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Issues Monitor

Sharing Knowledge on the Food, Drink and Consumer Goods Industry

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Welcome to the May edition of *Issues Monitor*. Each edition pulls together and shares our firms' industry-wide knowledge to help you quickly and easily get briefed on the issues that impact your sector.

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Keeping up to date with the very latest and most pressing issues facing your business can be a challenge and, while there is no shortage of information in the public domain, filtering and prioritizing the knowledge you need can be time consuming and unrewarding. I hope that you find Issues Monitor useful and welcome the opportunity to further discuss the issues presented and their impact on your business.

ISSUE 1: Product lifecycle management (PLM) in food, drink and consumer goods (FDCG) companies

Product lifecycle management is a complete process for managing the life cycle of a product, or brand, from the time it is conceived to the time it exits the market. Through employing a number of industry best practices at different stages of the lifecycle, FDCG manufacturers can improve their efficiency and productivity, create better products and hence impact their earnings – economic conditions notwithstanding.

ISSUE 2: Private labels versus branded products

Private label sales across the world are rising. Along with the low-value category, they are also gaining increasing consumer acceptance in the standard and premium categories. FDCG manufacturers need to innovate and simplify their brand messages in order to counter the rising private label threat.

ISSUE 3: Tough times for the luxury goods market

Global sales of luxury goods have been predicted to fall by 10 percent in 2009 as a result of the economic crisis. In response, luxury goods companies are considering high-growth economies as destinations for their products and for low-cost production. They are also adopting non-traditional channels, such as e-commerce and mobile-commerce (m-commerce), to better reach their target consumers.

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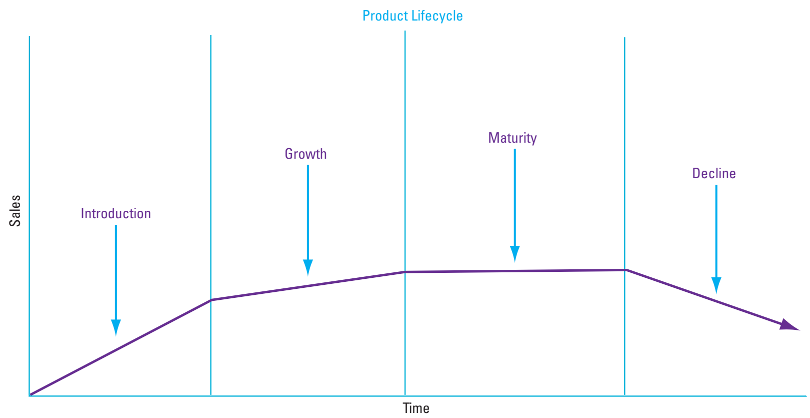
Product lifecycle management (PLM) in food, drink and consumer goods (FDCG) companies

Product lifecycle management – Overview

- PLM is an all encompassing process for managing the life cycle of a product or a brand.
- It facilitates better collaboration among different product teams.
- Collaboration with suppliers through PLM practices helps companies exploit supplier experience in new markets.

The product life cycle comprises four stages – introduction, growth, maturity and decline. After being conceived and developed, a product is **introduced** into the market. In the **growth** stage, products become more profitable as companies focus on building and establishing brands through increased advertising spend. Products that survive these stages reach market **maturity**, after which growth slows and then stabilizes. Manufacturers try to sustain the growth through such tactics as price wars and brand differentiation. As newer products are introduced into the market and customer tastes change, the product reaches the **decline** stage, wherein the product may eventually be withdrawn from the market.[1] Figure 1 shows a generic product life cycle in 'sales' versus 'time' graph.

Figure 1: Product life cycle (sales versus time)



Source: Product Life Cycle, Learnmarketing.net, Website Accessed on 13 April, 2009

PLM is a complete process for managing the life cycle of a product, or brand, from the time it is conceived to the time it exits the market. It is a cross-functional process involving all functions that touch the brand or product from research and development (R&D) to marketing and distribution. The approach supports collaborative creation, management, distribution and utilization of product information across the extended organization throughout a product's life cycle.[2] This facilitates closer working together of different departments and systems, resulting in enhanced data transparency. This transparency, throughout the process, increases efficiency and eliminates redundancy among different departments.[3] When executed effectively, PLM can give a company a competitive advantage. Based on the product lifecycle stages, PLM is said to include the following components.

- Innovation
  - Innovation & Ideation Process
  - Portfolio Management
  - Product Development
- Trial & Testing
  - Product Trials & Testing
  - Market Testing
- Promotions
  - Trade Promotion
  - Co-Op Advertising
- Product Introduction & Launch
- Product Rollout
- Growth
- Maturity & Maintenance
- Decline

Adopting an effective PLM strategy can be beneficial to companies. According to CIMdata, a US information management consultancy, companies using global product development systems usually enjoy a return on investment of 100 – 300 percent. Collaboration with suppliers through PLM practices helps companies exploit supplier experience in new markets. Implementation of PLM processes enables companies to stay alert so they can respond to changes in the market place, including competitor moves, and make suitable adjustments to products launched in different markets. Moreover, effective sharing of information enables companies to be updated on the latest information regarding a product or a product line and helps them adhere to regulatory requirements.[4]

"Companies using global product development systems usually enjoy a return on investment of **100 – 300%**.

