Food for thought

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Expanding Frontiers: Gearing up on New Opportunities

Highlights of PricewaterhouseCoopers' 8th Annual Global Retail & Consumer Business School

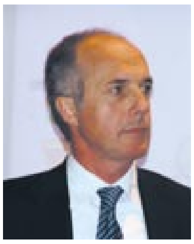
The 8th Global Retail & Consumer Business School took place this year in Milan, Italy, from October 11-13. This year's event continued to build on the success of former business schools which have taken place in several major European cities and also in Shanghai, China. These annual business schools are deeply attached to PricewaterhouseCoopers' Connected Thinking ethos, and are dedicated to bringing together senior executives and PricewaterhouseCoopers professionals in a spirit of shared experience and open discussion. The 250 participants from 30 different countries that attended this year's event contributed to an atmosphere of exchange, challenge and excitement that has been the hallmark of this unique event since its inception.

The Business School sessions were facilitated by Fiona Carter, Business Development, PricewaterhouseCoopers London. The following special insert summarises the content of each of these sessions.

Innovation and the emergence of new business models will be driving tomorrow's global retail and consumer scene

"Retail and consumer companies are operating in a challenging environment."

Carrie Yu, PricewaterhouseCoopers Global Retail & Consumer Leader, said that this year's theme mirrored current strategies in the retail and consumer sector, where companies are expanding the markets and geographies in which they operate, the products they are providing and the consumer segments which they are targeting. The speakers show how both transitional economies and more developed parts of the world are very attractive destinations for investment. "Expanding frontiers" involves geography and marketing: companies in the retail and consumer sector can – and must – capitalise on both. At the moment, a deflationary climate in many countries is making business tougher, as can be seen by Carrefour's exit from Korea and Wal-Mart's from Germany, but at the same time, other companies are opening new stores across the globe such as the Spanish retailer Inditex, which is expanding into the Scandinavian countries, and the Italian eyewear leader, Luxottica, which recently acquired a retail chain in North America. Indeed, globalisation is very much on the CEO agenda, with 78% of respondents to PricewaterhouseCoopers Global CEO survey for 2006 considering globalisation as one of their major priorities, but wherever business operates, innovation, creative thinking and the development of new business models are key to future success.



"There is no alternative to innovation."

These remarks were supported by **Roberto Adami, PricewaterhouseCoopers Retail & Consumer Leader for Eurofirms and Italy.** In spite of the dramatic changes taking place in the economic environment today, the speaker said the greatest opportunities arising from globalisation are to be found in the retail and consumer sector. But at the same time the impact of global sourcing, greater consumer choice and technological convergence – all involving new risks and new costs – constitute challenges for the sector. How can operational and management models be renewed, without destroying the essential core competencies that have historically contributed to the success of the sector? The answer is innovation which drives differentiation and growth. In response to expanding consumer needs, the link between core business competency and operational areas – such as sourcing, sales and distribution channels – is becoming much more complex. This creates the challenge of making the right investment decisions in both areas. To succeed, companies need to incorporate into their business models high levels of efficiency, more flexibility, more personalisation – and provide meaningful experiences for the consumer. But, finally, as the strategies of the major players converge, it is the quality of execution that will distinguish the winners from the losers.

Expanding frontiers: new geographies

"Global players are becoming increasingly local-minded – or glocal."

From São Paulo to Shanghai: New consumer dynamics – the impact on modern retailing*, the 5th edition of PricewaterhouseCoopers' regional study, was launched at the Milan Business School. This annual study analyses the different and changing investment challenges and opportunities for companies in the retail and consumer sector in transitional economies. This year, the study focuses on six specific markets: Argentina, Brazil, China, India, Poland and Russia. Some of the key findings that the research throws up are the stark contrasts in the urban-rural divide, the widening gap between skilled and unskilled workers, and the polarisation of the formats and products needed by highly differentiated consumer segments at each end of the social spectrum. These different factors are significantly reshaping the strategy of retail and consumer companies in emerging markets.

