Issue 17

Consumer Currents

Issues driving consumer organizations

KPMG
cutting through complexity

Fulfilling demand

Your delivery system may be cost-effective but is it serving your customers?

Digital technology is not just empowering consumers to buy whatever they like, whenever and wherever they like. It also means their expectations have been raised about having their purchases delivered when and where they want. Now it's up to retailers and suppliers to ensure that they, too, use technology to empower their businesses.

Consumers now have as much processing power right in their smartphones as NASA used to put a man on the moon in 1969. They are in the driver's seat. How can large, multilayered and multinational retailers and suppliers keep pace with them – and smaller, startup competitors? Complacency is not an option. As American humorist Will Rogers once put it: "Even if you are on the right track, you'll get run over if you just sit there."

In this issue of *ConsumerCurrents* we explore the opportunities and challenges of the 21st-century technological revolution. These are crucial challenges because history shows us that judging the relevance, potential and impact of disruptive new technology is something businesses have often found ruinously difficult.

As web access spreads and smartphones become commonplace in far-flung corners of the world, cash is no longer king in many countries. Bitcoin may dominate headlines, but what does the rise of these cryptocurrencies – and other, more immediately useable forms of digital money – mean for the consumer industry? On page 10 we explore the implications of a world where consumers are switching from physical purses to digital wallets, and where retailers may join governments in issuing their own currencies.

Another technology that is making the transition from the drawing board to real world is 3D printing, also known as additive manufacturing. The first working 3D printer was created in 1984, but it has taken until now for the technology to become advanced and cost-effective enough to make its mark. Some experts predict that 3D printers will be in every home within a decade. Is this hype justified? We examine the potential applications of 3D printing in retail stores on page 20, as well as the key questions every FMCG needs to consider before pursuing this sales channel.

Technology can make or break retailers' fulfillment strategies. While complex digital algorithms can help retailers optimize their delivery routes, the refusal of customers to stick to a "standard fulfillment workflow" has turned delivery into a pressing concern for the consumer goods industry. On page 16 we investigate how and why retailers need to reassess their fulfillment strategies, especially taking into account consumers' high propensity to return items purchased online.

In an increasingly crowded market, technology is helping retailers to differentiate themselves from competitors by inspiring them to interact with their customers in new ways. US apparel retailer Urban Outfitters has launched an app that rewards consumers for their in-app purchases with loyalty points and early access to products. On page 22 we examine the loyalty lessons that can be learned from the computer-games industry, as retailers and brands engage consumers through the 'gamification' of shopping.

To make the most of this array of technology, brands and retailers need to live in the real world and ensure they listen to the communities they serve – and societies they operate in. For Unilever CEO Paul Polman, the conscious cultivation of a responsible, action-driven culture that permeates the organization at all levels and in all regions is an essential basis for success. In our exclusive interview beginning on page 6, Polman discusses how this vision has transformed Unilever, and why companies in the FMCG sector are in need of partial reinvention.

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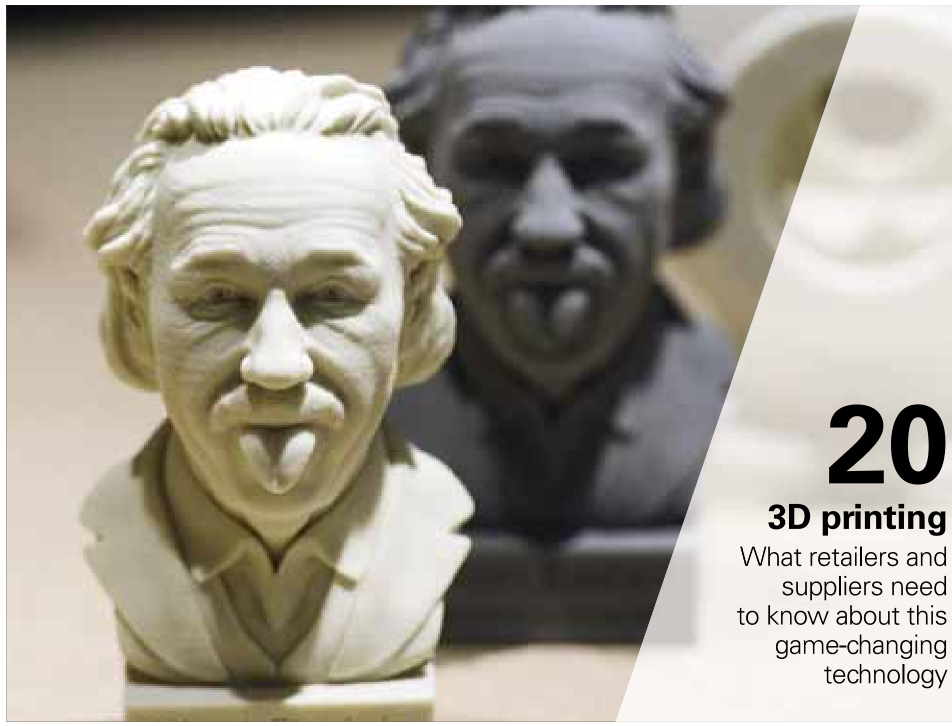

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Off the shelf

Online shoppers in China spent US$230 on average on their most recent luxury purchase

China's luxury puzzle

With e-tailers' sales of luxury goods booming in China, why have so many famous brands been slow to develop online strategies and engage with social media?

The online and smartphone market for luxury goods in China is growing rapidly, yet many global brands are failing to capitalize on this boom. That's one of the striking conclusions in a new survey, *China's Connected Consumers*, produced by KPMG in partnership with Glamour Sales (an Asian flash retailer of luxury brands) and Mogujie (an online marketplace platform for young female shoppers in China).

The report, based on a survey of 10,200 consumers in China, found that 70% use PCs to buy or research luxury products every day and 60% use smartphones. Three out of four shoppers buy online to save money while 55% want to save time. Outside the big cities, many brands are not available in bricks-and-mortar stores, so consumers go online to enjoy greater choice. The most sought-after luxury goods online are cosmetics (bought by 53% of shoppers), women's shoes (39%) and women's apparel (36%). The average amount shoppers spent on their most recent online luxury purchase was US$230.

Nick Debnam, Chairman, Asia Pacific Region, Consumer Markets, KPMG in China, says that, despite growing online demand for luxury: "Many have been reluctant to embrace online strategies because so much of the brand is about the experience of going into shops to learn about the brand's heritage."

Thibault Villet, Chief Executive Officer and co-founder of Glamour Sales, estimates that only five of the top 60 brands in China operate their own online sites. "They have been late with their online strategy because they have focused on expanding their bricks and mortar network and many brands did not anticipate how quickly Chinese consumers would shift to online purchasing." This is starting to change, Debnam says, as consumer spending through PCs and smartphones expands: by 2020, China's e-commerce market is predicted to be larger than those of the US, UK, Germany and Japan combined.

Companies looking to position luxury brands online need to be aware, Debnam says, of the power of the big marketplace platforms and the need to cater for opinion-forming bloggers in social media. For example, Mogujie has built an e-community in which customers and opinion leaders share their product experiences, which will be overlaid with a platform so shoppers can buy.

China has largely bypassed landlines, so consumers have migrated straight to mobile platforms. Debnam says: "Companies now create online stores for smartphones and then adapt them for websites." This strategy is paying off for Glamour Sales, which expects 50% of its business to be derived from smartphones by the end of 2014.

Debnam warns that brands should not underestimate the sway celebrity-bloggers hold over consumers. Chinese e-tailers have become savvy about monitoring opinion leaders who will become even more influential with apps such as WeChat looking to integrate social media with e-commerce.

China's luxury goods market is growing. Increasingly convenient and affordable delivery will help put e-commerce at the heart of that growth. Faced with such a significant opportunity – and domestic sellers cementing their positions – can foreign luxury brands afford to maintain a cautious approach?

The full report, *China's Connected Consumers*, can be downloaded from **www.kpmg.com/chinaluxury**.

Nexttech

RFID and beyond

The internet of things – in which uniquely identifiable objects can be digitally networked – is revolutionizing the way retailers and manufacturers do business. Radio frequency identification (RFID) tags are at the forefront, helping manage supply chains, trigger in-store video promotions, and even track grapes so growers can tell customers about their wines. Yet of all the applications, a device that helps consumers keep track of the eggs in their fridge may be the most intriguing harbinger of revolutions to come.

Developed by New York-based research and development firm Quirky, the Egg Minder uses RFID in an internet-connected tray linked to a smartphone app so consumers can remotely count eggs in their fridge.

This may sound like a whimsical application of smart technology, but it points to a future where fridges, even smart kitchens, could be points on the same network of sensors as a supermarket. Such strategies could make the internet of things one of the most disruptive innovations retailers and manufacturers have ever had to manage.

"In the next decade, customers will be able to use their car to order goods from a supermarket and pick them up on their way home," says **Mark Larson**, KPMG's Global Head of Retail. "The challenge for brands and retailers is to think about how the internet of things could transform their business – and how that could impact their business model."

World Cup economics

Whichever team wins in Brazil, will the finals help the host nation – and big-spending sponsors – fulfill their goals?

"Brazil is a country that likes to party," says **Carlos Pires**, Partner and Head of Consumer Markets at KPMG in Brazil. This month, it is inviting citizens, fans, broadcasters and brands to join the FIFA World Cup party.

The quadrennial football fest is the biggest showcase for the world's consumer brands in 2014 – and a game-changing opportunity for the host nation to persuade the world to look beyond sun, samba and, ironically, soccer. The event is expected to attract 600,000 foreign tourists and 3m from within Brazil – and could generate US$2.7bn in revenue, though some analysts fear "World Cup couch potatoes" will dampen retail sales.

"The finals are expected to attract 600,000 foreign tourists – and could generate US$2.7bn in revenue"

The long-term impact of the event – especially of the country's US$10.5bn infrastructure investment – is central to Brazil's goal of becoming the world's fifth largest economy by 2023 (it is now seventh, behind the UK).

Private finance has funded 15% of these investments, which represent 5% of the budget for Brazil's ambitious growth program. Pires notes the funding will improve stadiums, transport and internet services in a dozen host cities at the same time. "The difficulty is that, since 2007 when Brazil was awarded the World Cup, the economic climate has changed significantly," says Pires. This has led to protests that the money should be spent on schools and hospitals. Yet Brazil is passionate about soccer and it is hard to predict the nation's mood if it wins the competition for a sixth time.