"Within a corporation, just working harder and faster on design is not sufficient anymore. You need to close the information loops, i.e., get the right information to the right people in the right context. If you make that happen, whether you're an Original Equipment Manufacturer (OEM) or part of its supply chain, it makes a huge difference."

Debashish Dutta, Professor of Mechanical Engineering, Michigan University[5]

PLM in the FDCG sector

- PLM addresses increasing complexity due to extended supply chains.
- Helps counter ineffective innovation through better communication across global supply chain.
- Aims to archive and control voluminous data.
- Facilitates better collaboration among different product teams.

Does your company have an effective innovation process in place?

PLM is important for the FDCG sector as a number of challenges can be addressed through its effective implementation. Increasing globalization of businesses has resulted in extended and complex supply chains for FDCG companies. "*The globalization of business, combined with an international economic downturn, has created a difficult environment for CG (consumer goods) companies*" says Rosemary Grabowski of Dassault Systèmes, a global PLM solution provider.[6]

Only 25%

of FDCG companies are estimated to have effective innovation processes in place.

Although offering numerous advantages, extended supply chains have resulted in increased complexity. There is an increased need for cross-functional project visibility, information availability in different systems, and streamlined global processes. According to Grabowski, most large consumer goods companies deploy as many as 750 disparate information technology (IT) applications across their global ecosystem. This hampers collaboration as applications are not linked.[7] Moreover, according to Grabowski, only 25 percent of FDCG companies are estimated to have effective innovation processes. PLM can help companies innovate by providing integrated information systems that enable effective communication across a fragmented global enterprise and an extended supply chain.[8]

FDCG manufacturers also need to effectively manage their retail channels in order to ensure on-time delivery of a wide-spectrum of volume-based goods in the market. This is important to remain competitive in the market.[9] Efficient management of retail channels again requires increased collaboration across the supply chain. Other areas where PLM can assist FDCG companies are: managing burgeoning product portfolios, ensuring regulatory compliance, and reining in supply chain costs.

PLM best practices at different product lifecycle stages

FDCG companies can adopt PLM best practices at various stages of the product lifecycle to drive a competitive edge in the market.

Innovation

As stated earlier, only a quarter of FDCG companies are estimated to have effective innovation processes. Hence, PLM best practices at the product development stage are crucial to the performance of an FDCG company. The best practices adopted by companies at this stage are as follows:

- **Knowledge re-use**[10]: PLM facilitates the re-use of knowledge by providing a single source containing product information for the entire organization. Solutions enabling such practices can help improve cycle times as they facilitate the re-use of componentry for new product development. "*We cannot afford to invent a completely new product every time we need to innovate. The re-use of componentry in new and creative ways is as important as the inventive step itself*", says Huw Evans, R&D Director of Information, Home and Personal Care Division, Unilever. The company uses Siemens' PLM system for knowledge re-use.
- **Knowledge and intellectual property (IP) management**[11]: For better innovation, it is important to have timely and accurate exchange of information between decision makers and people from various teams such as ideation, engineering, design, specification and requirements, sourcing, manufacturing, production, and sales and service. Documentation and storage of key information related to innovation can be done through effective IP management. Also, with comprehensive data management solutions, companies can better control IP management and address sensitive and time-consuming regulatory challenges.
- **Pipeline innovation**[12]: Besides providing time and productivity benefits, PLM also helps in better aligning the innovation pipeline with the company's goals, leading to resource savings. A PLM strategy helps in gathering customer responses, thereby influencing the company to make more focused product pipeline choices.

Examples of companies adopting PLM best practices at the product development stage are given below.

Unilever: In 2007, the company concentrated its R&D activities in global and regional centers, following the completion of a major re-organization of its R&D activities. The move was aimed at making the best use of the company's resources and creating innovation powerhouses.[13]

P&G: The company has focused on improving service levels and enhancing value creation in its shared services business model – Global Business Services (GBS). By 2008, the model had delivered approximately US$600 million in savings, a major portion of which the company has re-invested into innovation. Furthermore, the company has increased the use of virtualization, computer modeling and simulation through collaboration between GBS and its R&D and engineering functions. The practice helps P&G to co-design its products with its customers and to set up virtual in-store displays for approximately half the cost and time of physical shelf designs. This helped the company save about 17 years of design time in 2008.[14]

Diageo: In 2007, the company entered into a multi-year business agreement with Anaqua, a provider of intellectual asset management (IAM) software and services, to manage its global IP portfolio of brands, patents, trademarks, trade secrets and designs. The system automates a number of standard processes followed by IP departments in order to assign tasks to the company's internal and external staff and raise alarms in case the tasks are not done in a timely manner.[15]

Trade promotion

Companies can adopt PLM processes for better synchronization in promotional activities. Miller Brewing Company was one of the first FDCG companies to install a Web-based trade management system to support interactions with its 600 beer distributors. The system enables the company to collaboratively manage promotional activities. It also helps in automating the processing of distributor reimbursements through the company's enterprise resource planning (ERP) system.[16]

Does your company have effective synchronization processes for trade promotion and product launches?