"The question for CEOs the world over is no longer 'Should my company go to India? but rather 'Can my company afford NOT to be in India?'"

India is a prime example of the different trends emerging from this year's regional study. **NV Sivakumar, PricewaterhouseCoopers Retail & Consumer Leader, India** explained that India is an economy on the move. This country's growth is estimated to overtake that of China by 2013 and GDP is expected to amount to US $2 trillion in 2015. The country is young, with 50% of the population under 25 years of age. The retail sector represents 13% of GDP and 6% of the workforce, and at the moment 12 million retail outlets serve 209 million households. There is therefore a huge amount of potential for the organised retail sector, which should help push total retail sales from the current US $300 billion to some US $637 billion by 2015. This sector currently represents only 3%, but it is set to boom and grow in tune with the private consumption spend, which is increasing at a rate of 10% per year. At the moment the "retail journey" is still challenged by lack of infrastructure and skilled labour, and supply chain issues, but there are some significant growth drivers, including:

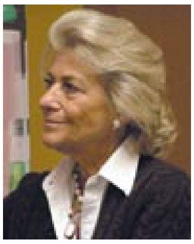
- The increasing number of women who work and who are very much part of economic progress;
- The expansion of purchasing power with an increasingly prosperous middle-class;
- Easy credit availability; and
- The growth of modern trade and shopping malls.

As far as market trends are concerned, the speaker said that the Indian consumer is "two-faced", expecting good value in more basic product categories, but willing to pay much more for luxury items. The product mix therefore needs to be rationalized in order to achieve healthy margins. Avenues for retail growth include the development of private label, expansion into tier 2 and tier 3 cities, new approaches to the retail agribusiness – contract farming and moving goods from farm to fridge – and experimentation with new retail formats by offering variety to cater for local tastes as no single format is the right answer. At the moment, there are three main entry strategies: franchising, cash and carry, or single-brand retailing. Foreign investors need to set up a strong, in-house training programme, to focus on managing the supply chain and to identify the right Indian partner.

"The Big Boys maintain, improve – but very rarely innovate."

The Chairman of Campari, Luca Garavoglia, explained how his company trades in 190 countries with operations in three business segments: spirits (68.1% of sales), wines (15.5%), and soft drinks (15.4%). Campari enjoys a leading position in Brazil and Italy, and has a strong presence in the US, Germany and France. Manufacturing is organised in 8 plants in 3 different countries: Brazil, France and Italy. Sales have risen from €366 million in 1999 to €900 million today. The wines and spirits sector's success hinges on two distinguishing strategic factors: marketing and distribution. These factors need to be linked to globalisation and this key question needs an answer: how important is size for marketing and distribution? That is, how can marketing and distribution create economies of scale? Can you survive if you are not one of the Big Boys? To answer these questions, the two strategic factors need to be measured to see to what extent economies of scale are relevant. Marketing is not that sensitive to size: it is about creativity, freedom to act, willingness to think out of the box, innovate and take risks. Size can introduce bureaucracy, too many procedures and lack of flexibility. It can also kill creativity. But as far as distribution is concerned, size is highly significant. The strength, the size, the number of salesmen can be key to success. Therefore, while remaining a very focused and sharp marketer, in order to achieve the necessary critical mass to underwrite its distribution function, Campari initiated 10 acquisitions between 1995 and 2006. It now uses a three-pronged approach to distribution. The group runs its own distribution network in Italy, the US, Brazil, Germany and Switzerland, has joint ventures in the Netherlands, Belgium, UK and Spain and utilises third party distributors in over 180 other countries of the world. Flexibility is therefore the secret of success.

Expanding frontiers: new opportunities in the fashion industry



"Fashion is also about details, not only creativity and techniques."