For the event's top line sponsors and partners – which include adidas, Anheuser-Busch InBev, Johnson & Johnson, McDonald's and Sony – the benefits could be spectacular. Sportswear giant adidas has talked of a US$1bn boost in revenue. For Anheuser-Busch Inbev, the goal is to make Budweiser the "Coke of beers" and to increase the Budweiser brand's footprint in Africa and South America.

Most of the World Cup's 14 sponsors and partners have long-term deals with FIFA. The big brands are keen to avoid blunders like that made by Eastman Kodak when Los Angeles hosted the Olympics in 1984. The photographic giant dithered over sponsoring the games, allowing rising rival Fuji to promote its film to millions of North American consumers for the first time and sideline Kodak in the public's consciousness.

For the brands that sponsor these mega-events, it's not just about the revenue you generate – it's the revenue you deny the opposition.

Flag bearers: Brazil hopes the World Cup will boost its economy

Trend Spotting

Deals or no deals?

The pull of food and drink brands, the cash they generate and evolving corporate strategies will drive acquisitions, says **Liz Claydon**, Head of Consumer Markets, KPMG in the UK

Some famous food and drink brands have found new owners in the last two years. The acquisition of such famous names as Bertolli, Burton's Biscuit Company, Ribena and Weetabix is, in part, a reflection of evolving corporate strategies. With the big FMCG groups constantly refining their portfolio – and the mood among customers, regulators and rivals changing – businesses that were once deemed core can come to seem peripheral.

The intriguing aspect of these transactions is that sellers have so little difficulty finding buyers. The acquirers – be they private equity firms, companies in emerging markets or established players – are attracted to brands with a global resonance, that are stable businesses, generate resilient cash flows, and have the kind of intellectual property and know-how they can learn from and apply across their business.

This rationale underpinned the acquisition of Weetabix by China's Bright Foods in 2012. As Bright has also acquired Manassen in Australia and 56% of Tnuva, one of Israel's largest food businesses, the company certainly doesn't lack ambition.

The allure of Western food and drink brands with a rich heritage was underlined by Suntory's acquisition of Ribena last year. Given the synergies between the businesses, it was clear that Suntory could afford to pay a significantly higher multiple than potential bidders in the UK, US and Europe.

Companies in the emerging markets may find it easier to make transformational acquisitions than established players in North America and Europe. KPMG's own research suggests that most acquisitions do not deliver enduring value for their shareholders and the CEO of an FMCG company would have to make a very compelling strategic case for a colossal, multi- billion-dollar acquisition. Regulators and consumers have become more critical of such transactions, as Kraft discovered with its purchase of Cadbury.

I would expect to see more of the same when it comes to mergers and acquisitions in food and drink over the next year or two. FMCG giants will continue to sharpen their portfolios, companies will look to exit sectors that no longer fit their strategy and will acquire businesses – or facilities – that help them become number one or two in key markets, with Africa and Asia especially high priorities. Private equity firms and companies in emerging markets will always be interested in the right deal at the right price.

The one change we are seeing is a growth in joint ventures, which may occur where companies are keen to share risk and knowledge or where markets converge. In an area such as neutraceuticals, where the health benefits of food are the key selling point, I would expect more alliances between pharma and FMCG firms.

Analysts have long speculated as to whether the food and drink industry will experience the kind of global consolidation that occurred in pharmaceuticals and over-the-counter medicine. Such a shake-up would seem logical, yet food is so deeply embedded in a country's culture, that consolidation may take longer – and be less uniform – than elsewhere. Companies that ignore these nuances will find it much harder to derive real value from their acquisitions.

Unilever CEO Paul Polman has put the company's sustainability at the heart of its long-term business development plans

"We have to go back to putting **business** at the service of **society**"

Unilever CEO **Paul Polman** has never shirked controversy. In this exclusive interview, he reveals what it took to change the FMCG giant, how the media have misunderstood emerging markets and why capitalism needs partial reinventing

With his silver U-for-Unilever-shaped cufflinks and steel-gray hair, Paul Polman looks every inch the modern corporate CEO. But the Dutch head of Unilever, the fast-moving consumer goods company that is the world's second-largest food producer by sales, is in many ways a radical. When he was appointed in 2008, the group – the maker of brands such as Dove soap, Domestos disinfectant, Omo laundry cleaners and Lipton tea – had been underperforming for a decade and was in dire need of fresh ideas. Polman supplied those by initiating the Unilever Sustainable Living Plan. The plan was certainly ambitious. Polman's aim was to double the size of the business while halving its environmental impact by 2020. So far, it's working. Sales are up – 3.6% year-on-year in the first quarter of 2014 – and Unilever is meeting its green targets. The company has reduced waste by 66% per tonne of production compared to 2008, and by the end of 2013 it responsibly sourced 48% of raw agricultural materials, up from 10% four years ago.

One of the unexpected consequences of this transformation is that Unilever has become one of the world's most sought-after employers – it is now the third most-searched-for company on LinkedIn globally, after Google and Apple.

ConsumerCurrents caught up with Polman in Unilever's famous HQ in London's Blackfriars, looking out across the Thames. After 35 years in the FMCG sector – he held senior posts at Procter & Gamble and Nestlé before being asked to lead Unilever – he has the kind of experience needed to initiate cultural and strategic change at a US$68.6bn revenue business which derives 57% of its sales from emerging markets. Yet he brings his own particular worldview to the task. He addresses such august bodies as the United Nations General Assembly on issues such as poverty, biodiversity and the environment – concerns he feels businesses cannot afford to ignore.

You have pushed through massive changes in a short time at Unilever. What are the secrets of good leadership?

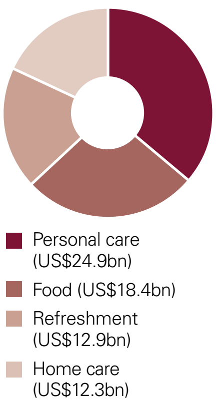
I don't believe in any of these '10 tips for leadership' or 'How to be a leader in five minutes'. It's about being yourself and being human. For me, the definition of a leader is being able to reach someone in a positive way. There are millions of leaders in the world, from social entrepreneurs to teachers. People talk about certain qualities being inherent in leaders, such as having an introvert or an extrovert personality, or being a good communicator, but they are not that important.

You don't need to be a good communicator: it helps, but it's not essential. If you are a sincere and honest communicator, people will notice. And if you are an introvert, it makes it a bit harder – but if you have integrity, a great sense of purpose and mission, it doesn't matter. Fundamentally, leadership is about authenticity, integrity, values and purpose. Too much emphasis is put on those other things.

First person

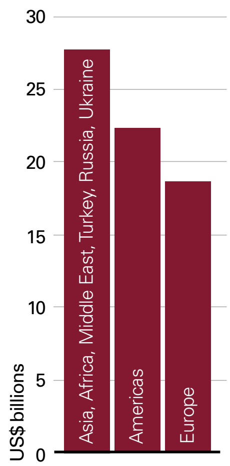
Unilever 2013 turnover by product category

Source: Unilever Annual Report and Accounts 2013



Unilever 2013 turnover by region

Source: Unilever Annual Report and Accounts 2013



"In 2008-9, when many companies were being cautious, we invested in IT systems, R&D, new launches in new markets and made acquisitions. We made it clear the company had a strategy"

You have spoken a lot about the culture and values of Unilever. Did you have to change the culture when you became CEO?

When a company doesn't do so well you tend to get an internally-focused culture. The question is: how do you turn that around to become a consumer- and customer-focused culture? Sometimes big companies become bureaucratic and slow, so how do you create a bias-for-action culture? When a company doesn't grow, people become more concerned about themselves than others, so how do you create a culture where there is a passion for people? If you haven't won for 10 years, how do you start to create a winning culture? To change these elements and to change our mindset was a big task.

Can you give some practical examples of how you did this?

The first thing we had to do was get the growth agenda back, so we said we wanted to double our business. We worked on compensation and firmly linked performance reviews to results. At the beginning we had too many people in the top right-hand quadrant of exceeding leadership and exceeding business results, at a time when the business was not performing. Everybody thought: "It's not me that's the problem." We had to bring that number back to 20%, place people in a performance curve, and focus the compensation plan on long-term goals.

We instituted 30-day action plans for things that were not working, to create a bias for action. We also stepped up our investments. Back in 2008-9, when many companies were being cautious and laying off staff, we invested in IT systems, research and development, and stepped up new launches in new markets. Instead of selling brands, which we had been doing for 10 years, we made acquisitions. We made it clear that the company had a strategy.

Was there anything there that you felt should not change?

It's important to separate culture and values. Culture changes, but values remain the same: if Lord Lever [who founded the business in 1885] came to this company today, he'd find the same ideals as when he built it. We spend a lot of time making sure that our pioneering work is carried out globally with integrity and respect, while always ensuring the communities we work in are as successful as our own.

I have been blessed to work for three of the great consumer goods companies and their beliefs are basically the same. But they had never been written down at Unilever. There was a sense that: "people will know the values, because they are in the company's DNA." You can't rely on that. How will people we recruit in the Far East know what we stand for? So we took the time to take a good look at our principles and consulted widely inside the company, and I spoke to a lot of retirees to understand what made the company tick. We then captured the beliefs on paper and began to celebrate those people who embody them. Now every year we have a big event to celebrate unsung heroes and make our values come alive.

Do consumers care about values and ethics?

Yes. There is a perception that they don't, but it is increasingly clear they do. After the disaster in

the clothing factory in Bangladesh, consumers spoke up. They are more educated now about what they buy. In general, citizens are driving change. You see it in the Arab Spring, and you see it in consumer goods. I understand that if you sell Lipton tea the price must be affordable and the product has to taste good, but consumers do care about how you treat people who work at the tea plantations. By its very nature the consumer goods industry represents the citizens of this world, so it should be in tune with their needs.

How much can Unilever do on its own? Doesn't the whole industry have to come on board to make a real difference?

Yes. We want to take advantage of the size and scale of our company. What is unique about our plan is that we have taken responsibility for the whole value chain. We try to be a positive force, whether it be on illegal deforestation, in food security, obesity, nutrition or hygiene. Most companies are working in the corporate social responsibility space if they are doing anything at all, but being less bad is just not good enough any more.

Many people have realized that the cost of inaction is often greater than the cost of action. We need partnerships across the industry – ones that probably haven't happened before. Competitors need to say that it is in our own self-interest that we move to sustainable sourcing, stop illegal deforestation, and move to natural refrigerants. If the consumer goods industry does not move to a more sustainable model, most of its profits will be wiped out in 30 to 50 years, and if you are in food even earlier.

What do investors say?

The investor community is starting to come round, sometimes for risk or cost reasons. There has been too much chasing of short-term profits, which has caused long-term damage. We have to go back to putting business at the service of society.