Similarly, Colgate-Palmolive Company is working with SAP Consulting to roll out the SAP Trade Promotion Management application globally. The company is looking to establish a standard return-on-investment (ROI)-based process for global promotions, as 75 percent of its consumer goods sales come from international markets.[17]

Product launch[18]

Companies can minimize errors on product launches and reduce the risk of compliance issues through synchronizing product manufacturing and sourcing processes with other product development processes. Sophisticated computer simulation and analysis can reduce the need for multiple design iterations. Avon Products, Inc., a company manufacturing women's personal care products, uses a PLM platform developed by Dassault Systemes to plan and track product launches for different regions and markets. The system stores live data and is updated every time the launch date or volumes change. It helps the company monitor their launch timings across quarters for different product categories and brands.[19]

Heineken uses an ERP system developed by Demand Solutions, a provider of supply chain management software. The system is used during a new product launch to review and change the forecast numbers, and hence simplifies the launch process.[20]

An increased visibility into raw material specifications can help companies save on raw material costs.

Product rollout

PLM can help companies enhance productivity by bringing in efficiencies in their supply chains, while the product is being rolled out in the market.

- **Specification management**[21]: This is the practice of putting together the specification for a product or the raw materials at the product roll out stage. Product specification management is required in order to safeguard the IP and hence the company's economic interests. Companies can also save on raw material costs by gaining visibility into raw material specifications and by striking better deals with their suppliers. The time and money saved through the use of this tool can be re-invested in the R&D process. For instance, P&G uses data mining to purchase ingredients. It maintains a database to keep track of the amount of citric acid used in every product line in every country. The database helps P&G buy citric acid in volume from fewer suppliers to get better deals. "*We can go to fewer suppliers, and get larger bids. The database is empowering*," says Greg White, the company's Director of Global Data Management.[22]
- **Value chain synchronization**[23]: Value chain synchronization initiatives enable FDCG companies to optimize idea exchange and effectively share product and process information across the value chain. This helps companies respond effectively to global demand, and gain greater visibility into the value chain. For instance, logistics professionals at General Mills deploy state-of-the-art supply chain management systems, E-commerce and SAP tools to manage inventory levels, and plan ingredient and material requirements. These systems are also used to manage complex transportation systems and support customer's demands through a network of distribution centers.[24]

Growth

Managing FDCG product categories as separate strategic business units helps retailers and manufacturers deliver better results through a focus on delivering consumer values. Commercial management of these categories is done with the help of intelligent software. Well-implemented category management results in higher margins, higher turnover and substantial cost savings for both the retailer and the FDCG manufacturer as it aims to satisfy consumer needs.[25]

Effective category management entails increased co-operation between a retailer and an FDCG manufacturer. Such a relationship is in contrast with the traditional sales-purchasing relationship. An example is the collaboration between P&G and Carrefour. By sharing information, the two companies have developed annual joint business plans based on national data such as brand share and shopper insights. P&G and Carrefour joined forces in late 2004 to satisfy the demands of Carrefour shoppers in the face of a growing threat from hard-discounters in France. The two companies conducted a data sharing trial of store level data to understand consumers' buying behavior and, therefore, identify specific business opportunities.[26]

On a national level, the data helped the companies to identify and rectify issues with particular stock-keeping units (SKUs) and to measure the short-term benefits of specific events such as promotions. At a regional level, the data helped to identify regions performing below average and to devise tactics to improve their performance. The data also helped to develop a customized tool to measure store performance. This data sharing exercise was measured and the gains from acting on the information clearly demonstrated.[27]

Another unique best practice at this stage of the product lifecycle was adopted by Starbucks as a part of expanding its business portfolio into financial services. In 2003, the company teamed up with Bank One and Visa USA to offer Starbucks Card Duetto Visa – a two-in-one product that is both a stored-value card and a traditional credit card. The card rewards its customers for every purchase made through it. It offers flexibility and security offered by a Visa credit card, along with the speed and ease of a reloadable Starbucks card.[28]

Maturity and maintenance [29]

Companies can constantly monitor the quality of a product, after it has been launched in the market, through processes that help drive efficiency and ensure that requisite quality-standards are met. The Colgate-Palmolive company uses SAP software to support quality monitoring, compliance and data analysis. The company has launched a Global Rewards and Recognition program to recognize and communicate top practices for promoting quality across the company. Examples of best practices followed by the company across the globe include

- **Brazil**: Exhibiting samples of consumer complaints in plants to assist employee learning
- **Italy**: The invention of an effective method to sample powders from storage silos
- **South Africa**: The formation of an effective cleaning and sanitization schedule to improve productivity on the plant floor

The company has also initiated a global quality auditing program to monitor the progress at its manufacturing facilities and technology centers. The responsibility for these reviews lies with auditing teams composed of experts across functions such as quality, manufacturing and product development. An annual internal audit is conducted at each manufacturing facility and technology center. Approximately 20 audits are conducted by Colgate's Corporate Global Quality team at various sites around the globe. Each site receives a corporate evaluation approximately every three years, and subsequently develops a clearly defined forward action plan for continuous improvement. Best practices, identified through the audits are shared with other facilities.