The Vice-President of the National Chamber for Italian Fashion (Camera Nazionale della Moda Italiana), **Giovanna Gentile Ferragamo,** described how the Chamber for Fashion promotes Italian fashion at home and abroad. This non-profit organisation, which was set up as early as 1958, represents 200 companies at the top-end of the fashion sector with a common goal, the promotion of "Made in Italy", seeking to protect, co-ordinate and enhance the highest cultural values of Italian fashion. It does this by organising several fashion events every year – attracting over 30,000 attendees – and by establishing a fashion school which provides professional training responding to the need for increasingly specific skills. More generally, the speaker noted that after a four-year downward sales trend, the Italian fashion sector has switched to growth again in 2006 – with a continued increase in exports. At the same time, product costs are on the decrease. The Italian fashion business provides employment for 890,000 people in about 100,000 companies. On a per capita basis, the value of the industry is similar to that of the automobile industry in Germany or the electronics sector in Japan. What are the secrets of this immense success? "Technological creativity" said the speaker, based on Italy's cultural heritage and applied research in technological applications, and a product philosophy, "Small is beautiful, beautiful and well made." As far as the future is concerned, the manufacture of basic products will be shifting to low-wage countries such as China and India, while the production of higher-end goods will remain in a few European countries. The speaker ended by sharing her view that fashion is a very serious industry which, through its creativity, influences lifestyles and projects the future. It is not only about products, but also about people's thinking and aspirations.

"Do not waste money in advertising unless you are great at it."

Armin Broger, CEO of 7 for All Mankind BV, described the different market conditions and the factors that have, together, contributed to his company's substantial success: a revenue growth that has expanded from some $50 million in 2001 to sales of almost $250 million in 2005. This luxury denim brand is now sold in 80 different countries, embracing consumer segments from children through to the elegant woman. The first advantage was the ability to focus on quick learnings, made possible in a very young and entrepreneurial company, which benefited from a comeback for US jeans brands in the international jeans market but with a high-end fashion positioning. This was done by changing the brand building tools, away from advertising and instead focusing communication through its superior retail partners, movie celebrities and new media. The sophisticated consumer needs to be attracted by a move away from the mass-consumption model to one of exclusivity and self-reward. The evolution of the notion of luxury involves not only price but also a venue, in-store entertainment and the power of word of mouth. The company also adapted to fragmented market trends with specialized and narrower offerings. Its distribution strategy is extremely selective and benefits from the shift from luxury to a more casual style of dressing in Europe, in which jeans play a pivotal role. As far as financing is concerned, the company took advantage of significant changes in financing structures and the wider availability of performance-based capital for worldwide expansion. Although the company is based in California where it manufactures its products, it is actually managed by a global team and the different markets are very independent and highly decentralised. A strong machine needs to be built behind the product, with product obsession and delivery precision as the driving forces, – and a good team. Good people are expensive. "Build a great team and pay them", was the speaker's advice.

"Diesel is a mindset: to us, share of mind is more important than market share – and advertising IS the product."

Giorgio Presca, Brand General Manager of Diesel, explained the development of the company in which the quality/price positioning is aimed at the middle to lower part of the market. The business model corresponds to the current European trend where major growth is being generated by the fast fashion model: the vertically integrated store, such as Mango or Zara. More generally, as far as global trends are concerned, the luxury industry has grown from €20 billion in 1985 to €95 billion in 2005, and is expected to reach €100 billion by 2008. Japan and China are the countries with the fastest growing luxury goods markets in the world, but Moscow is the city with the highest growth. The premium casual and premium sportswear segments, conveying individuality as a key message, also have major potential. Indeed, consumers are buying simultaneously in all these segments: they are mixing products. As far as brand trends are concerned, most trends are defined by today's "youth culture" and as they change so quickly, all retailers are under great pressure from competing chains such as Zara, which are constantly introducing new product assortments. The key differentiation point is in building a distinctive brand and here Diesel projects sexiness, fun and provocation through its advertising. Corporate innovation relies on intuition, rather than on market research. The goal is to project Diesel as a mindset – a set of values which can be taken on board by two generations – for instance a father and son. Diesel seeks to project an emotional value that transcends the generation gap and generates loyalty. The company's merchandising policy is not to impose a corporate strategy on stores, but on the contrary, to allow them to adapt their assortments to local environments: no two Diesel stores look the same. The brand is re-positioned in each country corresponding to varying shifts in the perception of product and assortments. But communication everywhere is based on creating and maintaining an intimate relationship with the end consumer.