You talk a lot about sustainability, but what about other ethical issues? Where do you stand on diversity, for example?

Of course this is important too. Just to take the example of gender balance, at Unilever we have a gender-balanced organization. Europe is very diverse and cosmopolitan, but it is moving much too slowly on this question. Instead of governments putting quotas in place, they should provide childcare and flexible working: initiatives that enable women to work, rather than laws and regulations.

The reason we need more women in the workplace isn't just about how many women buy our products, or recruiting from 100% of the population, or fostering creativity. It's also because the Unilever Sustainable Living Plan requires long-term thinking, partnership and a purpose-driven way of working, and these are things that women are good at. We will not be able to solve the world's problems if the gender mix isn't balanced.

How does the idea of sustainability play in emerging markets?

In some respects they are running ahead of developed economies – China certainly is. The emerging markets are where population is growing fastest, and where resources are most constrained. It is better for those countries to develop growth in a more sustainable way. Because the people there have never had much, they are more resourceful so it is much easier to start a circular economy there and to make sustainability mainstream.

Consumers in these regions understand this need. Where do our waterless shampoos grow fastest? The emerging markets. Where was the one-rinse fabric softener that saves an enormous amount of water most successful? In emerging markets. Where do we make bar-soaps that take 10 seconds to disinfect hands rather than 30? In India.

We sometimes discuss the emerging markets as if they are one homogenous block. In reality, how do Latin America, Africa and the Far East differ?

I had the fortune to have some interactions with the business thinker C. K. Prahalad [author of *The Fortune at the Bottom of the Pyramid*] when he was still alive and he made it very clear to me that the world is not flat. Just to take the Far East, there are many different stages of development there, with Singapore at one extreme and North Korea at the other.

At Unilever, we have divided the world into seven clusters. De-averaging is very important. Even in the US you have to de-average. It looks like the US economy is improving, but the middle classes are actually slipping back so you have to make adjustments by having low-price, mid-price and high-price products. In the emerging markets you see the same thing – a premium sector but also a segment where you have to raise people out of poverty still.

The overall state of the emerging markets is not as bad as the newspapers make you believe. There is a lot of geopolitical tension, but a lot of people are being lifted out of poverty. The fact, though, is that a system where we over-use resources, where the rich part of the world lives beyond its means, or a system where too many people are left behind is not a system that is in equilibrium and so we have to address that. We have to evolve our business models and reinvent capitalism a little bit.

UNILEVER BY NUMBERS

14 Unilever brands have sales exceeding €1bn (US$1.38bn), making up 54% of its business.

90% of Unilever's growth is driven by emerging markets.

4.3% growth in underlying sales achieved by Unilever in 2013.

14.1% was Unilever's **core operating margin** in 2013.

€3.9bn (US$ 5.3bn) was the value of Unilever's free cash flow at the end of its last financial year.

Two billion people use one of Unilever's brands on any given day (the company has more than 400).

450 million consumers across the globe use Unilever's Hellmann's mayonnaise.

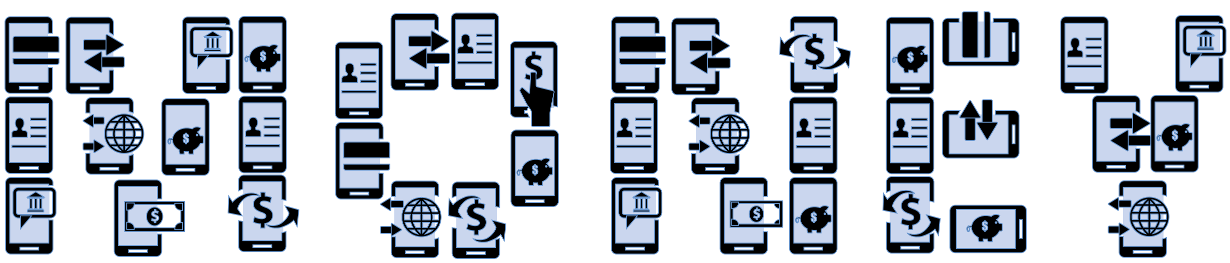
€100m (US$136m) in revenue is generated by the **Cornetto ice cream** brand in China.

11% is the waste impact reduction **achieved** by Unilever since 2010.

42% of Unilever's managers **are female**.

Low tech meets high tech. Kenya's M-Pesa is changing the way money is transferred worldwide

REINVENTING



In a digital age, how consumers pay for goods and services is increasingly becoming a lifestyle choice

Digital technology has already brought major upheavals to financial services, but in one crucial area the revolution has only just begun. Consumer payment for goods and services – relatively stable over the past 50 years – is being transformed by a flurry of new, competing methods of payment across the globe.

Mobile technology has enabled many of these new payment systems, not least the advanced two-way connectivity of near-field communication (NFC) between devices and merchant readers. By even the most conservative estimates, mobile payments will account for more than US$1 trillion of transactions worldwide by 2017.

Seeking to protect their payment revenues, the traditional financial players have introduced apps for mobile payment. But competition from telcos, technology innovators, and even retailers themselves is fierce. Google and a slew of tech start-ups (such as Square and LifeLock's Lemon) are betting on virtual wallets, which store credit and bank cards, loyalty programs, and even digital coupons. There are also non-bank-based money transfer services such as PayPal, created for online transactions and popularized by eBay, which more than 1.9 million merchants in the US have committed to accepting.

A report last year by Allied Market Research predicted that the mobile-wallet market would reach US$5,250bn worldwide by 2020 – driven by increased smartphone penetration and improved security – and that Asia Pacific would embrace it with the most fervor.

Starbucks has enjoyed much success with its closed-loop payment app. In a typical week, more than four million mobile transactions are made. The global coffee giant's next move? To "extend the mobile payments that we have experienced inside Starbucks stores to other places within the marketplace," said Howard Schultz, the company's president and CEO, in March. The coffee chain's next step could be to license or white label its mobile payment systems – it has developed its own apps for iPhone and Google Android in-house – to retailers, creating what Schultz described as "opportunity for new sources of revenue and profit complementary to our business".

Looking further afield, even cryptocurrencies could gain acceptance. Bitcoin, the most hyped of the peer-to-peer virtual financial systems, is now accepted by a small number of retailers

Payment systems

> **"There is an opportunity for retailers to promote their own brand through the payment process, and cultivate a better relationship with the consumer"**

such as Overstock.com and Tiger Direct.

"There is so much movement out there and speculation about what will gain traction," says **Chris Hadorn**, Principal at KPMG in the US. There will be winners and losers but he is convinced the tipping point for consumer payments isn't far away. "We will see some major shifts in the next few years," he says.

Traditional payments under fire

As with the Internet revolution, the payment system transformation is occurring at different speeds in different countries, depending on current methods. Debit and credit card use, for instance, is widespread in mature economies such as the UK and US. Yet those options have faced greater scrutiny from regulators, governments and large-scale retailers.

At the heart of this dissatisfaction, Hadorn says, are the fees that issuers charge merchants – as much as 5% of gross sales. Push-back has been driven by the perception that credit card companies are not transparent enough about explaining fees to consumers, and detailing how exactly they may drive up the costs of goods and services.

A few years ago, the Durbin Amendment – an 11th-hour addition to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 – capped the interchange fees that debit card issuers can charge merchants. Now the Federal Reserve is advocating improvements in the speed and efficacy of payment systems.

"Traditionally, when the federal government has looked at this issue they have done so from a bank-to-bank point of view," says Hadorn. "In a recent report they said they 'understand the need to look at the end-to-end value chain' around the payments. That means considering the retailer's point of view. In other words, they're now looking at this through the lens of the customer rather than just that of the banks."

Looking to wrestle some of the payment process away from banks, and thereby reduce the interchange fees they pay, some of America's largest mass-market retailers have banded together. Their coalition, Merchant Customer Exchange (MCX), aims to create "a customer-focused, versatile and integrated mobile commerce platform."

"This could be a major disrupter," says Hadorn, who provides some insights into the factors that could result in a successful play for retailers *[see panel overleaf]*. "But regardless of what takes off in the long run, whether it's MCX or more success stories like Starbucks, there is an opportunity for retailers to promote their own brand through the payment process, communicate the benefits of doing so and cultivate a better relationship with the consumer."

New customer segments

Many of the new payment methods in developing markets allow retailers to tap into new customer segments, particularly the "unbanked" – those who have never had a bank account or credit. The World Bank estimates that around three quarters of the world's poor – more than 2.5 billion people

GLOBAL M-COMMERCE

INDIA

With an estimated 40% of India's population "unbanked," Kenya's M-Pesa solution is finding favor. The service's rollout started this year because government regulations require telcos to partner with banks on mobile payment. In M-Pesa's case, Vodafone India has linked up with ICICI, India's largest private sector bank. Critics blame that restriction on the slow growth of mobile, arguing that banks are slower to innovate than telcos and that such partnerships force potential customers to endure the hassle of paperwork. Indian regulators argue that the cautious approach will pay off long term. For now, cash is still king in India, accounting for 90% of all retail payments.

SOUTH KOREA

Year-over-year growth of credit card spending in South Korea slowed to 4.7% in 2013. This slowdown could continue as household debt has reached record levels, and the government has introduced tax incentives to encourage consumers to choose other forms of payment. Credit card companies are reeling from the aftershock of a security breach involving the data theft of more than 100 million credit cards. Security concerns could restrain growth of mobile payment, but smartphone maker Pantech has introduced a scheme to authenticate payments with fingerprints.

BRAZIL

The Brazilian government has created a framework it hopes will encourage a thriving mobile payments sector. It has introduced a new legal entity called a "payments institution," which can include non-banks as mobile payment and banking services providers. The Brazilian Central Bank has been tasked with regulating these institutions, and will grant them access to domestic payment rails. The government has also called for a common standard for m-payment initiatives. Lack of consumer awareness may constrain progress. Brazil's first mobile payment service, Zuum, launched in 2013 by Telefónica/Vivo, and MasterCard Worldwide, has said educating consumers is harder than building a network. With mobile penetration at around 23%, it is surely only a matter of time before consumers become less reliant on cash.

JAPAN

Japan was one of the first countries to embrace mobile payment. By December 2010, comScore reported that a tenth of Japanese mobile subscribers had used a mobile wallet to make a purchase. New players hope to persuade merchants to accept credit cards by turning mobile phones into card readers. These solutions could save merchants money, as they wouldn't need to invest in expensive point-of-sale systems and could circumvent high transaction fees. Tokyo-based Coiney provides merchants with a small attachment to their smartphone, that enables credit card payments to be processed with no installation fee and a modest 3.24% transaction fee.