Conclusion

In order to remain competitive in the market place, FDCG companies need to develop better products at a lower cost and a faster time-to-market than their competitors. With the obvious solutions to offer better value having already been exploited and commoditized over the previous decades, companies have to generate innovative ways to satisfy their customers.[30] Moreover, in the current economic conditions, customers are looking to curb their spending and hence, are shifting to less costly options such as private labels. This enhances the pressure on FDCG manufacturers to deliver better value to their customers. With the help of PLM practices at different stages of the product lifecycle, these companies can add value to their products and effectively market them.

Manufacturers also need to focus on developing products that will satisfy customer requirements in different markets once economic conditions improve. PLM is important for companies to ensure that they offer the right products at the right time and in the right place, otherwise they could lose sales even after the global economy recovers.[31] Manufacturers need to look for unique solutions through relevant PLM practices and work toward satisfying customers, as there is no set formula for success in the marketplace.

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2 Private labels versus branded products

Consumer acceptance of private label products in the food, drink and consumer goods (FDCG) sector has increased during the past couple of years. With the global economy in recession, consumers are spending less and are increasingly turning towards private label products that are cheaper than their branded counterparts. Moreover, consumer perception that private label products are inferior to the branded ones is changing. Retailers are trying to maximize on this opportunity by effectively marketing their products in all segments – low-value, standard and premium. Such developments are expected to have a negative impact on the sales of branded product. In response, FDCG manufacturers can revive and sustain their growth by simplifying their brands and developing better products through innovation.

Rise in private label product sales

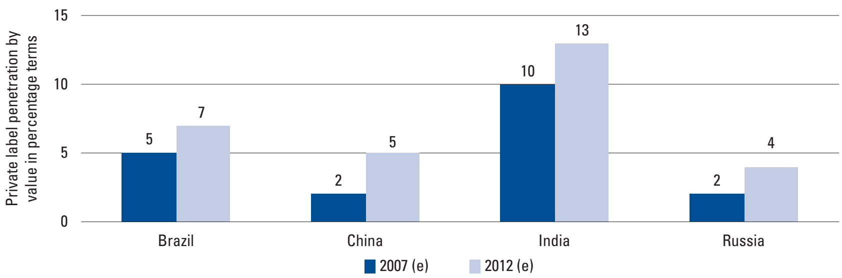
- Private label sales to grow at CAGR of 3.7 and 4.2 percent for US and Europe respectively during 2006 – 11
- Private label penetration in developing countries is low but is expected to grow rapidly by 2012
- Increased acceptance, lower cost, increased shopper loyalty, direct interaction with customers and economic slowdown are the reasons for expected growth in private label sales

Private label penetration in the emerging markets of China and Russia is expected to double itself during the period 2007-2012.

In the US, sales of private label products for the year ended September 2008 increased 10.1 percent year-over-year (y-o-y), driven primarily by a rise in prices. However, according to Tom Pirovano, Director of Nielsen's Industry insights, "*Recent months show growth in private label units, indicating that shoppers are beginning to switch in favor of the savings offered by store brands*".[32] The figure is expected to grow at a CAGR of 3.7 percent during 2006 – 11; for Europe it is expected to grow at a CAGR of 4.2 percent during the same period.[33]

Private label penetration in the emerging markets is lower than the global average – only 2 percent in the emerging markets of China and Russia vis-à-vis the global average of 19 percent in 2007.[34] However, the figure for the emerging markets is expected to grow rapidly (Figure 2).

Figure 2: Private label penetration by value in percentage terms (2007 – 12)



Source: Private Label Shares: Retailers and Market, Planet Retail, September 2008
e – Estimated

The increasing popularity of private label products in all product segments can be attributed to the following reasons.

- **Private label products are good substitutes for branded ones**: Private label products are no longer considered to be lower quality, cheaper alternatives to branded products. In a survey conducted by the Nielsen Company in the US in 2008, almost 72 percent of consumers thought that private labels were good substitutes for branded products.[35]
- **Private labels cost less than the branded ones**: According to John Williams, a partner with Toronto retail consultant firm J.C. Williams Group, private label products can cost at least 20 percent less than the national brands.[36] With the global economy in recession, consumers are looking to reduce their spending and hence are switching to cheaper, private label products. The Nielsen survey revealed that two-thirds of consumers viewed private label products as providing "extremely good value" for money.[37]
- **Increased shopper loyalty**: Customers frequently choose to shop with the same retailer as a level of trust has been developed and they can identify with its brand values.[38] This enhances the acceptance of private label brands sold by the retailer across all segments. Further research, conducted by the Nielsen Company in 2008, suggested that shopper loyalty results in increased

private label sales. According to the study, markets in the US that are dominated by a few retailers with an opportunity to establish shopper loyalty are the top markets for private labels. On the contrary, markets with numerous small grocery chains have a lower private label share, since it is difficult for customers to establish loyalty with a particular retailer in such a scenario.[39]

