The Boston Consulting Group

Confederation of Indian Industry

Changing your Orbit

The Handbook for Transformation in FMCG and Retail Businesses

June 2014

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CHANGING YOUR ORBIT

The Handbook for Transformation in FMCG and Retail Businesses

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June 2014 | The Boston Consulting Group

CONTEXT

FOREWORD

The FMCG and retail sectors in India have shown steady, albeit lower, growth even in the last few quarters despite a slowing economy and several other challenges. Today's business environment is characterized by rapid, extensive change and unpredictability. The combined effects of demographic shifts, globalization, hyper–connectivity and feedback through social media are posing many external challenges to companies. In addition, we see that companies are often hampered by internal complexity that makes change difficult.

Corporate transformation—the end–to–end reinvention of a business—has often been seen as a last–ditch effort undertaken by companies that have failed in the market place. But that does not hold true in today's environment. It is important for companies to start transforming themselves before they are forced to do so by external challenges. But too many companies, especially those with a sustained track record of success, fail to transform themselves till it is too late. Flat sales, rising costs, disgruntled customers, demotivated employees as well as increasing and new competition are typical late signals that a company needs fundamental change. Yet, it is only after the business comes under severe pressure that they wake up to the need for this change.

This report highlights how an integrated top–down effort to drive successful transformation can be undertaken in the FMCG and retail industries. The report defines several drivers that companies must take into account, as they set themselves up for a journey of reinvention and relevance in an ever changing market place.

We would like to take this opportunity to thank The Boston Consulting Group (BCG) for sharing their latest and best insights on the subject of large scale transformations through this report. We look forward to your continued cooperation and support as we work together toward accelerated performance in both sectors.

We hope you find this report interesting and informative for your businesses.

Kurush Grant

Chairman, CII National Committee on FMCG 2014–15 and
Executive Director, FMCG Businesses, ITC Limited

Suresh J

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Managing Director & CEO, Arvind Lifestyle Brands Limited

EXECUTIVE SUMMARY

Transformation Imperative

The business environment in India is getting more challenging and complex. For all companies, adapting to this rapidly changing situation is imperative. It is hence critical for the senior leadership to drive a large scale transformation agenda to make true impact happen.

- The market is extremely dynamic with changing demographics and changing consumer behaviour along with new technologies and competitors to deal with. Challenges observed in company performance, market share and shareholder returns are clear calls for transformation.
- In BCG experience, there are two broad phases that a company experiences during a transformation journey. In the first phase, initiatives are undertaken quickly to generate sales and release cash to fund the core transformation agenda. In the second phase, companies actively seek measures for truly differentiating themselves and building organizational capabilities to gain competitive advantage.
- Senior leadership commitment towards driving such a large and integrated change effort is critical. While many companies attempt such a transformation effort, our experience suggests that more than 2/3rd of all such efforts turn out to be unsuccessful in meeting the original targets. This is mainly due to the lack of a full senior leadership commitment to the change agenda and not taking an objective, outside–in view as the primary driver for change.

A typical transformation journey is examined through four lenses:

- **Fund the journey**—generate quickly cash from their existing operations to support investments required to pursue their medium term goals. Typical methods are to relook at the core pricing and trade spending models, driving supply chain performance and cost / sourcing improvement programs with an end–to–end view of the business.
- **Win the medium term—**identify the truly winning consumer proposition for the next 6–8 years and align the operating model to this mission. This requires a complete assessment of the categories and formats to play in and designing the go–to–market and backend operations to consistently deliver consumer promise.
- **Take measured bets—**look for the 2–3 emerging but important trends that will be critical to the business in the future. Investing in some of these trends will ensure a strong market standing when the true commercial potential plays out.
- **Enable the transformation—**invest in people and technology to improve efficiency, productivity and improve morale.

A transformation journey is a long and challenging one—it requires senior management and shareholder commitment, a strategic orientation to define the future goal posts and executional resilience and rigor to achieve milestones.

EXECUTIVE SUMMARY

Business Transformation for FMCG

The FMCG space in India comes with a rich mix of opportunities and challenges. Our experience suggests that undertaking a holistic transformation effort can have a significant impact on the performance trajectory of any company.

Companies need to examine three levers for fund the journey…

- **Pricing strategy and trade spend rationalization—** Indian consumers are value sensitive however also show high propensity to trading up. Tapping the true potential of 'right price' can deliver significant commercial impact while driving the right perception with consumers. Similarly, deploying trade spend dollars with the most effective channel(s) and within the channel with the winning partner(s) can be very rewarding.
- **End–to–end supply chain performance**—The supply chain in India is complex with many internal and external constraints. Improving service levels and stock availability is a powerful lever for topline growth. Best–in–class supply chains are demand driven and take an end–to–end view.
- **Optimal operating cost structure**—In recent years companies that manage their cost structure tightly are rewarded the most by the stock markets. With growth becoming harder to get, companies are focusing on costs to continuously improve profitability. Cost reduction efforts yield significant benefits when initiatives are cross functional in nature.

…and win in the medium term by pursuing opportunities in three areas:

- **Explore new consumer occasion and need based opportunities**—FMCG companies are shifting focus to identifying 'consumption occasions' and 'need states' of consumers in their macro–category. This allows them to devise a much more effective innovation agenda as well as re–position brands to more effectively engage with consumers.
- **Develop a sustainable 'Go–to–market' model**—The retail environment is extremely fragmented, unorganized and complex. FMCG companies make a wide set of choices on multiple parameters on their go–to–market activities based on their context and evolution. A successful distribution strategy needs to link closely with the overall brand promise, comprehensively thought through on choices to be made and enables rigour in execution.
- **Advantaged business model—**The competitiveness of every business model comes under pressure over time and needs to be regularly refreshed based on a company's core proposition along with supply side dynamics. Choices on the business model allow a fine balance to be maintained between consistently delivering the core proposition and the cost of delivery.

EXECUTIVE SUMMARY

Business Transformation in Retail

Retail experience suggests the need for an identity refresh every 6–8 years. The front end is remodelled with capital investments that need to pay back prior to the next refresh cycle, with the back end configured to deliver the new proposition consistently.

There are three effective levers for extracting cash from the current business to prepare for the identity transformation journey…

- **Retail pricing and promotion strategy**—Price perception plays a key role in deciding choice of shopping destination. The typical benchmarking driven approach does not identify the opportunities to drive both price perception and profitability. A holistic approach in which the pricing model is well synchronized with the banner proposition along with tools to handle large amounts of data can drive benefits in a short time.
- **End–to–end supply chain**—Most retailers still struggle with integrating merchandise planning and replenishment resulting in various availability and inventory led issues in stores. Taking a complete end–to–end view of the supply chain with transparent sharing of information across elements can have manifold benefits in driving sales, lower costs and reduced working capital.
- **Margin enhancement through COGS reduction**—Gross margins of Indian retailers are lower than international peers. With share of Modern Trade increasing and much improved retailer capabilities, margins are expected to gradually keep moving up. Multiple levers can be pulled to reduce COGS such as working with a wider supplier base, leveraging local scale and driving private label share and profitability.

…winning in the medium term in retail also involves examining three levers to truly establish a competitive edge:

- **Re–discover the new banner proposition**—Shopper requirements in India are changing fast, be it from a products, services or experience point of view. Successful retailers identify the need for a format refresh well in advance of seeing a decline in consumer traction and sales productivity. Building a contemporary store front end model with an economic payback rationale, testing with a pilot and then extending to the fleet is a rewarding journey.
- **Multi–channel management—**International experience shows that, consumers who shop across channels spend more than single–channel shoppers and are also more loyal to the banner. Though the multi–channel environment in India is still nascent, establishing multi–channel presence will be a large opportunity in the future due to increased access of consumer shopping missions and need gaps.
- **Advantaged business model and network**—Leading retailers opt for their winning proposition to win consumers and then orient their operating model to deliver consistently. The chosen model also defines the format and network density algorithm based on targeted consumer missions.