IRELAND

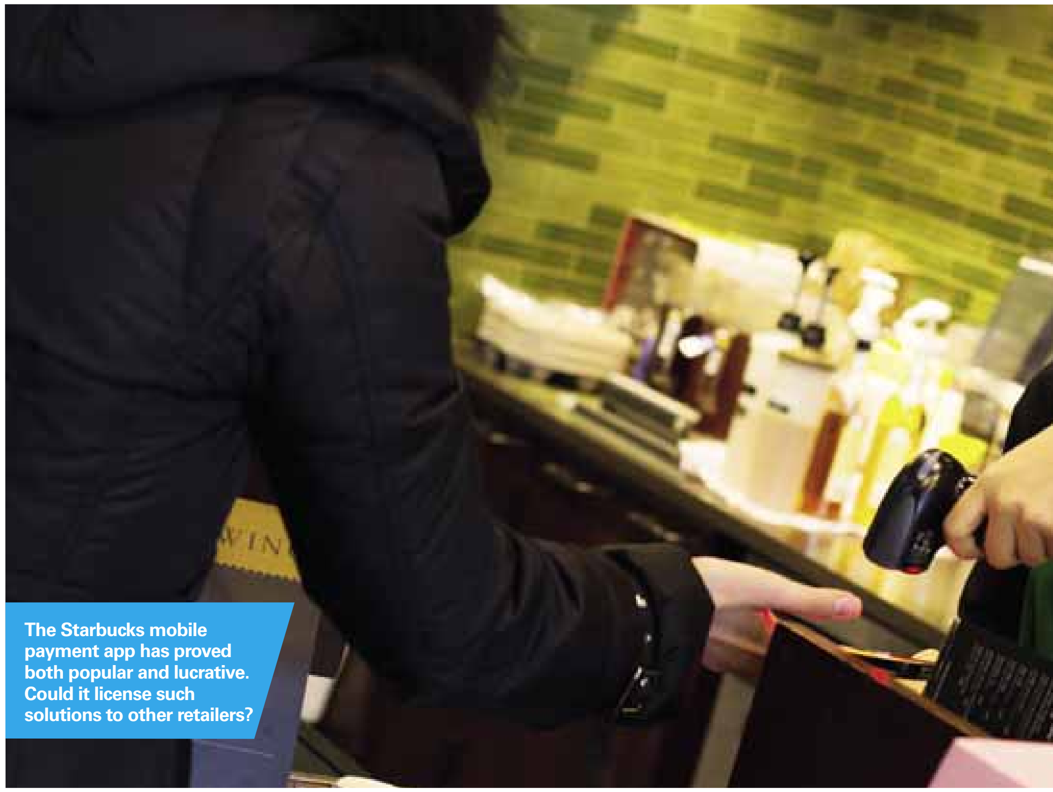
Ireland has become something of a hub for companies like Facebook and PayPal in Europe as the government is keen to encourage electronic forms of payment. The Central Bank of Ireland says the country has the highest ATM withdrawal per capita among major European countries and still pays half of its social welfare payments in cash. New solutions include mobile billing provider txtNation, which has partnered with Vodafone and O2 to enable customers to make one-click purchases on mobile websites that are charged to their phone bill.

– don't have a bank account. Many are now looking for options other than cash, which is vulnerable to theft, to make their purchases.

In Kenya, over 17 million citizens – more than two-thirds of the adult population – now use M-Pesa, which was launched by mobile network operator Safaricom (pan-African Vodacom's company in the East African country). What started as a way for mobile-to-mobile money transfers, helpful for urbanites sending money to their families in rural areas, is now being used to pay for everyday purchases.

"It was an African solution to an African problem enabled by government regulators as a way to bring millions of citizens into the financial system," says **Frank Rizzo**, Technology Sector Leader for KPMG in Africa. "And it works because M-Pesa provided a way for people to access a payment system without going through the rigor of setting up bank accounts and formal documentation."

Many of these people, he says, distrust the traditional banking system. As many of them were already buying airtime on their mobile devices, it required no great leap of faith to put money on them.



The Starbucks mobile payment app has proved both popular and lucrative. Could it license such solutions to other retailers?

Risk versus reward

The processing solution for merchants does not cost much: a mobile phone is all they need. "It has opened a whole new market for merchants," Rizzo says. "Retailers who don't offer the payment option risk cutting off potential customers. M-Pesa may be the only means by which they can pay." He believes the next step is using NFC to enable contactless payment, but the technological infrastructure in Africa isn't quite there yet.

In other developing markets, traditional banking products are gaining popularity. The People's Bank of China reported that financial institutions in 2013 issued 4.2 billion bank cards – 20% more than in 2012. Here the growth of mobile payment has less to do with competing against traditional forms of payment than creating solutions for the unbanked, says **James McKeogh**, Director at KPMG in China. Over the past few years, the country has issued payment licenses to 250 companies, many of them mobile providers. "It is about offering alternative payments to the masses and at a relatively small price," says McKeogh. "Until now, processing has been a crippling factor for smaller merchants who can't afford credit card and other fees."

McKeogh notes that economic policy in Asia Pacific has usually encouraged a migration to electronic payment. In particular, this is driven by consumers' passion for smartphones, but it makes sense for governments trying to boost tax revenues too.

In an effort to crack down on the black economy and compel consumers to demand receipts, the Chinese government made each receipt a lottery ticket. The system, updated in 2011, has helped fill the government's coffers. "The solution is quite savvy," says McKeogh, "but it underscores that this is a real problem for China and why they are moving away from a cash economy."

In the US, the Federal Deposit Insurance Corporation reports that there are as many as 68 million Americans without a bank account or debit card. Could a mobile solution for the unbanked also work in a developed market?

"Banks have been conservative about going down this path because of the regulatory scrutiny around whether they are providing fair pricing and transparency to those customers," says Hadorn. "Additional regulatory and government intervention will be required, but there is certainly an opportunity to further penetrate that market and do so on the tenets of trust and value."

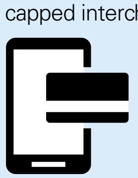
With so many new payment options becoming available, McKeogh says, the temptation for merchants is to wait and see what gains critical mass. Yet with a revolution moving this fast, retailers need to gather as much learning about new payment methods

KEY DRIVERS

What will it take for a new payment method to succeed over the long term with consumers and merchants? **Chris Hadorn**, Principal at KPMG in the US, outlines five factors

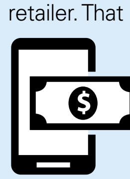
1 TRANSPARENCY

A lack of openness by financial institutions has been a fundamental flaw of traditional payment methods. That is reflected in markets like the US, Canada and the European Union, where regulators have capped interchange fees and called for greater consumer education about costs. Operators of alternative payment options – including retailers – can change the game by being more transparent.



2 UBIQUITY

The mobile payment market will become very fragmented, but the solutions that survive and thrive will grow in ubiquity. Shoppers will not want to worry that their mobile wallet might not be accepted by a particular retailer. That is the challenge of many mobile and wallet-based solutions such as Starbucks Card. They work if you're part of the cozy community but right now they are closed-looped and not ubiquitous.



Payment systems

as quickly as they can. It makes sense to pilot various payment options, particularly given the relative low cost of entry.

"Right now these solutions are being provided to retailers on a trial basis rather than requiring an outright purchase," McKeogh says. "Retailers do not need millions of dollars to spend on these payment systems. It costs in the low hundreds of thousands of dollars to do a significant project."

He also underlines a key point for retailers: as economies embrace electronic payment, the level of information available to understand the consumer will grow exponentially. The investment isn't just about savings on payment fees but the payment data that can inform promotions and real-time engagement offers.

"It is not the case of having offline marketing strategy and then the online marketing and payments strategy," says McKeogh. "It is about bringing the two together and having a unified approach. Merchants who don't use the technology should realize that somebody else will. Payment processors are already doing the analysis, will soon understand your customers better than you, and will tell your competitors about it if you're not part of it."

He also says pilots can help address an issue that could prove to be a real challenge: the clutter of extra payment terminals on counter space. These could seriously slow down check-out lines. "Merchants will need to develop a strategy otherwise they can find themselves pulled in different directions, implementing a multitude of solutions that never talk to each other and confuse consumers," says McKeogh.

Hadorn also warns that retailers will have to invest in their back-end systems – at least until some payment methods fall by the wayside. "What rails are you clearing payments over: card network, ACH (Automated Clearing House) network, FPS (Faster Payment Services) network? All of these translate to exceptions – errors in payment – and returns and different accounts with banks that they have to reconcile, clear and settle. It makes the back end more complex and more costly."

Even though this aspect of retailers' business will become increasingly complex, Hadorn doesn't expect payment processing departments to expand. He suspects departments will take on new payment types with a view to saving money on interchange fees in the long run. "They will look for opportunities to reduce back-office costs," he says. "Some payment types have pretty high exception rates, and when you talk about an improved payment system in the US you would hope to see those rates go down."

Cryptocurrencies: fad or future?

Virtual currencies have dominated the headlines lately, mostly because of Bitcoin's recent troubles, although there are other digital currencies such as Dogecoin and Litecoin. Collectively, these solutions face an uphill battle. "There are a lot of issues, including the fact that it is completely untied to any solvent currency and has such a volatile value," says McKeogh. "We've also seen that it has been utilized to move money around the world in money laundering schemes."

The US has launched a criminal probe into the use of Bitcoins, and the vice chairman of a trade group promoting the currency has been charged by US prosecutors with conspiring to launder money. Virtual currencies are vulnerable to criminals, and there are also concerns about data protection and identity theft.

Pat Litke and Joe Stewart, researchers at Dell SecureWorks, recently evaluated the threats facing Bitcoin. Although they noted the system is protected by strong cryptography, they found that thieves have stolen millions of dollars of Bitcoins from victims by exploiting weaknesses in the currency's private key storage systems. This includes the creation of malware that targets individual users' wallets or exchange accounts.

"There's definitely a big overhead in trying to launder money from credit cards and bank accounts, but there's no overhead in Bitcoins," Stewart said. "It's much easier to cash out money from stolen wallets than it is to employ money mules to move money out of compromised bank accounts."

Indeed, given all its challenges, the analysts say this is one new payment system to which they should take a wait-and-see approach. While Rizzo does not see the value of retail brands creating their own virtual currency, he says the rise of virtual currencies does pose an interesting question as they not only bypass interchange fees but create a way to transfer money across international borders.