- **Retailers can interact directly with customers**: Retailers can interact directly with their customers and use the feedback for developing better private label products. Using shopper insights, propositions to be tested can be immediately placed in store, and results data seen in near real time. On the other hand manufacturers of branded consumer products might take months to test a new product through the retailer channel. Hence, R&D costs for retailers developing private label products are lower as compared to branded consumer goods manufacturers. This offers an opportunity for retailers to capture increased share of consumer spending through their private label products.[40]
- **Favorable impact of the economic crisis on discounters**: The current economic conditions are favoring discounters. For instance, growth of discounters, along with an increasing acceptance of private labels, is expected to push private label sales in Germany to grow at a CAGR of 4.8 percent during 2006 – 11.[41] Also, members of the national dollar store trinity in the US, which are hard-discounters, have witnessed strong growth in sales during Q3 2008.[42] Table 1 shows the rise in comparable sales for the dollar store trinity during Q3 2008 as compared to that in the previous quarter.

Table 1: Percentage increase in comparable sales (Q3 2008 vs Q2 2008)

Dollar Store	Percentage increase (Q3 2008 vs Q2 2008)
Dollar General	10.2
Dollar Tree	6.2
Family Dollar	2.1

Source: Dollar shops are at heart of consumer sentiment, FT.com, 2 January 2009

Evolution of private label products from low-value to the premium category

Retailers are no longer marketing their private label products as “poor relatives” of branded consumer products. They are foraying into new and different product categories and diversifying to compete in categories that have traditionally been dominated by branded FDCG manufacturers.[43] Also, consumer preferences for private labels are changing – they are now considering buying private labels across standard and premium categories, as well as in the low-value category.[44]

Datamonitor analysts *Katherine* Collins and Richard Parker said, “*The market (for premium products) may slow due to mainstream consumers freezing or reversing any propensity to trade up to* ***branded premium products.*** *However, they may still trade up to* ***private label premium items*** *based on the price advantages they still offer.*”[45]

“

Private labels are no longer considered to be the “poor relatives” of branded products.

Although volume sales of private label products in the US declined in 2008, value sales went up. This indicates that within the private label segment, consumers are shifting towards innovative and higher-end offerings.[46]

Table 2 shows the private label food and drink brands of five leading retailers in the standard and the premium product segments.

Table 2: Private label food and drink brands of five leading retailers

Store	Country	Standard	Premium
Wal-Mart	US	Main Stay	Sam's Choice
Carrefour	France	Produit Carrefour	Carrefour Bio (Organic) Reflets de France (Local) Escapades Gourmandes Destination Saveurs Filére Qualitè Carrefour
Metro	Germany	Aro	A La Carte Disney Magic
Tesco	UK	Tesco Brand Tesco Kids	Finest Organic Whole-foods Free-from Healthy Living
Kroger	US	Kroger	Private Selection Naturally Preferred (Organic)

Source: Promoting Brand Simplicity in Food and Drinks, Global Business Insights, 2008

At times, retailers take cues from FDCG manufacturers to launch a series of "me-too" products striving to emulate branded products.

Implications of private label growth for FDCG companies

- Retailer leverage with FDCG manufacturers strengthening
- Private labels gaining increasing share of customers' minds
- Private labels could continue to grow post economic recession, if they maintain their quality standards
- Copyright infringements by retailers

As consumers are turning towards private label products, established brands are losing market share. This could strengthen retailers' leverage with their suppliers and FDCG manufacturers could be forced to offer discounts and attractive deals in order to push their sales. Moreover, this could also lead to suppliers offering rebate offers to retailers in order to incentivize the sales of branded products.[47]

Although a rise in the price of branded FDCG products was the main reason for growth in private label sales, in the longer run, these products are gaining an increasing share of the customers' minds and wallets.[48] Therefore, these products

could continue to hamper branded product sales even after the global economy has recovered, provided they sustain their quality standards.

Historically, retailers have taken cues from brand manufacturers to advertise the benefits of private label products to customers. Certain attributes and benefits of branded products, identified by FDCG manufacturers, have been used by retailers to position their private label products. This has resulted in a series of "me-too" private labels striving to emulate the branded products.[49]

At times, private label products have been accused of violating the copyright of branded products. In August 2006, P&G sued a private label manufacturer for trade dress, trademark and patent infringement involving its 'OLAY' skin care products. In January 2008, the company filed a trademark infringement lawsuit against Blue Cross Laboratories for P&G's Herbal Essences brand of shampoos and conditioners. The issue was primarily around the unique shape of the Herbal Essences bottles.[50] Also in January 2008, McNeil Nutritionals, LLC, which manufactures a sweetener called 'Splenda', accused Heartland Sweeteners, LLC, of marketing its sweetener in "look-alike" non-branded packaging. The court ruled in favor of McNeil Nutritionals, LLC.[51]

Strategies adopted by FDCG manufacturers to counter private label products

- Brand simplicity
- Innovation
- Brand repositioning

FDCG manufacturers can counter the competition from simpler and cheaper private label products by simplifying their product positioning.