EXECUTIVE SUMMARY

Measured Bets and Enabling Transformation

While multiple areas of business are addressed in the transformation journey—it is equally critical to think about some trends that are important to consider today as they may define a company's competitive standing in the future. These themes are broadly consistent across FMCG and Retail:

- **Digital experience—**digital is becoming more and more influential to decision making of consumers in India. To win in the digital world, the organization has to make a long term commitment to internally resource the initiative and adopt a test–refine–scale up approach.
- **Creating brand advocacy—**conventional communication media are getting less credible as sources of recommendation. Creating strong advocacy for a brand by influencing word of mouth will be a key marketing tool for the future.
- **International markets** (**FMCG only**)—many developing markets in the world show very similar characteristics to the Indian consumer markets—large population, low penetration and an unorganized, fragmented supply side. Taking proven business models from India with customization to the local market, can be a significant value enhancer.

And finally, investing in people and technology are critical levers for successful transformation:

- **Leverage technology to drive productivity—**The use of technology in Indian industry has so far been limited to ERPs and accounting packages. The 'democratization' of technology can be large unlock to not only improve systemic productivity but also manage the increasing complexities of today's business.
- **Talent management and organization—**Companies in India face manifold challenges related to the supply and retention of talent and leaders. While there is no simple answer to this challenge, some of the issues can be addressed with a comprehensive HR and talent management strategy. The approach needs to recognize and accommodate functional / regional variations, while maintaining an enterprise–wide view.

Transformation Imperative

The business environment globally, and especially in India, is getting more complex and challenging. To adapt rapidly to changing demographics and consumer behaviour, the macro–economic environment, the rise of new technologies; and volatility of commodity markets, all companies continuously need to examine their starting positions and strategies.

Transformation is a fundamental cross functional change that (re)defines a company's core customer proposition, operating model and organizational construct. It is an integrated approach adopted by the company leadership to ensure that they remain competitive in the short and medium term.

What is Transformation? Why do Companies Need to Transform?

What is transformation?

- A transformation is a CEO-led, cross-functional, result-oriented, plan for large scale change to outperform competitors sustainably
- It requires strong engagement of senior leadership and strong involvement at all levels in the organization
- It has disproportionate impact on the core customer offer – with multiple changes made to the operating model and organizational capabilities

Why does transformation matter? – changing business environments

Changing consumers

- By 2020, the average household income in India is expected to grow nearly 3X that in 2010...
- Share of middle-class households will rise from 28% to 45%...

Increasing uncertainty of leadership position

- Average positional volatility of top global companies has almost doubled in the last three decades...

Rise of new technologies

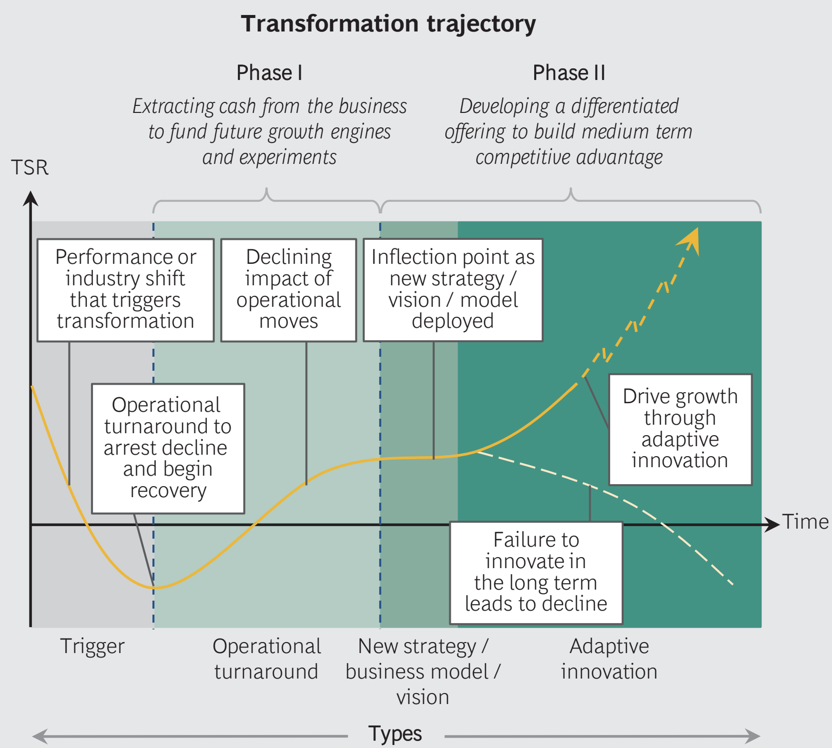
- Innovative digital technology offers customers a new product and shopping experience...
- Technology to harness the power of "big data" is becoming available...

Increasing commodity-price volatility

- Commodity prices have shown tremendous volatility after the financial crisis – For example, prices of crude oil, coffee and palm oil have varied as much as 1.5 to 2 times what they were three years ago

Source: BCG analysis.

Transformation Requires Continuous and Long–term Effort



Note: TSR–Total Shareholder Return.

Companies need to identify performance symptoms calling for transformation carefully. Stagnant sales, dropping market share, volatility in profitability, under–indexed shareholder returns and emergence of new competitors with non–traditional business models are all strong indicators.

No transformation is short—truly sustainable results require time. BCG experience suggests that there are two phases in a transformation journey:

1. In the first phase, quick and simple operational initiatives are undertaken to generate adequate sales and cash to build a war chest to fund the core transformation agenda.
2. In the second phase, companies find avenues to differentiate themselves truly and build organizational capabilities to live the new way of working.

While the true intent to transform is critical, it is even more important for the senior leadership to believe in the reasons for and mechanics of driving such a long term change initiative. Global research suggests that nearly 70 percent of all transformation efforts do not succeed in achieving the end goals set out originally.

BCG's experience with many transformation programmes across a wide variety of industries suggests that there are seven drivers of why these transformation initiatives fail across organizations.

Multiple Reasons Why Transformation Efforts Often do not Succeed !!

Extracting cash from the business to fund future growth engines and experiments

Developing a differentiated offering to build medium term competitive advantage

Phase I

Halfway stop
- Stopping with just operational efficiency improvement, rather than driving growth and long-run TSR

Phase II

Legacy trap
- Failing to shed core elements of the current business model that are no longer competitive

Insufficient moves
- Not making sufficient moves proportional to the scale and scope of the challenge

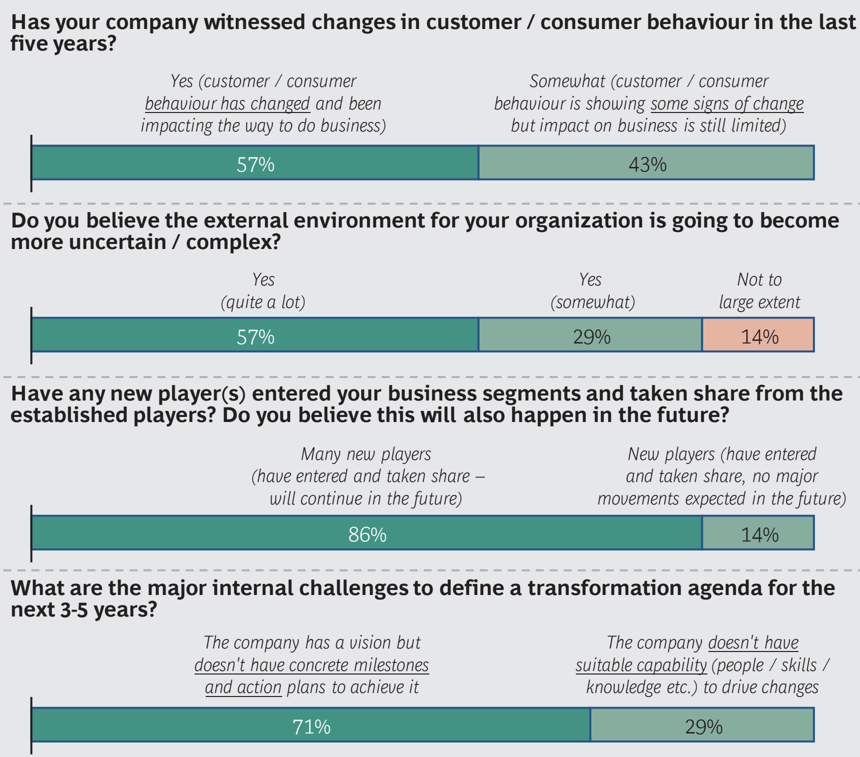
Inadequate independence
- Undermining new business models by keeping them too close to the core organisation and operations

Lack of persistence
- Underestimating time and effort required to see results; changing course prematurely

Lack of strategic focus
- Doing too many things due to lack of coherent and consistent vision and strategy

Premature confidence
- Believing that the change is on the right track early on and not continuously revisiting vision and strategy

FMCG and Retail Sectors in India Indicate Strong Need for Transformation



Source: BCG–CII industry leaders survey (May 2014).