"Bitcoin has challenged legal, tax and regulatory systems," he says. "It is too soon to predict how governments might regulate these systems but it has forced everyone to think about solutions that work beyond borders."

While retailers would be wise not to rush into the first mobile payment scheme that comes along, they should study closely all those available and be prepared to make some quick decisions. It's one thing to be wary of overestimating change in the short term, but quite another to underestimate it in the long term, and this particular revolution will not be slowing down any time soon.

3 CONVENIENCE & SPEED

It is important not to miss out on the benefits of new technology, and offering consumers a wide choice of payment options can be a selling point. However, retailers must ensure that the plethora of different methods doesn't slow down check-out lines. Merchants need to get customers through as soon as possible and get to the next sale. Customers want to get through quickly as well.

4 PRIVACY AND SECURITY

One of the largest US retailers suffered a security breach during the 2013 holiday season, with millions of customer records stolen. As a result, debit and credit card issuers had to reissue cards to holders. Retailers will need to be aware of any vulnerabilities and changes that may be required to their operating model. There is an opportunity for retailers to build trust with new payment methods.

5 CRM

Systems that securely collect useful customer data while not infringing on their privacy will in turn drive other business objectives, such as improved marketing ROI. Retailers will be able to reap the benefits of even bigger data to mine and better understand the behavior of their customers. This will also help to improve loyalty programs, and will ultimately benefit their brand recognition.

Material gains

The desirable fabrics of Dutch company Vlisco Group have been at the heart of West Africa's fashion trade since 1846. The customer-centric company is now using brand identity to accelerate its growth

"What surprised me most when I first started working for Vlisco," says CEO Hans Ouwendijk, "was that the African consumers really feel like they own our brand, not the other way around." It's something of a paradox that one of Africa's biggest cloth companies is based in a small town in the Netherlands. Founded in 1846 in the old textile town of Helmond in North Brabant, Vlisco originally sold hand-printed fabrics along the Dutch East India Company's trade routes. These fabrics, which used European industrial know-how to speed up labor-intensive Indonesian wax batik processes, were bartered during stopovers in western Africa and became highly sought after.

Over the years, Vlisco's compelling mix of Far Eastern inspiration, European adaptation to African demand for bolder colors and patterns, and high-quality 'Dutch wax' fabric helped it become a central part of commerce and culture in West and Central Africa. Designs acquired different names and symbolic meanings in different countries. In Togo the market women who sold Dutch wax were known locally as 'Mama Benz' because they became wealthy enough to own the first Mercedes-Benz cars there – and became influential politically and socially.

"African consumers really feel like they own our brand"

Fast-forward to the present day, and the continued popularity of fabric that is turned into made-to-measure, bespoke garments by local tailors in Africa – where 95% of Vlisco Group's sales are generated – has helped the company flourish. In 2013, turnover reached a record US$378.4m, a 61% increase on 2009's sales of US$234.2m. Volumes are up too, from 52.4m yards of fabric in 2009 to 65.7m in 2012.

"We are growing fast in our markets because we are listening to consumers," says Ouwendijk, who has radically changed the company's strategy since arriving in 2010, when it was acquired by London-based private equity company Actis. "That is not a unique strategy, but we are one of the few companies doing this specifically for Africa."

Ouwendijk joined Vlisco Group from Fashion Fund One BV, a private equity firm he founded in 2006. Under his leadership, Vlisco has repositioned itself as a brand-driven fashion company, helping it counter cheap counterfeits that threatened profits. "The company I inherited was very focused around design and manufacturing," he says. "Now we focus more on the consumer: on marketing, brand development, innovations and customer loyalty. Being close to our consumer is critical."

The company owns four distinct brands. Vlisco is the luxury, aspirational brand, still produced in the Netherlands. Uniwax and GTP, which are made in Ivory Coast and Ghana respectively, target the growing middle-class. Woodin, the firm's smallest and fastest-growing product, is made in Ghana and targeted at younger, pan-African consumers.

All four brands offer fabrics for consumers to create their own clothes, which accounts for most of the group's sales. Top-of-the-line Vlisco also produces scarves and luxury handbags, while Woodin's ready-to-wear range includes men's shirts and ladieswear.

The fact that one of the most successful fashion brands in Africa is a fabric maker is driven by cost – it's much cheaper to have the fabric tailored in Africa – and customer taste. Rather than signifying their allegiance to a trend or community, the consumer wants to stand out with their own designs.

Sales channels play their part too. With traditional bricks and mortar retail still under-developed, most of the company's fabrics are sold via wholesalers and open air markets. Vlisco Group has 30 stores of its own and may double or triple that network in the next four or five years.

E-commerce is less developed than bricks and mortar. "Because of logistical limitations, African consumers are not ordering so much from the web yet," says Ouwendijk. "That is likely to change in the next few years. We believe there will be a massive opportunity for online sales in Africa when the logistical challenges are resolved."

Having a product for every price point is key to success. "Each brand serves a different consumer. This is an ideal position: multiple brands in different parts of this fast-growing consumer brand. For Uniwax and Woodin, we produce about 400 or 500 designs for each brand every year. We bring new designs to market in a few months," Ouwendijk says.

Customer tastes vary as widely in Africa as in Europe. Ghanaian consumers, for instance, like traditional green hues. Certain designs are popular in particular regions, often influenced by local sayings or landmark events. In Togo the Love Bomb (or Wounded Heart) design symbolizes the mood of a woman heart-broken by her husband's adultery. Vlisco's customer focus helps it understand such

Many African consumers prefer to buy fabric and have it tailored to their design, despite the availability of ready-to-wear garments

Case study

Vlisco Group CEO Hans Ouwendijk

FACT FILE
Name Vlisco Group
Founded 1846
HQ Helmond, The Netherlands
CEO Hans Ouwendijk
Website www.vlisco.com

nuances and react accordingly.

"We get a lot of feedback from our wholesale customers and our stores in West Africa," says Ouwendijk. "We also spend a lot of time and money on research: looking at trends in the market, what is happening to particular consumers – different cultural groups, for example – and the key decision-making points for individual consumers."

Vlisco Group is sourcing more of its raw materials in Africa: in 2010, all cotton was sourced in the Far East. Now, more than 30% is grown in the continent. "We are becoming more relevant in the societies where we operate," says Ouwendijk. "That really helps in a continent where governments are looking at the added value of businesses that enter the market, or who are looking to expand."

With seven of the world's 10 fastest-growing economies in Africa, Vlisco has cause to be confident about the future. "Consumer spending is moving more into products like fashion," says Ouwendijk. "The continent's economy is growing and our product offering is in the right spot to accelerate growth."

Vlisco's recent internal research indicates that the fabric segment will grow by 100% in the next five years. "I was expecting lower growth of sales and more focus on ready-to-wear," Ouwendijk admits. "In certain countries, consumers prefer to have ready-to-wear in African prints because they don't have time to go to the tailor or prefer the creativity of the company, but our growth will remain in our core products – our fabrics – for now."

Technology is bringing the brands closer to the people who wear them. "New forms of media are crucial for us," says Ouwendijk. "The number of Facebook subscribers to our brand pages are far beyond our expectations: we have more than a million 'fans'. This is building consumer loyalty."

For other brands and retailers contemplating Africa's market, Vlisco's story shows the need to be realistic about timescales – and that success starts with a lot of listening.

INTO AFRICA? KNOW YOUR BUSINESS

Wole Obayomi
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Africa is different
Dramatic headline figures about the continent's growing middle class don't tell the whole story. There is no guarantee that their consumer behavior will replicate what happened in other markets where the size of the middle class reached critical mass.

Know the infrastructure
Unreliable power grids and a dearth of consumer data can make doing business in Africa a challenge. One of the most attractive markets is Rwanda. Good transport systems, a government drive to win foreign investment – and the use of English as a business language – have helped its economy grow 8% a year.

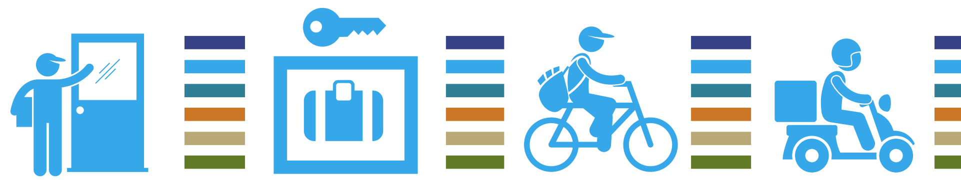
Choose your markets
New entrants may want to minimize risk and start small. With a population of 2.2m, Gabon has a high GDP per capita (US$14,500) and a retail sector growing by 13% a year. For some brands, size is king. Nigeria's consumer market is estimated to be worth US$400bn.

Listen to the customers
African consumers are much studied but little understood. Local knowledge is essential to avoid seeing them through the lens of Western consumer behavior.

Remember the opportunity
Africa will enjoy a demographic dividend (70% of the population in sub-Saharan Africa is under 30). With urbanization making a growing number of the continent's affluent consumers easier to reach, brands may want to start their learning curve soon.

GOING THE

Retailers are increasingly embracing the omnichannel model, but balancing customer service and the bottom line is far from easy



UK retail chain Argos had some creative thinking to do in 2012, as its traditional catalog-based sales model met growing pressure from new technology. Fast-forward to 2014, and the retailer has reinvented itself around a potent mix of online and digital stores, offering a glimpse into the future of omnichannel retail.

At its new digital stores, customers can pick up items ordered online – either with Argos itself or, in some cases, via partner eBay – or place orders for home delivery. This mixture of traditional retailing (even the catalog has survived) with new channels has led to a recovery in both profits and sales, and appears to have positioned the chain for future growth, after the business had initially been slow to embrace e-commerce.

Changing channels

As online and mobile become more established as sales channels, new pure-play e-tailers such as global giants Amazon and eBay, Flipkart in India, and Zalora in Thailand, are putting pressure on traditional retail operations to compete for customers. Cost is no longer the biggest driver. "The main driver for omnichannel is service," says Mike Bernon, Senior Lecturer in Supply Chain Management at Cranfield School of Management. "Customers now expect to have a variety of ways of buying products, either going to a store, buying it on a mobile or on a laptop, and we now expect to have everything on every system at the lowest price, and on the same day."

Increasingly, too, customers are mixing and matching their use of various channels to research products and services before committing to a purchase, and then picking a delivery option which best suits their needs at that time. "Sometimes they want to pick it up in the store, sometimes they want it delivered to their home, and it needs to feel like the same company doing both," warns **Jeanne Johnson**, a Principal at KPMG in the US.