Does your brand communicate its core vales to the customers with a simple message?

Brand simplicity

While branded products have the advantage of heritage and tradition, private labels score on simplicity. At times, proliferation and diversification of brands by FDCG manufacturers results in erosion of the brand's core values. Therefore, by simplifying their product positioning, manufacturers of branded products can counter the competition from simpler and cheaper private label products through:[52]

- Focusing on simple brand messages that help customers relate to the brand's heritage and tradition
- Following traditional processes for new product development and communicating this to the customers through effective marketing
- Ensuring clarity and simplicity in the company's brands and production processes

Marmite, Heinz, Cadbury Dairy Milk and Kelloggs Corn Flakes are examples of traditional brands that have managed to sustain simple brand values.[53] According to a report by Information Resources, Inc., private label share is lower in product categories with dominant brands and heavy brand investment.[54]

Innovation

According to Jan-Benedict Steenkamp, a marketing professor at the University of North Carolina's Kenan-Flagler Business School and the author of *Private Label Strategy: How to Meet the Store Brand Challenge*, innovation is the key to ensure success in the marketplace. FDCG manufacturers are better placed to innovate than retailers. Once a retailer starts behaving like a manufacturer the less the cost advantage of a private label will be, because they have to bear the costs of failed innovation. Hence, innovation is one of the areas where branded products can score higher than private labels. Also, according to Steenkamp, private label growth is less successful in those categories where brand manufacturers continue to innovate.[55]

Brand repositioning[56]

Because commodity prices are falling, private labels are reducing their prices. However, branded FDCG manufacturers, who spend heavily on advertising and marketing, are much more constrained when it comes to cutting prices. To counter this, some brands are completely repositioning themselves and stressing on the value proposition of their products. Procter & Gamble, for example, recently rolled out new campaigns for Pantene and Gillette. The Pantene campaign positions the hair care brand as an affordable salon alternative. Similarly for Gillette Fusion, the company has positioned the costly razor blades as delivering "high-performance" shaves for "as little as a dollar a week." According to P&G spokesperson Kelly Vanasse, "*Guys have consistently told us that they think our blades are costly, so reframing the true expense for them makes good sense.*"

Outlook

The 2009 outlook for private label product sales is highly optimistic, because the tough economic conditions continue to force customers to cut spending. As the global economy continues to worsen, consumers are likely to become increasingly price sensitive and alter their shopping habits. An increasing number of them are expected to switch to cheaper alternatives when buying FDCG goods.

The private label crusade could carry on even after the world economy recovers if retailers continue to deliver quality and not give their customers a reason to shift back to the branded products. To remain market leaders, FDCG manufacturers must deliver extra value to customers for the additional price they pay for a branded product, and this can happen only with product innovation. FDCG companies can also take on private label growth by leveraging the legacy associated with their brand names. However, they need to simplify the brand messages in order to capitalize on the brand value of their products.

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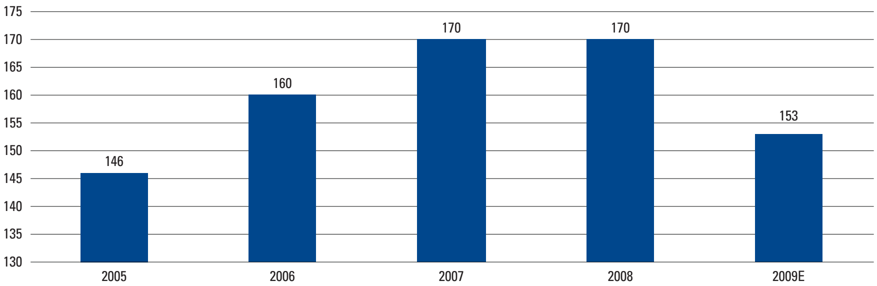
3 Tough times for the luxury goods market

Once considered recession-proof, the global luxury goods industry has begun to feel the pinch of the economic crisis. 2009 could be a tough year as global sales are predicted to fall by 10 percent. In response, luxury goods companies are approaching high-growth economies as the destination for their products and for low-cost production. They are also adopting non-traditional channels, such as e-commerce and mobile-commerce (m-commerce), to better reach their target consumers.

Industry witnesses a slowdown

Most of the segments of luxury brands have been affected by the economic slowdown.[57] Decreasing consumer spending in mature economies has put many potential shoppers off spending on luxury goods at home even during the festive seasons.

Figure 3: Global luxury goods sales 2005 — 09E (EUR billion)



Source: Worldwide luxury goods market growth projected to slow substantially by end of year and head into recession in 2009, Bain & Company, 29 October 2008; Press Release, Bain & Company, 20 April 2009

The industry is witnessing uneven growth across brand segments. Aspirational brands, such as Gucci and Louis Vuitton, were in line with market conditions and were expected to grow at 3 percent in 2008, as compared with 9 percent the previous year. However, absolute luxury brands, such as Hermes and Loro Piana, which target the wealthiest of global consumers, remained resilient and expected 8 percent growth in 2008. Accessible brands, such as Coach and Ralph Lauren, were the worst hit by the global economic crisis and were expected to remain flat in 2008.[58]

> Growth in global jewelry sales slowed down to 2.5 percent in 2008 from 9 percent in 2007.