BCG in collaboration with CII conducted a survey amongst the leading FMCG and retail companies in India. The survey polled the senior leadership of these companies to gauge the extent of challenge posed by the current business environment and whether their organizations were ready to meet these challenges.

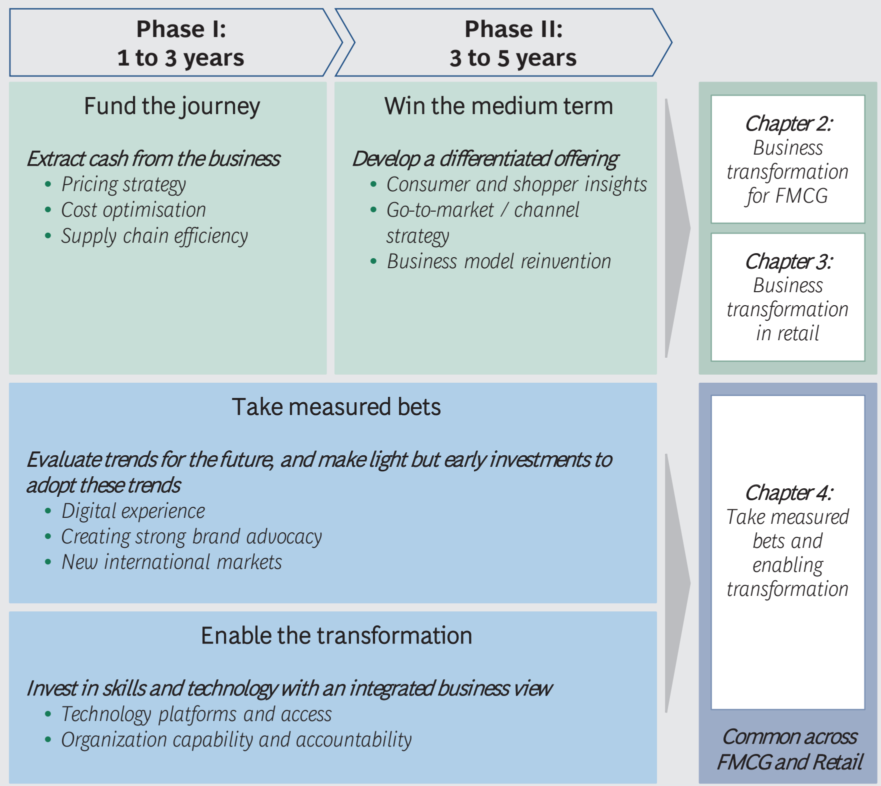
The survey reinforced the idea that most leaders are anxious about their competitive position and readiness to face the rapidly changing dynamics of business.

The typical transformation journey has four components; the importance and significance varies from case to case:

- Fund the journey: generate quick cash for the larger changes ahead. This is critical to prime the pump for continuous cash generation.
- Win in the medium term: identify the winning proposition for the next few years; align operating model to deliver consistently.
- Take measured bets: assess portfolio of options which can be big in the future.
- Enable the transformation: invest in people and technology to make all required changes

Our experience suggests that the 'Funding the journey' and 'Winning in the medium term' elements are distinctive and different for FMCG and retail and hence are covered separately for FMCG in section 2 and for retail in section 3. The elements 'Take measured bets' and 'Enable the transformation' are similar for both FMCG and retail and are covered together in section 4.

A Full Scale Transformation has Four Components



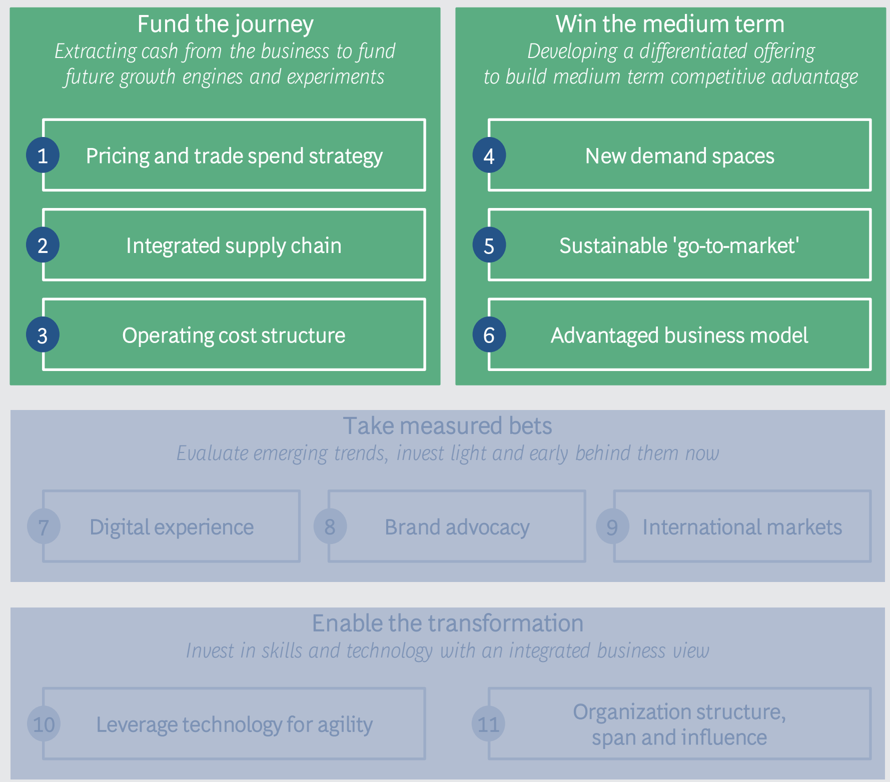
Business Transformation for FMCG

For the FMCG industry, there are three levers each for ‘Fund the Journey’ and ‘Win in the Medium Term’.

In funding the transformation journey, we believe there are many simple initiatives which can be undertaken in the business to generate cash quickly. These can be achieved through smarter pricing, managing trade spends better, driving supply chain performance and taking a hard look at end–to–end operating costs.

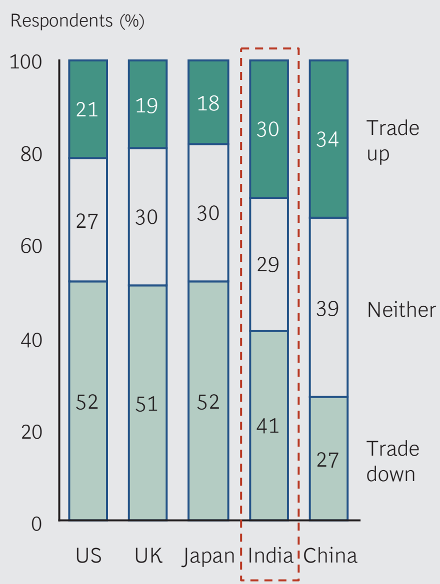
In winning the medium term, the levers are oriented towards developing a successful consumer proposition and then defining key business model elements such as the go–to–market structure and the operating model to deliver the promise consistently.