Gearing up on new business processes: operational excellence

"A great deal of time and energy is spent on developing fraud."

PricewaterhouseCoopers Fraud, Risks and Controls Leader USA, Jonny Frank explained how the PricewaterhouseCoopers in the US has split fraud operations into two teams: the fire-fighters and the prevention/detection team. The Enron crisis in the USA and the Parmalat crisis in Italy have shown just how much time and energy had been spent in developing fraud. And fraud is not just about "cooking the books," or financial reporting fraud, it also concerns:

- Reputation: retailers' and consumers' greatest asset
- Operations: improving the bottom line
- Legal and compliance: avoiding jail and fines
- Strategic: gaining a competitive advantage.

The importance of these factors can be illustrated by the fact the reputation is calculated as representing 7% of the market capitalisation of ordinary companies and brand value is even more important for the retail and consumer sector. About 6-7% of revenue is being lost because of fraud in the average US company. Fraud involves either the "meat eaters" (or large-scale theft) or "grazing" which involves smaller amounts, but in any case there has to be zero tolerance vis-à-vis fraud. Frank warned against corruption in some of the emerging economies such as China and India where having a fraud programme in place can constitute a real strategic advantage. PricewaterhouseCoopers teams have come up with a flexible and practical framework to deal with fraud. It contains 5 elements: the setting of objectives for an internal control environment; a process for event identification and risk assessment; control activities; a monitoring framework for detection and finally incident response: information and communication. These factors are all the subject of white papers, including a recent publication **"A deeper dive"**, which gets down to the nitty-gritty of fraud and misconduct at the business process level.

The three "must do's" for companies in order to realise the benefits of fraud management:

1) Conduct a scheme and scenario based fraud risk assessment followed by local unit self-assessments.
2) Develop and embed in-house fraud "champions"
3) Develop an incident response and remediation programme.

"Wage costs are rising everywhere – by over 20% in China over the last 12 months – and these increases are driving inflation in product prices and putting pressure on sourcing markets."

Li & Fung is a Hong Kong-based, global supply chain management company founded in 1906, with sourcing and wholesale operations in 41 countries worldwide and estimated sales of US $8.6 billion for 2006. It has developed from being a local trading business to its present status of being one of the biggest sourcing companies in the world, dealing in high volume, time-sensitive consumer goods in apparel and hard lines. **Ulf Brettschneider, Senior Vice-President, Li & Fung Europe,** said that since its listing on the Hong Kong stock exchange in 1992, the company has had compound annual growth rates of 22% in sales and 23% in net profits. Its main customer market is the USA with a share of almost 70%. The company is very strong in the department store sector, but also serves speciality stores and some of the major super/hypermarkets chains in over 100 countries. World sourcing markets are operating in a dynamic but increasingly complex environment. Two key issues for modern business are the globalisation of manufacturing enabled by supply chain management and information technology, and the entrance of developing countries into global trade, with their new infrastructures and labour markets. As labour markets everywhere come under increasing scrutiny, acceptable ethical standards as well as consistent quality are essential for buyers when they source their products. In Li & Fung's case, this entails the monitoring and control of a network of approximately 7,800 factories worldwide. All this demands a high degree of flexibility in terms of product, geography and adapting to new regulations. As they seek further efficiencies, retailers are demanding improved price/quality/service, customer focus, speed to market and compliance of the sourcing base. At Li & Fung, all vendors and factories are audited annually by a dedicated and trained compliance team. In terms of quality control, teams are trained to test and monitor every purchase order placed. Core business added value is given to customer's requirements by providing the management of raw materials and product development through the company's global product development and design teams.

Gearing up on new consumer markets: innovation

"It has been estimated that 70% of today's products will be obsolete over the next 6 years."