"There's more variability in what consumers want, whereas a lot of the fulfillment properties have previously been geared towards a more prescriptive path which they hoped consumers would go through. Customers are not following a standard workflow." This means organizations have to rethink their distribution and fulfillment models, she adds, with a greater emphasis on flexibility and multiple options.

The growth in online grocery orders has forced retailers to adapt their distribution strategies. Dr Roel Gevaers, a researcher in transport economics at the University of Antwerp, gives the example of UK retailer Tesco, which initially introduced a model where local stores would pick items for online delivery and then distribute it locally. Now the company is opening so-called 'dark' stores, which are set up in the same way as conventional stores but only serve online orders. Other UK retailers, such as Sainsbury's and Waitrose, are exploring the model.

Online-only retailers – such as Peapod, the US grocer that launched an app so users can shop from virtual stores at rail stations and schedule deliveries at their convenience – have had the luxury of building their systems around internet orders, focusing on item picking rather than pallets, and making more efficient use of technology.

"These distribution centers are much more automated and have a different set-up to the old-fashioned distribution centers, even for books or DVDs," he says. "In traditional distribution centers everything is stacked on pallets; but in an e-commerce warehouse, it's all placed in plastic booths or in cases that are easy to pick." While in the longer-term such bespoke facilities will aid efficiency and lead to cost savings, they do require a larger upfront investment from retailers.

As the online market continues to grow, however, more retailers – and manufacturers – will start to see the business case for investing in dedicated online-only distribution, says Bernon. "It's quite easy to put in fulfillment centers

"Customers are not following a standard workflow. This means organizations have to rethink their distribution and fulfillment models"

DISTANCE

that are dedicated to home delivery," he says.

"It's more difficult where you have assets in place, because often you're taking volume away from your stores yet you can't lay down a whole new network because you don't have the volumes for home delivery. A lot of companies are stuck in the middle. But we may now be getting to a stage – certainly in grocery retail – where businesses can realistically start thinking about having dedicated facilities for home delivery."

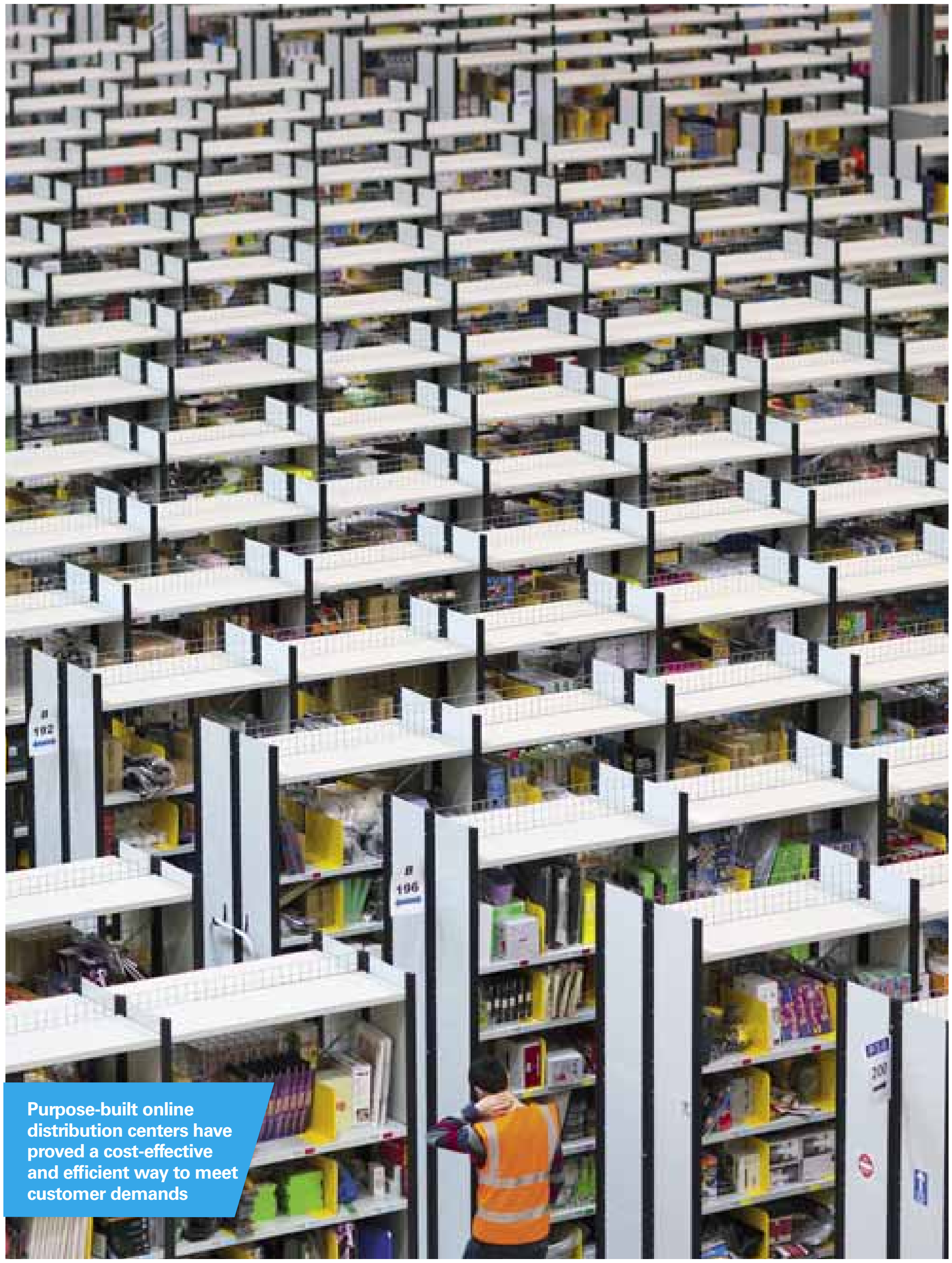
Dynamic relationships are key

Retailers are also adapting their stores' formats to reflect new customer buying patterns, says Gevaers, increasingly viewing them as places where customers can touch and feel a product and place orders, which can then be delivered the same day or the following one. "It means you can have a limited assortment in your shop because you can just ship products from your distribution center outside the city," he says.

"Storage – and in most cases, labor – will be cheaper in these locations: people in shops are more expensive to employ than those in warehouses." At the same time, pure-play online retailers are also developing "experience" shops, says Gevaers, where customers can test products ahead of placing an order.

Some retailers are breaking down the delivery rationale at an individual product level too, says Bernon, offering online delivery on certain items and not others. "A number of home furnishing companies will now offer home delivery on their big-ticket items, and they won't actually have those in the stores," he says. "That allows them to increase their range to customers. You've got to segment your products in a different way."

All this requires much closer working relationships with suppliers around both new opportunities but also managing risk, with the ability to react to situations as they emerge, says Johnson. "The trend for the last 10 years



Purpose-built online distribution centers have proved a cost-effective and efficient way to meet customer demands

has been around cost optimization where you have strong contracting and pricing management. Now you really need to have dynamic relationships, the ability to act with some degree of flexibility, and to have a supply chain that is truly resilient," she says.

"We're seeing different collaborations, both on the cost and efficiency side and on the risk and mitigation side, to provide more transparency up and down the supply chain," Johnson adds. "There's a lot more focus on anticipating disruptions in the supply chain, either externally driven or internally with the supplier. Those in relationships with suppliers that are willing to be transparent will have the competitive edge in the future." Retailers also need to make sure they retain sufficient control over their own operations to allow them to maintain the flexibility to react to unforeseen events, she adds.

The last mile is the hardest

Arguably the most challenging aspect of e-commerce, which has plagued retailers since the early days of the dotcom boom, has been that of the 'last mile': delivering items to consumers. People being out remains an issue, says Bernon, even when drivers call ahead to confirm appointments. "There are ways of improving it, but the proportion of times you cannot deliver is quite high," he says. "If it's a parcel delivery by a third party then often companies will drop it next door or find someone who can take it. For larger-ticket items that need to be signed-for, it's still a significant problem."

Here, too, the market is moving away from just cost, and home delivery is increasingly being seen as a point of differentiation, suggests Prithu Srivastava, Strategy Director, South and South-East Asia, at DHL Supply Chain. "A faster delivery time leads to better consumer satisfaction and more repeat purchases, which then drives the demand from customers to what we call this near-instant gratification model," he says.

"This puts huge pressure on supply chains, but cost is not paramount anymore. With any online shopping model, your business won't make money from a customer until they have bought from you around five times. It's no longer just about offering the cheapest and most efficient solution – but the fastest and most differentiated one." As a result some operators are now using branded trucks and ensuring delivery staff wear a company uniform, he adds.

> **"With any online shopping model, your business won't make money from a customer until they have bought from you around five times"**

Other countries have failed to embrace home delivery, says Gevaers, with Germany, Belgium and the Netherlands mainly using parcel deliveries through courier networks. In France, major retailers such as Auchan and E Leclerc rely on 'le drive', where customers can pick up goods from petrol stations or separate company 'drive-through' outlets at a specific time. This model is also developing in Germany and the UK, adds Srivastava, where goods are delivered to secure pick-up lockers in railway stations and convenience stores.

In Asia, meanwhile, higher populations in city centers, as well as congestion and pollution concerns, are driving initiatives to set up hub centers located out of town. In the future, retailers and manufacturers could be obliged by local regulations to drop off customer orders at these hubs. "It's designed to combine volumes and take the pressure off the road infrastructure," says Srivastava. "There are pilot projects happening in Singapore, Japan and China."

In some areas, there is a growing move towards expecting manufacturers to deliver items direct to consumers, in some cases bypassing retailers altogether. "We're seeing that happen even in more traditional supply chains," says Bernon. "Moving towards direct delivery will change the relationship between retailers and suppliers, and it will certainly change the cost structure as well." He gives the example of Amazon, which now offers more than 15 million products but operates a model where suppliers deliver directly to end-customers. "It's early days but you would expect more direct deliveries from manufacturers, rather than retailers stocking everything," he predicts.

There are pros and cons to this approach, says Srivastava. It can mean retailers avoid holding large amounts of stock they may be unable to store or sell, but also that they lose a degree of control over the end product. "Many retailers like the inventory to go through them because they can package the inventory in their branding," he says. "It's a mixed model."

Currently, though, many manufacturers are no better set up to handle such deliveries than retailers. "They are not equipped to do item picking," says Gevaers. "All the manufacturers produce enormous amounts of goods – in groceries they produce several thousand items per hour – and they ship full pallets or trucks. The majority are not suitable for shipping products straight to the consumer."