Global jewelry market slows down amid recession

Falling sales in Europe and America have slowed growth in the global jewelry market – from 9 percent in 2007 to 2.5 percent in 2008.[59] America, which accounts for half of the world's diamond consumption, witnessed a decrease in the number of buyers in 2008.[60] The hopes of diamond producers to fill the demand gap through the rapidly growing economies such as India and China were not realized once the downturn extended to Asia.[61]

Jewelry companies are struggling with falling demand across the globe. For example,

- De Beers, a leading diamond producer, admitted suspension of operations in February 2009 at Debswana, its joint venture with the Botswana government.[62]
- In September 2008, Alrosa, the state-owned Russian diamond miner, predicted a fall of 27 percent in its year-end annual profit.[63]
- Fortunoff, a New York-based jewelry retailer, filed for bankruptcy this year citing dismal sales during the 2008 holiday season, weaker consumer spending and unhealthy expansion costs.[64]

Waning preference for quality wine

According to the Comité Interprofessionnel du Vin de Champagne (CIVC), an organization of champagne producers, global champagne shipments from France fell by 4.8 percent during 2008.[65] Some of the French trade figures are provided below:

- Domestic shipments were down 3.6 percent; those in other European countries posted a 6.5 percent fall.
- The US recorded the sharpest drop – the number of bottles shipped was down approximately 20 percent.
- Shipments to the UK dropped by 12.3 percent by the end of October 2008.

The Liv-ex 100 Fine Wine Index, a leading benchmark of the fine wine industry, declined 12.4 percent in October 2008. This represented the biggest fall in seven years.[66] Lafite Rothschild 2004 and Chateau Montrose 2003, some of the worst hit stocks, dropped by 28 percent and 23 percent, respectively.[67] Louis Vuitton Moët Hennessy (LVMH), a major luxury house, reported a 3 percent fall in sales in its Wine & Spirit business group in 2008.[68]

Slow down in luxury watch industry

Swiss watch exports fared well in 2008 with an annual growth of 6.7 percent, although the unfavorable economic environment affected the industry in the latter half of the year.[69] According to the Federation of the Swiss Watch Industry, exports dropped by 15.3 percent in November 2008 y-o-y. The Richemont Group, a producer of luxury watch brands, reported an overall drop of 12 percent in its Q3 sales (inclusive of the Christmas season), with a steep fall of 28 percent reported

in the US market.[70] Going forward, sales of top Swiss watch brands are expected to grow at only 5 percent in 2009, as compared with 10 percent in 2008 and 16 percent in 2007.[71]

However, luxury watches are finding new consumers in Asian countries, where the sales registered a growth of 13.2 percent in 2008.[72] Asian economies, except Japan, are expected to witness a steady growth over the next few years. This has led many watchmakers such as Swatch Group, the world's largest watchmaker, to come up with optimistic forecasts for 2009 sales despite the economic crisis.[73]

Weakening demand in mature markets

Europe, the biggest luxury market with 38 percent of the global share, is expected to witness a slowdown after a record growth of 10 percent in 2007. As of October 2008, Bain & Company predicted the industry to grow at 5 percent in 2008. Much of this demand was predicted to come from the Eastern European emerging economies such as the Czech Republic, Hungary and Russia, where personal income levels were on the rise. In April 2009, Bain forecasted a decline of 10 percent for the industry in 2009.[74]

The US saw its wealth fall by 18 percent in 2008, the biggest drop since World War II.[75] Low consumer confidence and scaled-down personal spending hit luxury goods sales in 2008. Total luxury sales in the US were expected to remain flat in 2008.[76] However, the situation worsened at the end of the year and December 2008 luxury sales figures (for high-end restaurants, leather goods, department stores and jewelry) showed a massive decline of 27.6 percent. In April 2009, Bain & Company forecasted a decline of 15 percent for the industry in 2009.[77]

The Japanese luxury market, which accounts for 12 percent of the global luxury goods market, was expected to decline by 7 percent in 2008, due to falling consumption. In April 2009, Bain & Company forecasted a decline of 10 percent for the industry in 2009.[78]

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Luxury goods' spending in emerging markets is expected to rise by

20 – 35%

over the next five years.

Combating recession

Luxury brands have started taking measures to combat the recession. Claudia D'Arpizio of Bain & Company said, "*As with the downturn at the beginning of this decade, brands that cut overhead costs while investing in their customers and products will be in the best position to recover strong year-over-year growth once the economy improves.*"[79]

Luxury brands are **targeting emerging markets**, such as Brazil, Russia, India and China, to offset the fall in demand from developed markets. Leading companies such as LVMH are pursuing the emerging markets despite economic uncertainty there. Bernard Arnault, Chairman, LVMH, said, "*In 1998, the Russian economy was on the brink, and then it rebounded. It happened quite quickly. India too I have no doubt it will rebound.*"[80] Over the next five years, luxury goods' spending in emerging markets is expected to rise by 20 – 35 percent. This is due to a surge in spending by high net worth individuals in these countries.[81] Table 3 shows some luxury market activity in the emerging markets.