Six Levers for Transforming the Core FMCG Business



Product Pricing in India is Challenging—Needs a Structured, Data Driven Approach

Consumers in India show both trading up / down behaviour



Trade up intention stronger in India compared to developed countries

Three levers to approach pricing and revenue management

A Improve account profitability through pricing
- Improve realizations on low profitability accounts
- Focus on high profitability clusters

B Improve product profitability
- Drive margins for high volume SKUs
- Leverage high relative market share to improve price

C Redirect trade spend
- Focus trade spend on more profitable accounts

Source: BCG Global Consumer Sentiment Survey May and June 2013 (India N=2226).

It is common knowledge that Indian consumers are value–sensitive; however we have also observed that Indian consumers show higher profligacy. This makes product pricing a complex topic for Indian FMCG companies as not getting the pricing right could either cause consumer dissatisfaction, or leave money on the table. Most companies prefer to opt for the latter to protect themselves against losing sales in the short term.

BCG experience suggests that pricing, when approached objectively, can be one of the most effective levers to drive profitability. The big advantage of using pricing as a lever is that the increment flows straight through to the company bottom line.

With a large and disparate universe of retail points in India, managing trade pricing, schemes and promotions is a fairly intense task for most FMCG companies. It is often observed that companies do not always park their trade spend dollars with the most effective channel or channel partners.

BCG has supported multiple transformations in India and internationally, and has observed that a holistic approach needs to be undertaken when pushing to improve the effectiveness of trade spends. This includes multiple facets—right from selecting winning channels to partner with to being rigorous in on-ground execution.

Allocation, Structuring and Execution management of Trade Spends leads to Margin Enhancement

Best practice in approaching trade spend optimization

Strategic alignment and allocation criteria • How much • How often • On which product • Where	Efficient spend (product offer, pricing, and event optimization)	Take 'portfolio' view of brands	Steer to channel partners that perform and have potential plan collaboratively
Payment structures	Performance based	Simple Promote end-to-end efficiency	Flexibility at customer level within 'guardrails'
Execution, measurement and monitoring	Point of sale compliance enforced	Spend tracked and event returns analyzed	Sales force trained, and incentives aligned
Supporting pillars	Capabilities, culture, IT, organization, and process alignment		

FMCG Companies Face Multiple Issues in Supply Chain

Customer expectations are getting tighter

- Higher service levels
- Faster response times
- Integration – operational and IT
- Collaborative efficiency and loss reduction

Demand variability is increasing

- Greater short term swings led by economic sentiment
- Higher unpredictability of effect of promotional and pricing inputs, new products

Range of products and promotions is getting wider

- Larger number of innovations tested and launched
- Higher regional / segment specific offerings
- Newer wholesale delivery formats

Infrastructure quality is unable to keep pace

- Inefficient warehousing and cold chain
- Lower technology adoption
- Lesser number of logistics friendly zones
- Low improvement in road and rail infrastructure

Customization requirements of distribution are increasing

- Larger number of delivery configurations (channel, size, partner type...)
- Wider range of customers
- New multichannel activation: smaller orders straight to customer

Supplier base is becoming wider and more complex

- Higher number of suppliers – each for a specific advantage

External challenges

Internal challenges

Source: BCG analysis.

The supply chain for every FMCG company in India faces multiple external and internal challenges. Some are clearly structural and regulation–led which will take longer to solve. However, the internal ones can be checked early to prevent unnecessary complexity.

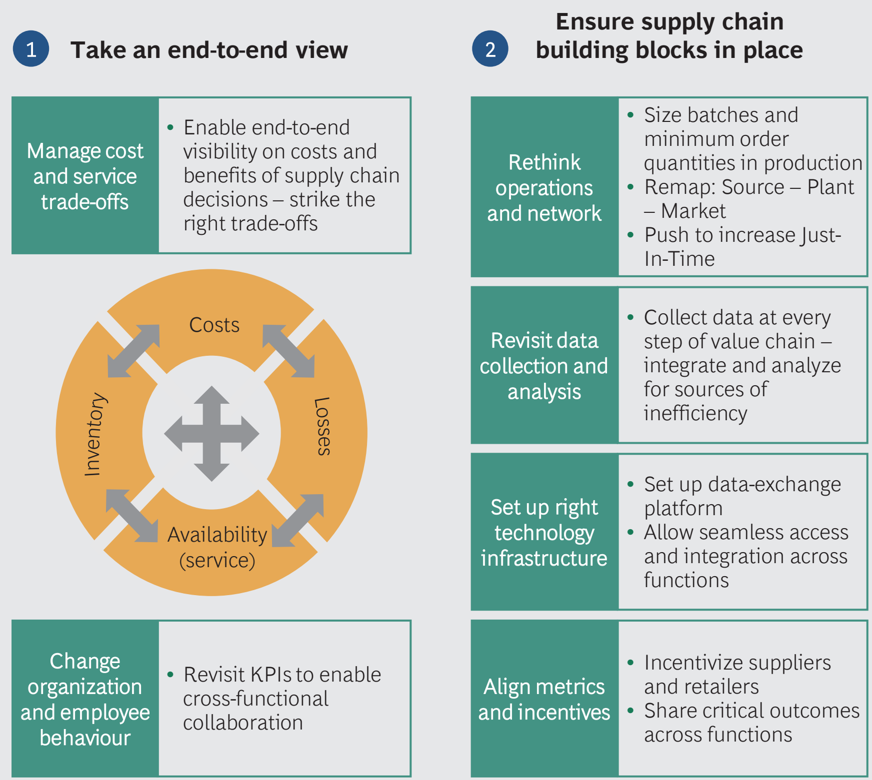
Our experience suggests that most internal constraints arrive out of the non–integration of supply chain outcomes across all functions.

The best–in–class supply chains in the FMCG space are configured on two principles:

1. Always take an end–to–end view of the supply chain outcomes; this prevents functions from taking isolated calls to optimize a set of local KPIs instead of focusing on the larger organizational objectives.
2. Set up the structural building blocks for the supply chain to perform consistently.

Following a cadence of regular, cross functional interactions around supply chain outcomes can greatly help in driving quick benefit.

Two Critical Elements to Ensure Fast Benefits from Re–modelling the Supply Chain



Source: BCG analysis.

Cost Improvements, not Growth, are Driving TSR in FMCG in India in Recent Times

Growth has a reduced impact on shareholder value during 2009-12 while cost reduction comes up much stronger

Source: Compustat; BCG ValueScience Center.
Notes: TSR–Total Shareholder Return. Includes Top 30 FMCG companies based in India. Cost includes COGS + SG&A, where SG&A excludes R&D expense.

BCG analysis of the TSR pattern of the Top 30 listed FMCG companies in India suggests that companies that have improved their cost position have shown better shareholder returns as compared to those that have shown a strong growth trajectory.

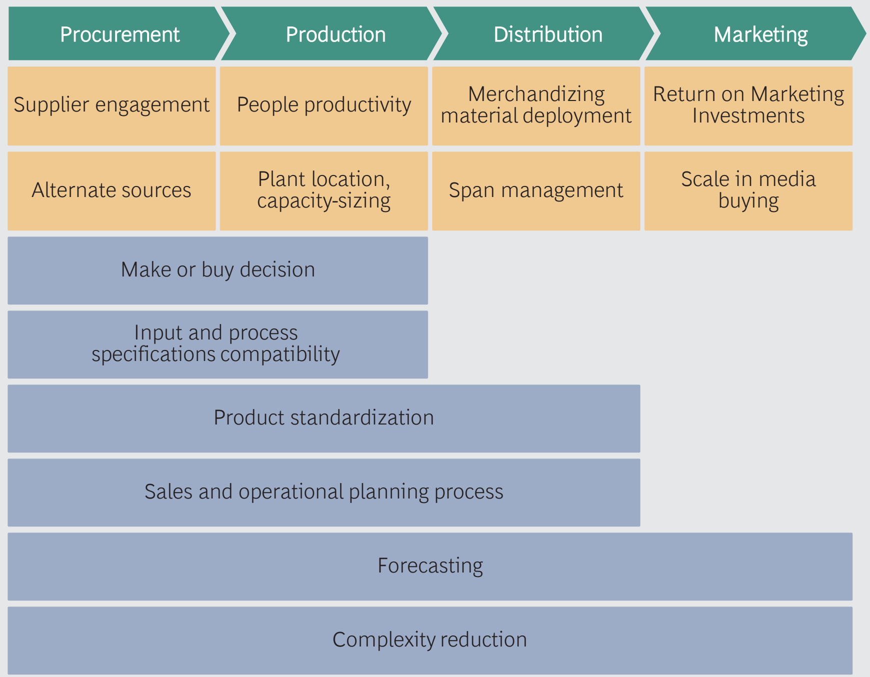
Most FMCG companies in India have historically enjoyed healthy gross margins and hence the focus has always been to get greater growth. With the entry of more local players with flexible business models and higher raw material inflation, FMCG companies that have delivered against cost targets have been rewarded by the markets.