Should they be able to overcome this, however, it also raises the prospect of manufacturers themselves selling online direct to customers. "There is a very big window of opportunity for the existing manufacturers and brand owners to go online, and we will see either existing incumbents or a new range of companies launching or manufacturing product portfolios which allow for last-minute customizations," says Gevaers.

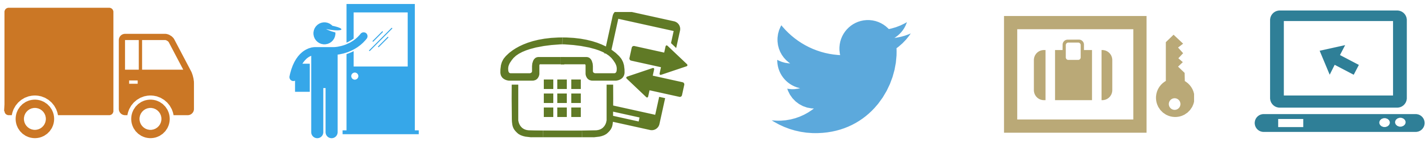
He gives the example of Levi's in the US, which allows customers to select their own body shape or preferences so jeans can be tailored to fit. "Adoption of the postponement of a mass product from the manufacturing side is still not there because of a lack of competition. But that trend will happen," he adds. Manufacturers who have a strong brand and a history of selling direct to customers in the physical world – such as Apple – will find this kind of transformation easier than those that have traditionally sold through either retail networks or franchise operations, he adds.

Reverse gear

One trend with which retailers are increasingly expected to grapple is that of reverse logistics, or customer returns of online orders. "Customers have hectic lifestyles, and returns can be a hassle," says Johnson. "They won't want to fill out lots of forms, or be restricted to a single return method. They want the flexibility to return items in-store or by mail, whichever best fits with their daily routines."

The ease of online ordering means the cost of returns from home delivery is more significant than it is from stores, says Bernon. "In some categories you might be doubling the returns level through a home delivery service. If you go to a store and look at a product then you'll be less likely to return it than if you have the ability to perhaps buy five items, send back four and keep one." Up to a third of online items can come back, he says, and the cost is around two-and-a-half times that of sending it out in the first place.

Most companies are now setting up reverse networks operated by third-party logistics firms, he says, and although they will usually be able



30% Up to 30% of delivery costs are incurred in the 'last mile' between supplier and customer

5% of online shoppers in Germany who bought five items or more in a five-year period returned 80% of them

54% of Indonesians shop on their smartphone, the highest ratio in Asia

15% of retailers with Facebook apps enabled users to browse products

1bn parcels online fashion giant Zalando UK will deliver to its pick-up points in 2014

3.3% of US groceries are bought online, generating US$16.5bn in revenue

to claim their own refund from manufacturers due to sale-or-return clauses in contracts, the additional costs of managing all this are significant. "Some companies are now saying they won't send it back if it's a low-ticket item," says Bernon. "One company, where 40% of returns were under £15 (US$25), were sending them all back to their manufacturers and suppliers to get a credit, and the cost of that was over £100 (US$167). So they decided they wouldn't send them back but they would still expect the credit."

Retailers could control the volume of returns they receive, but, points out Srivastava, they increasingly feel they need to offer this to customers. "Consumers are getting into the habit of ordering three different sizes online because they have a very convenient and safe solution to return the two they don't like. But if this option didn't exist, no consumer would think of doing that," he says. "That behavior has been partly encouraged by the retailers."

He also cites the example of a retailer that gave customers a cheaper option that did not allow returns, which did not prove popular. "People were not buying more from them because they were cheap," he says. "They do value those options."

Collaboration and convergence

The convergence of online and offline retail is only likely to continue, and as retailers move towards an omnichannel model, partnerships with suppliers and even other retailers will be particularly important. Those organizations that move early, pick the right partners, and collaborate well, will be the ones that ultimately succeed, believes Johnson.

"We're likely to see a blending of functions because people are going to share real estate, optimize shelf space, and optimize virtual real estate and apps," she says. "Customer preferences are going to shape how this will work, but this will be both an opportunity and a challenge. Some interesting collaborations will be required to make it work."

7 TIPS FOR AN OMNICHANNEL ENVIRONMENT

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1 Put customer service to the forefront

Customers now expect to be able to get the same experience online and through stores, and to switch seamlessly between them. Offering the ability to order items for home delivery in stores and to pick up online orders from a branch will be an important way for retailers to differentiate themselves. But it's important customers receive consistent information and service, regardless of which channel they use.

2 Find the best fulfillment strategy

For some retailers this will be direct from stores, but those with significant volumes may be able to look at a dedicated online delivery channel. This can require extensive investment in new warehouse operations, production lines and supply chain logistics, so retailers will need to be sure of the business case before committing to this.

3 Consider shipping direct from suppliers

There are cost advantages to this but you lose the ability to customize products and a degree of quality control. Retailers will need to identify how important it is to be able to tailor items to individual orders and the potential for suppliers to send out sub-standard products. Building long-term collaborative supplier relationships based on mutual trust as well as effective pricing is essential for this kind of initiative.

4 Explore partnerships

Working closely with third-party logistics providers, suppliers and non-competing retailers or other businesses could help improve your service to customers by offering a wider range of products that are accessible in more locations and shorter timeframes. But the ability to react to events is essential, and you need to retain control of your own destiny and avoid being overly dependent on any third party.

5 Identify the best delivery route

Many customers will expect delivery to their home or a place of work, but secure locations in city centers are also growing in popularity. Offering customers a range of options is important, and you'll also need to consider how you would cope with people being out. For some items and customers, leaving it with a neighbor or designated address or storage point will be acceptable, but for more expensive orders this is unlikely to prove practical. Ask customers what they would like, and what degree of risk they are prepared to accept.

6 Re-evaluate the role of the store

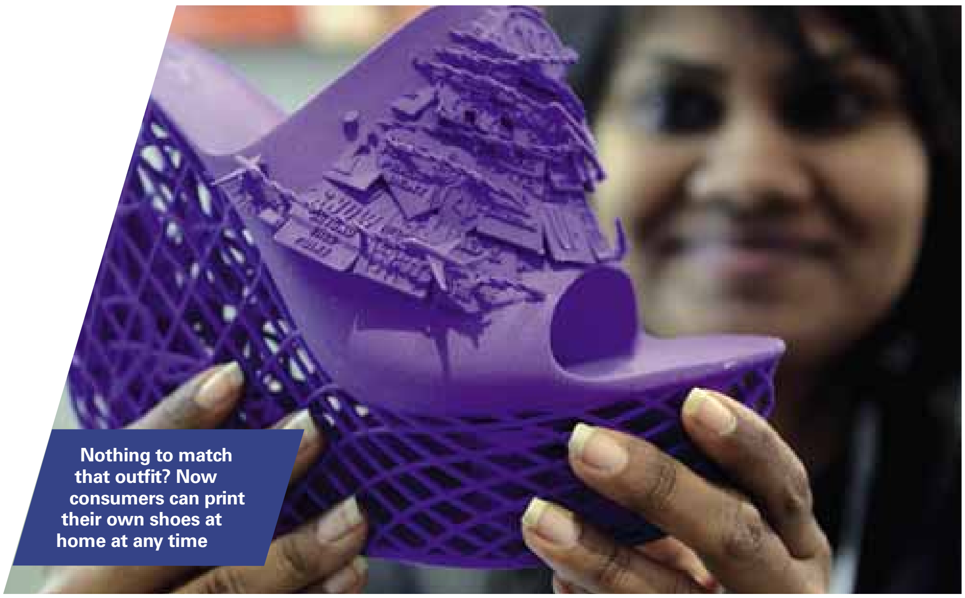
Do customer buying habits mean you're holding excess stock? Could you make better use of space by focusing on the customer experience and delivering items direct to customers? Encouraging online orders and offering home delivery on in-store purchases could allow you to ship products from out-of-town locations, freeing up space in retail stores to showcase more products or enabling retailers to downsize their real estate.

7 Should you offer multiple returns?

This can add considerably to the costs but is increasingly expected by customers. Retailers that handle their own final-mile logistics may be better placed to do this than those that rely on a third party. Negotiating with suppliers around refunds and the practicalities of returning damaged items can help to make this more feasible.

3D
BELIEVE THE HYPE

The advent of 3D printing could revolutionize the relationship between retailers and manufacturers – and consumers. Is your company ready for the opportunity, and the threat?



Nothing to match that outfit? Now consumers can print their own shoes at home at any time

By the end of 2013, Juniper Research says, the number of consumer-owned 3D printers reached more than 25,000 globally. This year sales are set to top the 44,000 mark. Such figures suggest the '3D revolution' is behind schedule, due to a failure to develop "killer applications with the right eco-system of software, apps and materials".

That's about to change. The company also forecasts that global sales of consumer-owned 3D printers will exceed one million a year by 2018, due to the "ever widening scope of applicability, driven by the entry and growth of more established printing vendors such as HP", falling prices and cutting-edge innovations. Due on the market this year at less than US$200, for example, the Mink allows users to print a bespoke range of eye shadows, lip glosses and blushers from any color they can capture digitally. After 2020, some studies suggest, more than half of households in the US and Western Europe will have a 3D printer.

This rapidly developing technology offers retailers the chance to engage with interested consumers in new, intriguing and hard-to-foresee ways. "The novelty here," says **Jerry Dimos**, Management Consultant at KPMG in Singapore, "is that consumers are allowed to participate in the creation of the product and can obtain it quickly without waiting for it to be shipped from the warehouse."

Some retailers are already exploring the possibilities. Office supplies company Staples has trialed this technology in Europe and now has 3D "printer experience" stores in New York and Los Angeles. In Japan, startup Fotofig has brought a new dimension to the selfie by enabling customers to create mini-figurines of themselves, family and friends.

In June last year, Paul Wilkinson, lead research specialist in Tesco's IT R&D team, led a fact-finding mission to Silicon Valley to explore how the retailer could use 3D printers.

"We already print photos and posters in many of our larger stores, so why not other gifts and personalized items?" Wilkinson wrote in a blog. "How about letting kids design their own toys and then actually being able to get them made? What if we had a digital catalogue of spare parts for items you'd bought? They could be printed on demand and ready for you by the time you'd finished shopping. You could even take a broken item into a store, where we could scan it in 3D, repair it digitally and make you a new one. This technology could revolutionize the way we view stores and what we can get from them."

Some grocery suppliers are experimenting with the technology. Italian food business Barilla is collaborating with Dutch company TNO to develop a 3D pasta printer. One potential application is cartridges containing pasta dough that can be inserted into a 3D printer to print customers' own pasta designs.