Betsy Hoag, Associate Consultant, Euromonitor International, introduced her company, which has 30 years of experience in business intelligence, employing over 600 research analysts worldwide. She said that the three major innovation drivers today are technology, personalisation and the impact of global transformations. Technology is creating a more empowered customer, who has a thirst for multi-functional products – such as the cell phone that can scan the contents of a fridge. Indeed, all-in-one technology is pushing all-in-one solutions, leading to category convergence. Goods and services are also becoming very personalised as consumers start designing their own products via the Internet – such as Puma sports shoes. Certain global transformations, for instance the move to inner cities by urban professionals - the SINKS (Single Income No Kids) and the DINKS (Dual Income No Kids) - are creating new niche market segments in which convenience is a high requisite for hectic lifestyles. A second global transformation is the increase in smaller family sizes which is driving the growing wealth of tweens, teens and young adults. In general, companies need to be positioning their approach to innovation in the niche or the universal marketing segments. But at the same time they need to adapt to the specifics of individual consumers. A strong research and development mentality needs to tap into global trends. As far as innovation processes are concerned, the speaker said they can be proactive, interactive or cyclical. Nokia and Google have proactive, “organised chaos”, decentralised management models. Both these companies have understood the new importance placed on design in innovation. Hallmark is an example of interactive innovation, in the way it immediately recognised the impact that Nine Eleven would have on greeting card content. Cyclical innovation involves re-using product or brand names over time. In innovation, timing is everything. A first mover may struggle to find the appropriate niche, whereas late movers can play on how the niche develops and what it still lacks. What do innovative companies have in common? An abundance of communication between departments and outstanding product functionality and design.

“Innovation is not a blueprint for growth; it is a blueprint for survival.”

The success of big corporations will be determined by the speed at which they can change past thinking, said **Peter Gutierrez, Chief Marketing Officer, Foods – PepsiCo International.** The macro trends that impact consumer behaviour are constantly monitored by PepsiCo. Today, the world is experiencing seismic changes in demographics, such as populations ageing faster than anticipated and the very rapid pace of urbanisation. Lifestyles are changing significantly – ageing, urbanisation and new technologies are all contributing to more sedentary lifestyles. This is having an impact on consumption habits and risks of associated problems, such as rising obesity and an increase in diabetes and cardio-vascular disease. These risks are creating new priorities for governments and special interest groups. In spite of rising health costs, governments have not been proactive enough, which has led to an uncertain regulatory environment. This has generated the development of corporate trust issues which the media and NGOs have been quick to seize. Consumers themselves are very concerned by health issues, and health and wellness are at the centre of PepsiCo’s current strategic thinking. There are shifts in consumer behaviour, as can be seen in the UK where, on one hand, the sales of carbonated soft drinks are slipping, whilst, on the other, the sales share of health and wellness products in convenience foods has risen from 32% in 2002 to 42% in 2005. Consumers decode health risks in products in a very simplistic way: natural is healthy, processed is unhealthy. Although carbonated soft drinks and candies are at the bottom of the health curve and fresh juices at the top, even health fanatics need to indulge and buy treats, even if they buy less of them. PepsiCo has started introducing new and healthier components into its everyday products. For example, in its popular Walker snacks, healthier oils are being used, saturated fat has been reduced by as much as 70% and salt levels decreased by 25%. At the same time, it is developing new products such as Pepsi Max, with a full cola taste but no sugar, or Potato Heads, with no artificial flavours, additives or preservatives. New advertising campaigns are communicating these new products with a “health can be fun” message. The strategic response to the health trend involves expanding a mixed and innovative product portfolio and creating a differentiated brand footprint.

“Find out what is in a baby-boomer’s mind.”