Every year every company undertakes a cost reduction effort, manages to derive some benefits and feels satisfied with the outcomes. However, it is often found that no true effort has been made to question the ‘holy cows’ of the operating structure and achieve beyond the obvious, over flogged initiatives.

The best–in–class consumer companies approach cost reduction efforts with a lens not only to draw immediate cash relief from within each function, but also through a holistic relook at the entire value chain.

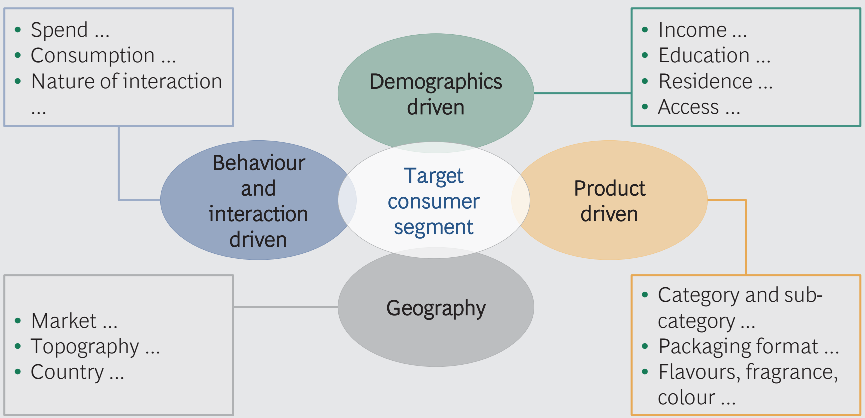
FMCG Companies Need to Take an End–to–end View of Their Cost Structure

Many cost reduction efforts pay handsomely when approached cross functionally



Consumer Segmentation Based Market Definition Needs to Evolve to the Next Step

Most FMCG companies follow a strong consumer segmentation based strategy...



...however, this approach does not answer two fundamental questions

How do categories interact with each other when competing for the same occasion or need state?

How does a consumer make a choice amongst categories and brands at the time of consumption?

Need to understand 'consumption segmentation' driven by occasion and need states

Many FMCG companies in India use fairly sophisticated consumer segmentation approaches to understand their category behaviours and consumption extremely well. These approaches are well suited to segment the consumers.

However, these traditional approaches are unable to answer two core questions:

1. How do categories interact with each other when competing for the same occasion / need state?
2. Why does the same consumer make different choices among categories and brands on different consumption occasions?

The best–in–class consumer companies have now started to redefine their market by segmenting consumption occasions rather than segmenting consumers.

BCG has devised an approach to define 'consumption segmentation'. The category landscape is divided into a large number of consumption segments created by the intersection of emotional need states and consumption occasions, locations and life stages.

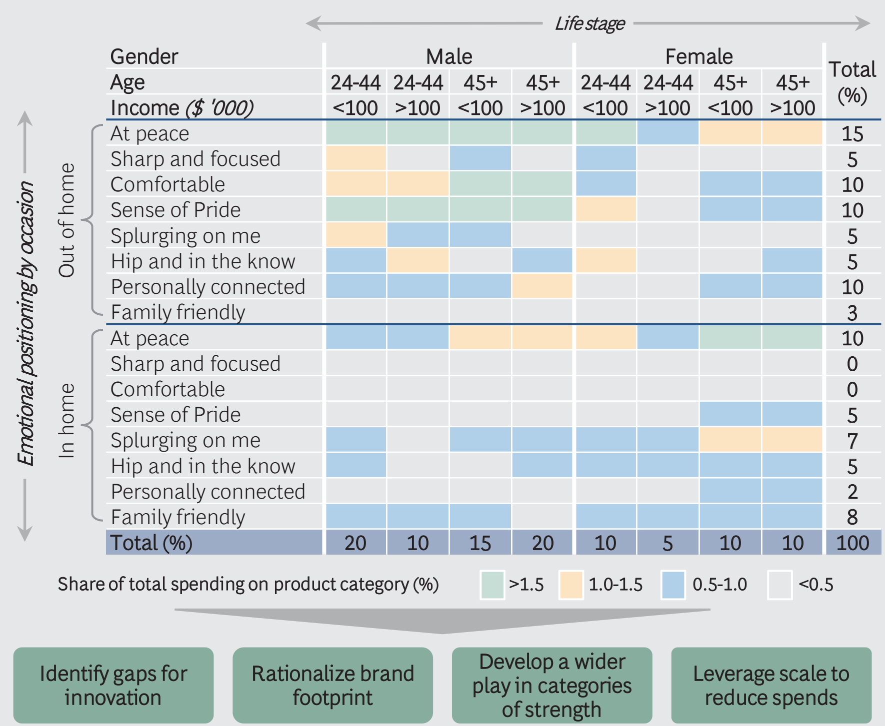
The 'consumption segmentation' approach has multiple advantages:

- Identifies opportunities for product innovations within and beyond the category.
- Rationalizes the brand footprint of a company–makes it simpler for consumers to navigate the company's offerings within a consumption segment.
- Allows for wider play within a category of strength–improving market share with minimal resources.
- Leverages scale and share to reduce overall marketing spend.

We believe that 'winning' in the future will require FMCG companies to adopt the consumption based approach to strategise category and brand planning.

'Consumption Segmentation' Based Approach Drives Share Growth with Reduced Marketing Spends

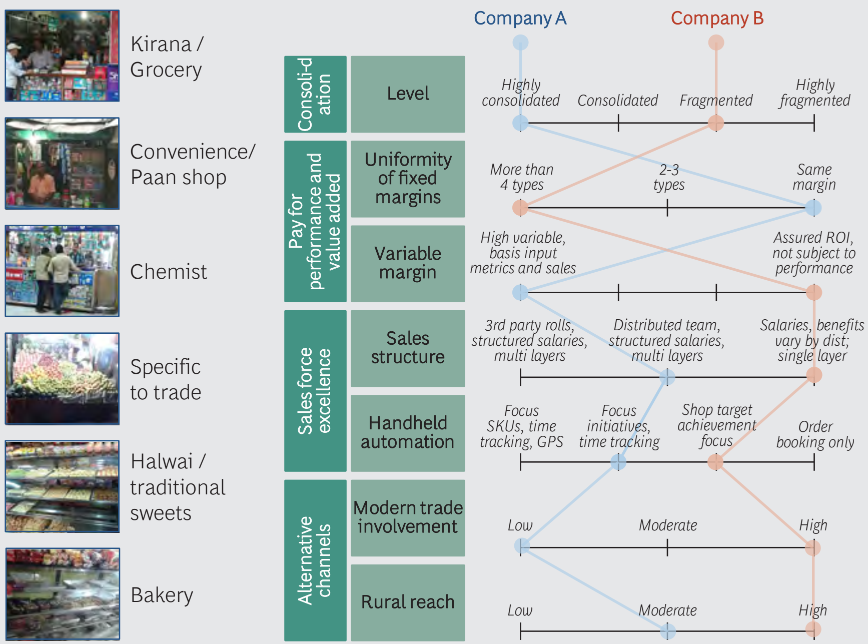
Detailed 'consumption segmentation' covering all occasions of consumption



Indian Retail Environment is Complex and Dynamic, no Simple Answer to 'Winning' Distribution