In the US, confectionery giant Hershey has teamed up with 3D printing press manufacturer 3D Systems "to explore and develop innovative opportunities for using 3D printing technology in creating edible foods, including confectionery treats".

Cathy Barnes, professor of retail innovation at Leeds Metropolitan University, sees enormous potential for 3D print for the food industry, particularly in personalization or customization, where vendors could charge a premium for their services.

"Gifting is the example that comes to mind," says Barnes. "Not too far in the future we might see additions being personalized, such as greetings and

KEY QUESTIONS

Four things FMCG bosses need to ask themselves about 3D printing

1. **What products in your current portfolio** could feasibly be 3D printed, either by retailers in store or by consumers in the home? And what products that you don't currently have, could you use 3D technology to create?

2. **Why would it be better** for you/ consumers to 3D print these products than have them manufactured in the current way? What is the driver for your business: cost, proximity to market, customer convenience, or redesigning your supply chain?

3. **If 3D printing a product** from scratch doesn't suit your business model, could you use 3D technology to embellish or customize conventionally made products for gifting?

4. **In a world where consumers can print 3D** files at home, how do you protect your intellectual property?

3D Printing

7 of top 50 multi-national retailers expected to sell 3D printers by 2015

2018 Year when sales of 3D printers for home use is predicted to top a million

US$ 10bn The potential value of 3D printed toys

US$ 125,000 The grant that NASA has awarded to contractor Systems & Materials Research to develop a pizza printer

US$ 4,783 Price of a printer from UK company Choc Edge that can create 3D chocolate illustrations.

messages printed in relief. We could also imagine a 3D-printed chocolate bar based on the drawings of a child."

Dimos sees instant snacking as another potentially useful application. "3D printing has the scope to bring instant snacks into the living room, like the Nespresso machine did for café-quality coffee in the home," he says. "Consider a large Pez dispenser that can produce a range of goodies on demand."

The opportunities seem even more promising in toy manufacturing. One of the major players is exploring how it can use 3D print to create its character toys. Lego has been awarded a patent for the 3D printing of plastic on its block bases and Mads Nipper, the company's chief marketing officer, has even said it might enable users to print their own plastic bricks. Toy manufacturer Hasbro is also working with 3D Systems to develop "creative play experiences powered by 3D printing".

Some fashion houses have been early adopters of 3D technology, with designers creating printed items from lingerie to footwear. Most of this has been done to showcase what can be achieved by haute-couture designers (as opposed to mass-produced commercial products), but Brooklyn-based designer Francis Bitonti recently unveiled a dress that can be customized for the wearer and 3D-printed at home.

Earlier this year Finnish designer Janne Kyttanen showcased a project called Lost Luggage, which enabled travelers to email 3D printable files of necessities or accessories – a handbag, a dress, driving gloves, sunglasses – that could be printed out at their destination.

Elite Robotics in China has a booth where it scans customers and uses a Makerbot to print 3D models

"The key question companies need to address," says Barnes, "is what is the 3D printed product and why is it necessary or better for it to be manufactured in this way?" The technology is ideal for creating bespoke or intricate objects, but, for example, it is usually going to be easier and cheaper for someone who's lost their luggage to find a clothing retailer than a 3D printer that can print clothes.

Retailers and brands must weigh the risk of counterfeiting and copyright abuse. Selling 3D printable files for confectionery, toys or items of clothing for printing at home may open up lucrative new revenue streams, but how do companies ensure that consumers only print a product once? They will also be keen to avoid the kind of piracy that afflicted the music industry and prevent consumers from sharing designs with family and friends. Given the advances in 3D scanning, how can firms stop people creating exact replicas of their brands on 3D printers at home?

If products and parts can be delivered or sold outside current channels, suppliers and retailers need to consider the unpredictable impact on their distribution strategy. "Ultimately the issues around profit protection will accelerate or restrict the speed of adoption," says Dimos. "Retailers need to consider how to sell the idea of 3D printing to their consumers in such a way that it will not cannibalize their existing business model."

There are many significant hurdles still to be overcome, but 3D print experts such as Terry Wohlers, of research firm Wohlers Associates, believe that retailers and brands will find a way around them to create a global market worth around US$10.8bn by 2021.

"Consumer 3D printing is still a nascent technology," says Dimos, "but we see no reason why 3D printing could not become a mass market product in 5-10 years' time. As technology progresses, 3D printing will offer more features at a lower price. It will reach a point where everyone thinks they can have one at home, just like 2D printers."

Barnes agrees, noting that when additive technologies – of which 3D printing is one – were lauded as game changers ten years ago, many experts derided such bullish predictions. "Yet today these technologies are mainstream and make all sorts of components from automotive parts to medical devices. Although it will take a while to catch on in retail, where margins are slimmer and the consumer is king, it will happen."

"It took 20 years to go from Sony Walkman to Apple iPhone," adds Dimos. "People will utilize this new capability in ways that are difficult for us to imagine now."

Lessons from other industries

Video game theory

Customer loyalty isn't what it used to be. Could the dynamics of games like Super Mario Bros. help retailers and brands rectify that?

The power of reward: what business can learn from Mario

Super Mario Bros. is a bizarre tale. A portly Italian plumber must defeat the army of a turtle-like creature to save a trapped princess. As our hero becomes more adept, he is rewarded with the power to break bricks, fly and shoot out fireballs. Yet this video game has such resonance, it has sold more than 40m copies and can teach retailers and brands something about customer loyalty.

Creating loyalty strategies based on game techniques is known as 'gamification'. In the words of Rajat Paharia, founder and chief product officer of Bunchball, which has pioneered its use, it draws on techniques designers use to change player behavior – points, rewards and leaderboards – to help brands and retailers connect with consumers.

This approach could help brands and retailers worried by shrinking customer loyalty. In August 2013, marketing agency Havas Media asked 134,000 people in 23 countries to rate 700 brands. Most of those surveyed would have been happy for 73% of the brands to vanish. Millennial consumers, who now account for US$1.3trn of global consumer spend, are not swayed by brands. One thing we do know about millennials is that most of them grew up playing video games – on consoles, hand-held devices or online – as the internet developed and that partly explains the current fascination with gamification.

Paharia is bullish about this new strategy's potential. "Companies started out trying to maintain customer loyalty with complex discount schemes – buy 10 get one free! These are transaction-based, focused on customers and don't generate the kind of loyalty businesses want. Then we tried one-to-one marketing, targeting loyalty through segmentation and personalization and direct mail and email. Open rates on these communications soon plummeted: customers were overwhelmed by the noise. The major enabling components in this new approach are: motivation (we're reacting to what consistently and honestly drives human behavior), big data (especially data from interaction with customers) and a competitive experience that offers autonomy, control, the chance to master a skill, a meaningful objective, instant feedback, and interaction with/ membership of a community."

Sometimes, gamification can be almost as simple as creating a game. When Japanese soft drink giant Pocari Sweat launched an electrolyte drink in Indonesia, it created an online game called Ionopolis in which 94,000 players signed up to combat comic book monsters out to dehydrate a city. Competitors posted updates on social media, checked in to FourSquare locations to perform tasks, and were rewarded for buying drinks with in-game benefits such as codes to check hydration meters.

Apparel chain Urban Outfitters built gamification into its app, which asks users to upload a photo, fill in a few personal details and customize their display background. The app gives points to users mentioning the brand on Twitter or Instagram and rewards them with such perks as advance warning of sales and early access to merchandise and concert tickets. Some photos have generated more than 50,000 likes.

Alwin Magimay, Head of Digital and Analytics at KPMG in the UK, says: "Gamification can create an emotional connection with a brand or service and can provide businesses with a way to create new value – improving customer service, for example. One of our large retail clients needed to train staff at different stores to do things in a consistent way. In this case, staff in the fish department had to arrange fish in a particular way, but there was no uniformity from store to store. Staff were trained, but the execution was ineffective. They used a game where staff could photograph their finished layout, upload it, and colleagues from other stores could comment and score their work. Using this game, they quickly achieved around 80% consistency in the way fish were displayed."

Paharia believes most businesses could benefit from gamification but success is not all about gimmicks and techniques. "The questions you have to ask are: What is this campaign? What am I trying to get people to do? And why are people engaged with it? If your offering has no core intrinsic value, gamification won't make any difference."

By value, Paharia means community; a compelling story (as odd as Super Mario Bros. sounds, the quest at its core is simple); reward (real or virtual) and engagement through real-time feedback (like Mario collecting his coins). Magimay says: "There's a big opportunity for companies to take advantage of gamification, but there's not enough imagination being put into how businesses can leverage it to drive economic value."

KEY LEARNINGS

1. The power of games
Some brands and retailers are using gamification to build customer loyalty. What's keeping customers loyal to you?

2. Craft compelling content
No matter how much you invest in gamification, you need to be sure you offer something that excites customers. If they don't understand the benefit to them, they won't play.

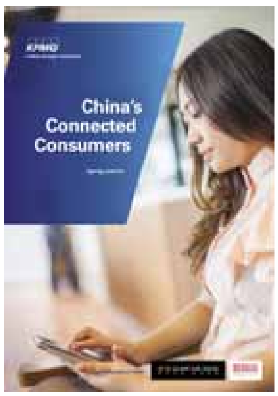
3. It's not just about customers
The same drivers can be used to change your staff's behavior and, in many cases, improve the way you serve the customer.

Insights

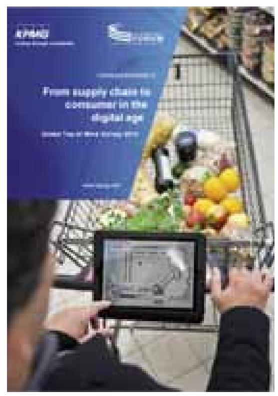
KPMG member firms provide a wide range of studies, analyses and insights for the Retail and Food, Drink and Consumer Goods (FDCG) industries. For more information, please visit **www.kpmg.com/retail** or **www.kpmg.com/FDCG**.

Other publications

Global Manufacturing Outlook 2014
reveals how consumer goods and other manufacturers plan to invest in data, collaboration and technology to drive growth, innovation and cost savings.



China's Connected Consumers
analyzes responses from 10,200 luxury consumers in China regarding their online spending patterns.



From supply chain to consumer in the digital age
This year's *Global Top of Mind Survey* of consumer executives looks at their top priorities in the areas of growth, technology, operations and corporate responsibility.

FOCUS on Consumer Goods
looks at some of the issues facing the Consumer Goods sector, including the impact of harmonization on innovation and tactics for beating cyber crime.

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