Gerd Bovensiepen, PricewaterhouseCoopers Retail & Consumer Leader, Germany and **Mike James, PricewaterhouseCoopers Retail & Consumer Leader, Australia,** gave a joint presentation based on their two recent studies: **“Generation 55+ Opportunities for Retailers & Consumer Goods Manufacturers”,** which was carried out in conjunction with the University of St. Gallen in Switzerland, and the chapter of **Retail & Consumer Outlook – Australia 2006** on **“We’re boomers, not seniors!”**

The segment of 55+ consists of 3 main target groups: the 50 year old Baby Boomers, the Best Agers - 60 years - and the Seniors of about 70 years. In Western industrialised societies, people over the age of 60 already make up some 20% of the population; in 2050, they will represent on average almost a third and as much as 42% in Japan. By way of comparison, in 1950, this figure was about 12%. In 2050, Italy will be the youngest of the industrialised nations, with birth rates similar to those of certain East Asian countries such as South Korea, Japan and Singapore and Central and Eastern European nations such as Slovenia, Ukraine, Slovakia and Lithuania. The population of over 65 will double by 2040 in Australia and the ratio of active workers versus those taking retirement will decrease from the current 5 to 1, to 2 to 1.

The Australian study highlighted the macro-economic impact of the baby boomers in this country, who are turning 60 this year. This group of Australians controls almost 40% of the country’s wealth and it is expected that their spending will rise by 61% by 2016. How can society deal with the cost implications of paying for more pensions and more health care for an increasing number of older, retired people?

Possible solutions as viewed in relation to the Australian economy:

- Encouraging an increased birth-rate – providing financial grants for second babies
- Encouraging more immigration
- Encouraging more baby boom participation in the work place through the retaining of older workers.

These solutions address the heart of the problem and can probably be applied to most "ageing" economies. Lifting workforce participation and retaining older workers seems to be a key solution. A DIY company in Australia has been engaging older workers and has found this makes good business sense: they are flexible, they have experience and share their knowledge with customers and they can be mentors to their younger colleagues.

The retail and consumer sector will also need to look closely at the values, attitudes and behaviour – rather than the biological age – of this increasingly important segment of the market – and understand how it will affect business models. Lifestyles should be considered the main factor for determining market opportunities. To do this, it is essential to understand the different dimensions, degrees and perceptions of ageing:

- Self-perceptual age
- Vitality age
- Emotional age
- Physical health age
- Cognitive age

This age group represents a real market opportunity because of its energy and buying power. Indeed, the banking, insurance and tourism sectors have already understood its huge potential as it actually shifts traditional target groups by occupying a new and big "middle" market. In both Europe and in Australia, spending on health, personal care and household goods will all represent priorities for this group. Businesses in the retail and consumer sector need to take on board four key success factors concerning the older consumer: quality is more important than price; convenience – simplicity, clarity, easy to carry, easy to open products are all essential; and an increasing demand for more personal advice and service. Finally, every single part of the business needs to adapt to this new and powerful lifestyle segment.

Learning from the world of sport

The business school ended with a management message from the sports world. Video shots showed images from the 2006 FIFA World Cup concluding the day with a strong and motivating message:

INSPIRE, ACHIEVE, DISCOVER, SHARE.

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MILAN BUSINESS SCHOOL: TAKEAWAYS

Expanding frontiers: new geographies

- Achieving critical mass is a must for global distribution networks
- Flexibility and differentiation are key components of success in new geographies
- In India, investors need to identify the right partner, set up in-house training programmes, and focus on supply chain management

Expanding frontiers: new opportunities in the fashion industry

- Product obsession is the driving force
- Customers are mixing luxury, casual and cheaper products; individuality is the common denominator
- An intimate relationship with the consumer must be developed through decentralised management models

Gearing up on new business processes: operational excellence

- A strong framework needs to be built to identify, assess and respond to fraud
- Constant monitoring, auditing and testing of global sourcing facilities is essential to ensure compliance and product quality
- Reputation is retail and consumer industry's greatest asset

Gearing up on new consumer markets: innovation

- The success of big corporations will depend on the speed at which they can change past thinking
- Mixed product portfolios can generate corporate balance in the health and wellness market
- Advertising and communication to the health and baby boomer markets should be attractive and enjoyable

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