Myriad forms of retailers 12+ mn outlets estimated

Leading companies have made a different set of choices based on their business context and market evolution



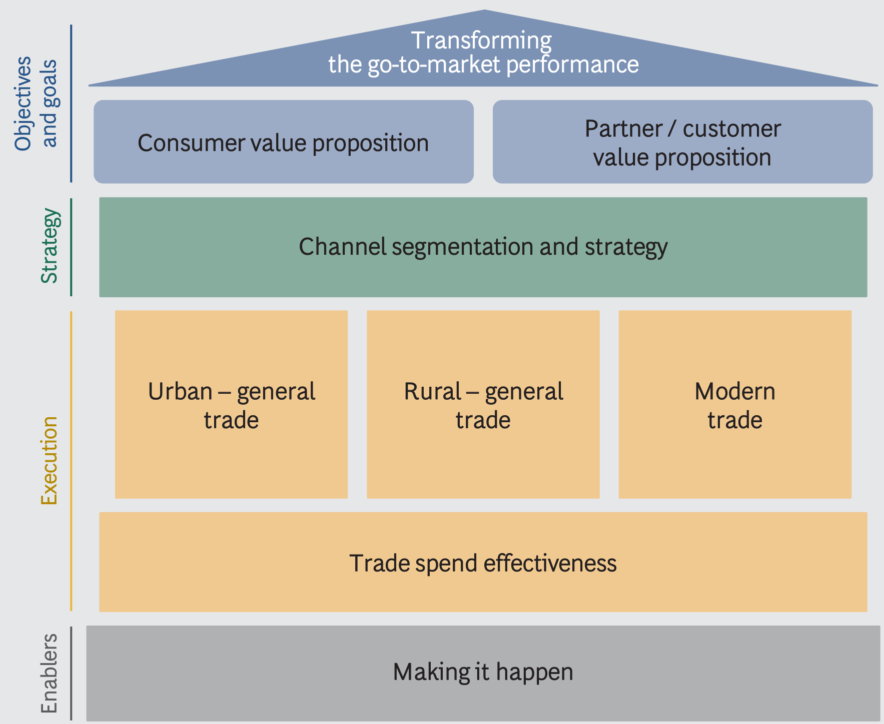
Sources: Expert interviews; BCG analysis.

The Indian retail environment is complex and dynamic. There are many forms and formats of point–of–sale that are geographically spread out and often have limited access. Both retail points as well as channels of reach are continuously evolving. We estimate that about 10 percent of Indian retail will be in the organized format by 2015.

Companies make a different set of choices on their go–to–market model based on their business context and evolution. Successful channel transformation requires a true understanding of retail formats and evolution, in–depth analysis of the economics of transactions and above all, disciplined execution.

BCG has worked on GTM strategy with many leading FMCG majors in India while they have been responding to the evolving needs of their market. Our experience suggests that GTM choices need to be made consistently along a large number of dimensions using a strong market understanding. FMCG companies must evaluate the effectiveness of all the building blocks of their go–to–market model at frequent intervals to ensure success.

BCG's Go–to–market Model Provides a Comprehensive Structure to Make the Correct Model Choices



The Complete Business Model Needs to be Regularly Refreshed in line with the Core Proposition

Value proposition	**Product to service to outcome** Change offerings either from product to service, or from service to outcome • IBM	**Product to experience** Integrated platform that goes beyond the product itself • Apple	**Trust premium** Establish a clear reputation and position the company to trust • Whole Foods	**"Free"** Provide a product / service at zero or very low cost and find other ways to monetize offering • Facebook	**Ecosystem generator** Join forces with external companies towards a common goal with complete alignment on value chain • UltraViolet
Operating model	**Matchmaker** Bring external companies together to better serve a market • Li and Fung Ltd.	**Integrator** Vertical integration to control all aspects of the value chain • Zara	**Low cost** Lower costs of operating across divisions • JetStar Airways	**Direct distribution** Shift from a B-to-B player to a B-to-C player • Nespresso	**Capillary networks** Grass roots sales and distribution to reach greater number of customers • Unilever
Business architecture	**Open** Leverage peer production, crowd-sourcing and open platforms to increase value of offering • Android OS	**Peer to peer** Establish and foster connections between customers • PayPal	**Adjacencies** Leverage core strengths and brand equity to enter a new market • IKEA	**System manager** Create standard system and sub-contract aspects of system to external companies • McDonald's	**Serial** Repeatedly seek opportunities beyond core business • GE

Source: BCG analysis.

BCG experience suggests that every business model eventually reaches a point of diminishing returns. Failure to recognise the need for change is costly; many companies have lost market leadership due to insufficient responsiveness.

Examining business model innovations across industries provides clear direction, the two key principles applied are:

- High synchronicity with the value proposition.
- Keep a realistic sense of what can be pulled off in execution.

Continuous reinvention of the brand and business model is much easier said than done. We see this being done over a 50 year time horizon in some of the western markets, it is observed that more than half of the top 20 companies lose their market position as they have not been able to transform and keep up with changing times.

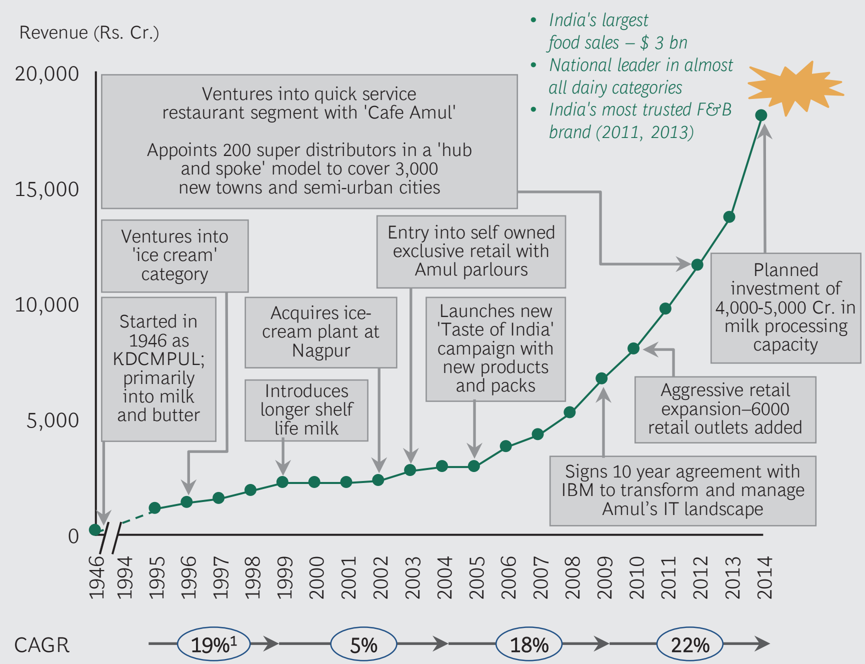
In India, we see GCMMF as a great example of an entity which has grown from strength to strength over a ~65 year journey. GCMMF's ability to pre–emptively transform its core brand proposition and supporting business model at regular intervals has led to its phenomenal success.

FMCG Transformation Case Example: Amul

A company and brand that has always stayed contemporary and relevant

Transformation case example

Key strategic choices made by GCMMF along their growth journey

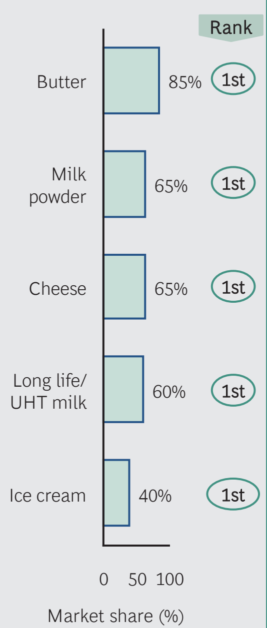


Sources: Press searches; Company website.
[1]CAGR for 1995 to 1999 calculated.

