacturers are keen to tap into. The stakes are high; in 2013

"Before, companies gave out samples without knowing what opportunity there was to turn a potential consumer into a loyal customer"

Euromonitor forecast the US beauty and personal care industry would be worth US$81.7billion by 2017.

The relationship between Birchbox and its partner brands is mutually beneficial. Beauchamp acknowledges that the company's fast track to success wouldn't have been possible without establishing and nurturing links with manufacturers.

When launching the subscription service, Beauchamp and Barna recognized that getting the right representation of brands in the first Birchboxes was vital to "signaling to customers what we were, and what the quality level would be". Beauchamp cites US premium brand Kiehl's, Australian 'indie' firm Lipstick Queen and San Francisco beauty powerhouse Benefit as some of the first to lend their credibility to the initial boxes. Now, with so many subscribers sampling and trading up to more expensive products, brands are vying to join the Birchbox portfolio so they can tap into the reams of data and feedback freely shared.

Birchbox's ability to capture and analyze complex data about its customers is far beyond what manufacturers can achieve on their own. "It's a really exciting proposition for our partners," says Beauchamp. "Before we came along, a company would hand out samples to consumers without knowing what their needs were, what products they were currently using, and what opportunity there was to turn a potential consumer into a loyal customer."

Detailed subscriber profiles and product reviews mean Birchbox can understand which customers respond most positively to samples and why, and track if they go on to buy full-sized products. "Our relationships with our brands are getting deeper and deeper," says Beauchamp. "We're now talking with them about how we can help with product development, packaging and sharing feedback from consumers on how they think products could be improved."

The company's growth plans don't currently include its own line of cosmetics but, Beauchamp says, "it's definitely not out of the question that Birchbox could have more of an ownership and stake in brands."

This year has also seen Birchbox take the first steps towards using its e-commerce knowledge in the physical world. The brand's first bricks-and-mortar outlet opened in Soho, New York City, in July 2014. Its aim is to offer the best of Birchbox in a single experience: the opportunity to purchase full-size products via editorialized displays; to choose samples; to attend events and beauty demonstrations; and review tailored recommendations via touchscreens.

"As an online-first beauty retailer, we felt that we were best positioned to understand and leverage our e-commerce experiences into creating a unique store," explains Beauchamp.

"It wasn't part of our original business plan. We did a few events and pop-up stores, and realized this was a great way to connect with our consumers. We knew they appreciated the value the Birchbox model brought to online shopping, and that they didn't feel they were being served by the current options for shopping for beauty in person." The store is a one-off experiment, but further openings are "not off the table".

Where Birchbox – or its business model – will be in another four years is anyone's guess. Companies such as Amazon already send out recommendations based on customers' past purchases, but only food seems to lend itself readily to the Birchbox model of fast reaction to consumer data. Graze delivers customized boxes of healthy snacks in the UK for US$6 a month and passed the 150,000 subscription mark only three months after launching in the US in January. This has not gone unnoticed by General Mills, which has now entered that market. Selectivity could be the key.

Lessons from other industries

Lead from behind

Transformational leadership isn't about guidance, according to Indian tycoon Vineet Nayar. The key is to allow people to find their own way

Vineet Nayar reorganized Indian IT giant HCL Technologies to accelerate innovation

Put any CEO of a large corporation on the spot and ask them to choose people from history who have inspired and shaped their leadership skills, and the trio of Nelson Mandela, Martin Luther King and Mahatma Gandhi might not be an unusual selection.

All three spearheaded movements that ultimately led to seismic changes in society. But it wasn't because of the direct action they took that these three historic figures were chosen as leadership heroes by Vineet Nayar, former CEO of Indian software company HCL Technologies (HCL). "I don't think they *did* anything," Nayar says, when asked to justify his choices. "Instead they enabled people to do what they thought in their hearts was the right thing to do. That is the future of leadership."

Nayar's refreshing approach to leadership, outlined in painstaking detail in his book *Employees First, Customers Second – turning conventional management wisdom upside down* and in a new book *Collective Genius: The art and practice of leading innovation* by Linda A Hill, Greg Brandeau, Emily Truelove and Kent Lineback, is that if the CEO of a business believes they are the "owner and the doer," they will not accomplish anything. The vital skill business leaders need is to empower people within an organization to contribute their skills and input to encourage innovation rather than stifling it.

Nayar followed this approach when he took the helm of HCL in 2005. The company, founded in the mid-1970s, had flourished during the 1980s and 1990s, but faced serious challenges. Despite an annual turnover of US$764m, which was growing at a cumulative rate of 35%, HCL was perceived as living on past glories. Having joined in 1985, Nayar had worked in management roles – including heading up a successful startup business within HCL – before taking the top job. This helped to hone his leadership skills, but didn't prepare him for the shock of realizing how far the company had slipped, with existing customers reluctant to renew contracts with HCL and new business opportunities scarce.

The answer lay in defying conventional wisdom by putting employees first and customers second. Nayar believed that since staff are the closest interface with the customer they are the new value zone for companies: the place where value is truly generated for customers.

By doing so, Nayar inspired employees and customers and set HCL on a journey that has made it one of the fastest-growing, profitable global IT services groups and, according to *BusinessWeek*, one of the 20 most influential companies in the world.

Nayar and his team implemented the employee first philosophy by creating a sense of urgency, enabling staff to see the true state the company was in and inspire them by showing them what it could become. They inspired trust by increasing transparency in communication and information sharing. He inverted the organizational hierarchy by making the management and enabling functions accountable to the employee in the value zone and helped staff fulfill their potential by fostering an entrepreneurial mindset, decentralizing decision-making and allowing them to own 'change'.

An online help desk called Smart Service Desk was developed so staff could raise issues, and an online channel called 'U&I' enabled employees to directly ask Nayar about the business. He didn't just consult about small issues, he invited colleagues from across the business to weigh in on strategy.

Nayar also used U&I to crowdsource business ideas. He put the plans of HCL's top 300 managers on the portal, before inviting 8,000 other managers in the group to review them and provide input online.

In a dramatic move, he also invited every employee to appraise him on an open platform that everyone in the company could see. This exercise in reverse accountability inspired staff across the organization.

Six months after Nayar unveiled his strategy, HCL won a US$330m outsourcing deal with DSGi – the largest in India's history. Further deals soon followed. Revenue increased six-fold to US$4.6billion in the eight years Nayar served as CEO (he stepped down in 2013 to focus on the Sampark Foundation, a youth charity he established in 2004).

"The lesson for those hoping to lead innovation is clear," write Hill, Brandeau, Truelove and Lineback in *Collective Genius*. "The last thing you want is a team that defers to you as chief innovator and simply implements your vision. That was the kind of organization Nayar inherited and had to change to save it."

KEY LEARNINGS

1. Be open to innovation, don't lead it
You can't know in advance what direction you will need to go in to drive change. Transformations that evolve from the inside out are more likely to last.

2. Enable employee engagement
Allowing managers and other staff to drive company policy can produce measurable improvements and release previously untapped creativity.

3. Think the unthinkable
Organizations should be structured to serve customers. Like Nayar, don't be afraid to reinvent the organization if it's necessary to transform the business.

Insights

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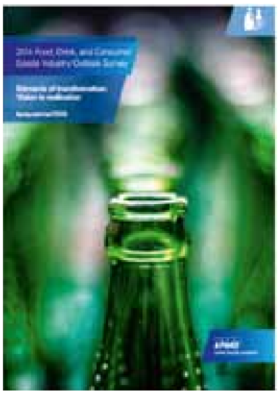

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