Table 3: Luxury market activity in the emerging markets

Country	Activity
Brazil	• Notwithstanding the global economic crisis, Brazilian consumers are spending on high-end fashion, handbags, watches and other accessories. • Many companies such as Ermenegildo Zegna are entering this market. The Italian fashion house opened its first store in Sao Paulo in April 2008.[82]
China[83, 84, 85]	• According to the World Luxury Association, China has already overtaken the US as the second largest luxury market. • The country's luxury goods market has been flooded with brands. A survey conducted by KPMG China revealed that consumers recognized 64 luxury brands in 2008, as compared with 52 in 2006. – Cartier, a French jeweler and watchmaker, opened six new stores in Q4 2008, taking its count in China to 28 stores. – Burberry, a British luxury fashion house which currently has 35 outlets in the country, is planning to open approximately five stores annually in Shanghai, Beijing and Macau.[86]
India[87]	• Although the Indian luxury market is smaller than those in the developed countries, it is growing rapidly. According to Value Partners, a leading management consulting firm in Europe, India's luxury retail market is expected to grow at a CAGR of 25 percent during 2008 – 13.
Russia[88]	• Russia is expected to account for 7 percent of global luxury sales in 2009. • Companies are opening up outlets to tap into the demand for luxury goods in the country. For example, Burberry opened a store in Moscow in April 2008.
Vietnam[89]	• In Vietnam, where 63 percent of the population is below 35 years of age, the cosmetics market is growing at approximately 16 percent annually. • World famous brands such as Shiseido, L'Oreal and Estee Lauder have already tapped into this growing beauty market.

Companies are re-thinking their marketing strategies and **adopting new channels to reach customers**. Some of the non-traditional channels adopted by leading players are as follows:

- **E-commerce** – Mark Lee, chief executive officer (CEO) of Gucci, said, "*I think eventually every company that runs stores will have e-commerce. Whatever the initial fears or reluctance, people are embracing it. It doesn't harm the brand in any way, and it's also very profitable.*"[90]
  - Many luxury-goods retailers have benefited by adopting online marketing early. For example, LVMH launched eLuxury.com in June 2000; the online e-retailer recorded consistent sales growth over the years, which reached double-digits during 2007 – 08.[91]
  - Other players are now aggressively opening online stores to access customers. For example, Cartier announced the start of an online shopping facility in Japan last year.[92]

- **M-commerce** – Although mobile marketing is a relatively new strategy for various businesses, luxury brands are now using it to better reach their customers.
  - Polo Ralph Lauren, an American luxury company, became the first company to launch mobile retailing through its m-commerce website in 2008.[93]

    Similarly, many companies are including Quick Response (QR) codes in their ads and stores; QR codes are images that can be scanned and downloaded through a camera phone and shoppers can obtain more information about the products and also buy them through their mobile phones. Gucci and Ralph Lauren have started using QR codes in Japan to link print advertising in magazines to mobile commerce sites.[94]

To cut costs, luxury goods companies are **shifting their manufacturing operations to low-cost countries** such as China and India. Luca Solca, senior research analyst at Sanford Bernstein & Company, said, "*More structural measures are necessary. European luxury brands will need to start looking at global diversity in manufacturing and (sales and general administration) costs.*"[95]

Besides the low-cost labor factor, a vast domestic market is also a key attraction for companies to move their manufacturing bases to these countries.

- Burberry has announced it is moving production of its clothes to China.[96]
- LVMH has announced it is to build a shoe factory in India.[97]
- Frette, an Italian company, is looking at India as a manufacturing base for its products.[98]
- Prada, an Italian fashion house, has already moved some of its manufacturing units to China.[99]

Conclusion

Will growth in the emerging markets provide much needed succor to the global luxury goods industry?

"Fitch expects 2009 to be, with the exception of a few countries, a challenging year in terms of demand for luxury goods. These concerns are only partially mitigated by the fact that the Asian region, excluding Japan, and parts of South America could remain a positive contributor to the overall performance of the European luxury goods industry."

– Johnny Da Silva, Director of Fitch's Corporate Finance Team [100]

According to Fitch, reduced production benefits due to lower-scale, decreased purchasing by consumers, and the need for companies to maintain brand value and product innovation will put luxury goods manufacturers under pressure up to 2010.[101]

FURTHER INFORMATION

Visit kpmg.com for the following related publications

- *China's Luxury Consumers - Moving up the curve*
- *Luxury Brands in China*
- *Luxury Consumption/Russia's Luxury Revolution, ConsumerCurrents 04*
- *Operating Risk in Emerging Markets (EIU: KPMG Advisory and Others)*
- *Product Sourcing in Asia Pacific*
- *Standing the test of time: Profile of the leading Swiss watchmaker, Patek Philippe, ConsumerCurrents 05*

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