GCMMF has a Winning Business Model Anchored Around Delivering the Core Amul Brand Promise

Transformation case example

Amul is the market leader in several product categories



Pricing and trade spend

- Attractive pricing across products – creating strong consumer traction
- Low and consistent distribution margins
- Gradually expanding exclusive / franchise retail

Supply chain

- Infrastructure geared up to manage supply chain for varied product range and conditions
- Simple ordering mechanics with IT integration from sourcing to sales

Cost structure

- Scale driven cost advantages – milk procurement from primary shareholders allows supply assurance
- Mother brand used to leverage scale on A&M spend

Proposition and product portfolio

- Leaders in innovation within dairy space
- Brand promise always contemporary to changing India

Go-to-market

- Four channels of distribution managed: frozen, fresh, chilled and ambient
- Network of 10,000 dealers and 1 mn retailers – largest in India in relevant categories

Advantaged business model

- Investment in processing technology and capacity
- Partner with other private packers and state co-operatives
- Wider procurement network through district co-operatives

Sources: Company website and interactions, press search, BCG analysis.

GCMMF's ability to keep the brand Amul relevant to the changing Indian consumer yet preserve its core values has been central to its success. Strategic business model choices made along the way related to product portfolio, wide distribution network in a complex category of chilled and frozen, processing capacity expansion and securing a captive sourcing base have allowed GCMMF to develop a sustainable advantage in the market.

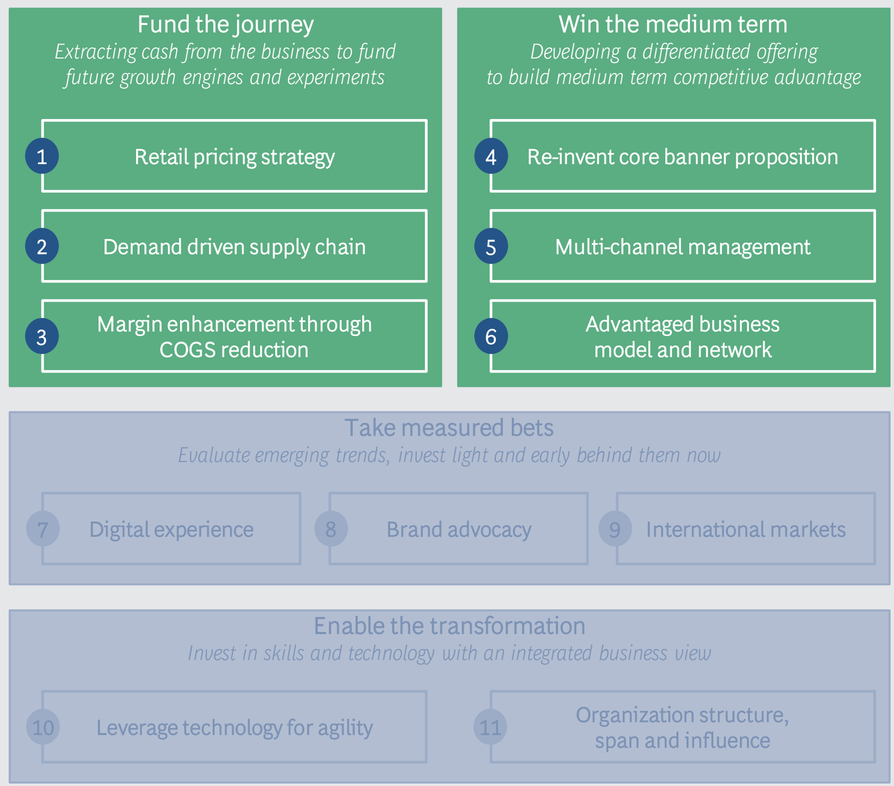
Business transformation in Retail

Transformation in retail requires an approach that generates cash quickly to fund the winning model in the medium term.

In funding the transformation journey, we believe there are multiple initiatives that need to be undertaken to release cash quickly. These are through robust pricing rules, much–improved supply chain performance and improving margins through better buying.

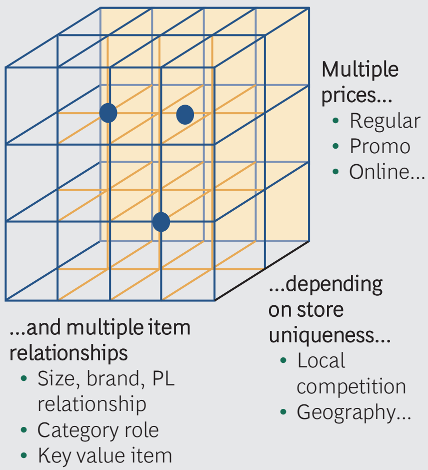
In 'win the medium term', the levers are around developing a differentiated retail identity, playing wider across channels of consumer access and setting up the operating model and store network for structural advantage.

Six Levers for Transforming the Core Retail Business



Pricing in Retail Needs to be Dynamic

Pricing is a complex topic in current retail in India...



A typical hypermarket retailer with ~20,000 items in 50 stores has **1 million prices** to set accurately every month

...and is often poorly executed as retailers take a short term view

- Focused on securing margin at expense of long-term perception registration
- Prices set against competitor prices instead of customer's willingness and ability to pay
- Promotions are introduced to boost sales tactically, simply to match previous sales
- Prices set by focusing on item-level or category-level sales instead of overall impact on store, customer loyalty
- True logic of pricing quantity or quality hierarchy is unknown
- Private label plays a major role today and getting pricing (and different sizes) right are critical to drive it
- Transactions data is not leveraged enough to make micro-decisions on pricing

Source: BCG analysis.

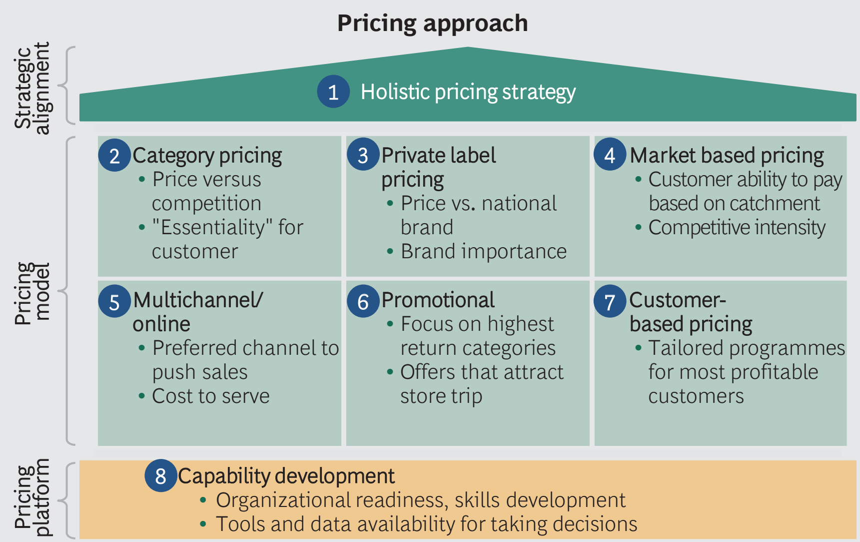
A host of issues comes up for consideration in retail pricing: the nature of the local competition; product discounts; and defining the rules of pricing by store catchment, geography and product hierarchy.

BCG experience in working with retailers in India suggests that most retailers today take a fairly simple benchmarking–based approach when fixing prices. The pricing methodology rarely considers the ability of the consumers in the catchment to pay, or the historical price elasticity. Hence, the true potential of pricing from a profitability or a 'perception builder' perspective is left untapped.

The key for deriving short and long term value from pricing is to win both price and price perception. It is equally critical that the principles behind the pricing model are closely linked to the core banner proposition.

A dynamic pricing model requires looking at a wide gamut of levers. It also requires institutionalizing the use of multiple objective techniques such as customer price discovery, benchmarking and elasticity analysis.

Need to Win Both Price and Price Perception



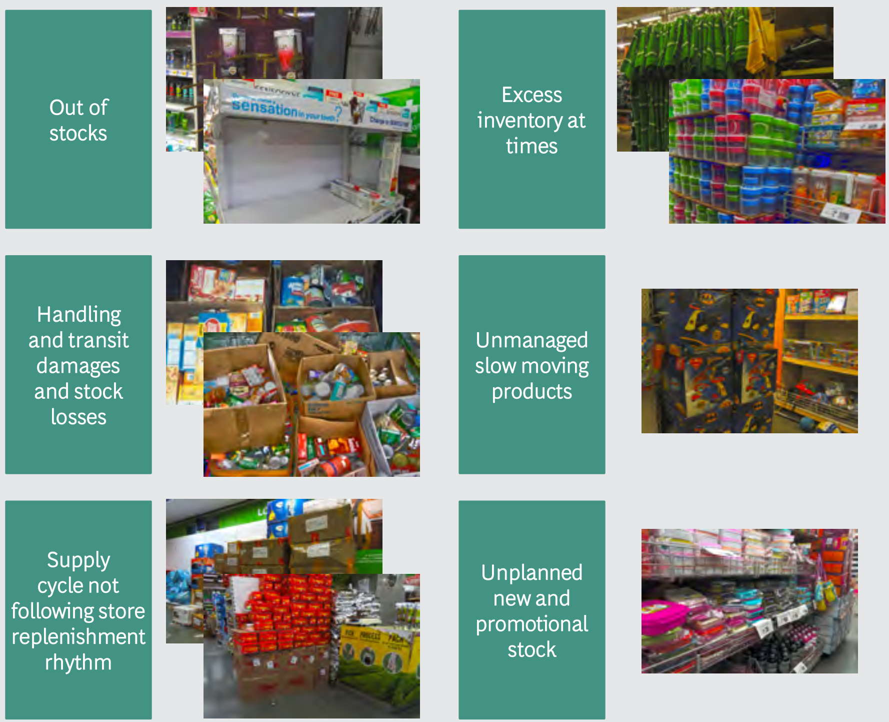
Price perception (example – driving a value perception)

Levers to build perception
- Direct comparison vs. competitor or national brand
- Deep vs. wide discounts
- Bundling

In-store initiatives
- Promo display locations
- Daily deals
- Price cut announcements
- In-store signage

External initiatives
- Marketing initiatives (coupons, pamphlets...)

Multiple Supply Chain Issues in India–Often Visible in Stores



The supply chain is less evolved in retail than in FMCG, but more critical for success. Several supply chain issues plague the Indian retail industry. Out of stocks, excess inventory and unmanaged slow moving products are typical problems at the store front.

The root cause of most of these issues is the lack of an integrated approach to merchandise planning and replenishment across the retail supply chain. Limited engagement with the suppliers to reduce the overall complexity burden and lack of scientific inventory management are also important reasons for the under–performance.

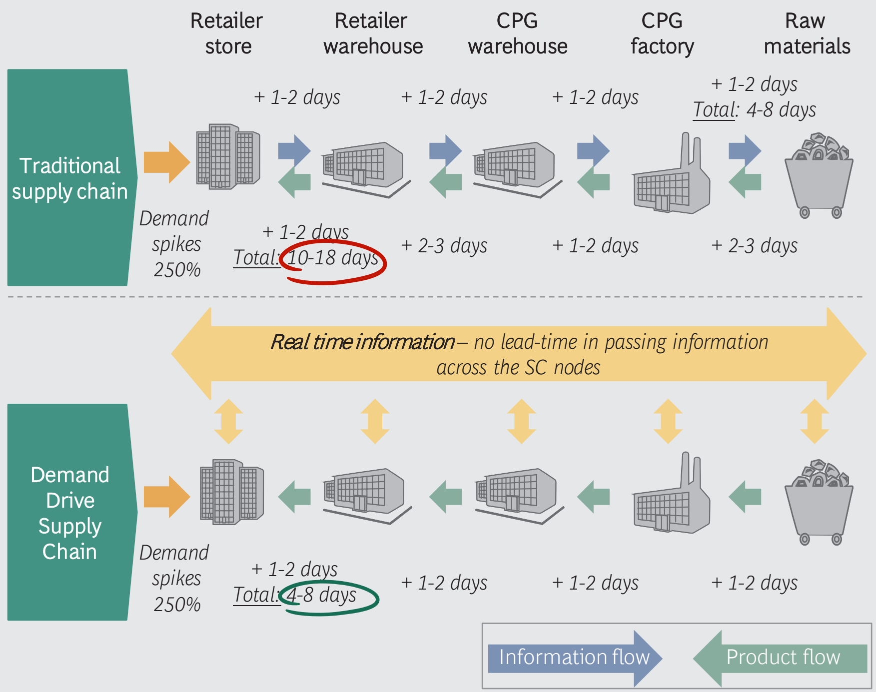
In a traditional supply chain, the transfer of information across the transaction points is not seamless. Contemporary demand–driven supply chains are anchored around real–time sharing of information among the stakeholders to enable end–to–end visibility of inventory flow.

With such seamless information flow, each stakeholder can work in parallel to reduce the time taken to respond to changes in demand. This enables retailers to plan more accurately and even respond faster to sudden changes in demand.

Need to Take an End to End View of Supply Chain: Optimize for the System, not for a Function

Illustrative

Flow of information and products across the supply chain

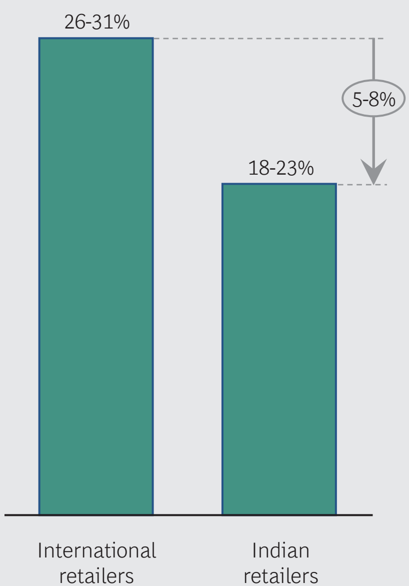


Source: BCG analysis.

Retail Gross Margins in India Lower Versus International Peers

Illustrative: Food and grocery

Large difference in margins between Indian and international retailers



Multiple reasons for low margins in India

1. Pricing pressures – suppliers govern pricing, intense local competition
2. Modern trade still small, limited room for leveraging size of buy for negotiations
3. Fragmented supplier base, no organized way of collaborating
4. Buying operations in some categories and commodities are sub-scale
5. Retailer internal processes are not standardized
6. Private label has low share of overall sales
7. Retailer skills in buying and procurement not best-in-class

Sources: BCG analysis and expert interactions..

Retailer margins in India are lower than in most international peers. There are a multitude of reasons for this–mostly stemming from sub–scale operations, and hence limited ability to negotiate scale–based buys. Given that the degrees of freedom on pricing are often limited, smarter and more efficient procurement is critical for improving margins.

We see the landscape in India changing gradually but steadily. Modern trade now forms a significant share of sales of most FMCG companies in many large cities. In parallel, retailer capabilities in terms of merchandise display and planning, supply chain, and handling a wider network of suppliers at source is also improving. Hence, it is important for retailers to make the best of this favourable trend and undertake large COGS improvement programmes to improve their margins faster.

Retailers should look at seven major themes to drive COGS reduction and build stronger negotiating rationale with their suppliers.

These include:

- Benchmarking margins received to share and space delivered across products and suppliers.
- Optimizing portfolio for enhanced profitability.
- Leveraging scale for increased efficiency, and price negotiations.
- Strategically partnering with vendors for preferential treatment.
- Discovering a wider base of suppliers closer to source.
- Driving private label profitability; and
- Maintaining cost parity across markets.

Seven Main Levers to Drive COGS Improvement

Cost and profit gaps

- Approach vendors based on net margin at class level
- Secure fair share for providing excess growth

Assortment balancing

- Use PL to maintain profit umbrella / negotiating position
- Rationalize supplier portfolio, SKUs to enhance profitability

Scale

- Assess scale efficiencies
- Negotiate holistically across categories

Strategic partnership

- Strategic partnership with net margin leader
- Improve speed to shelf

Supplier discovery

- Identify wider supplier base to get low cost / best sourcing

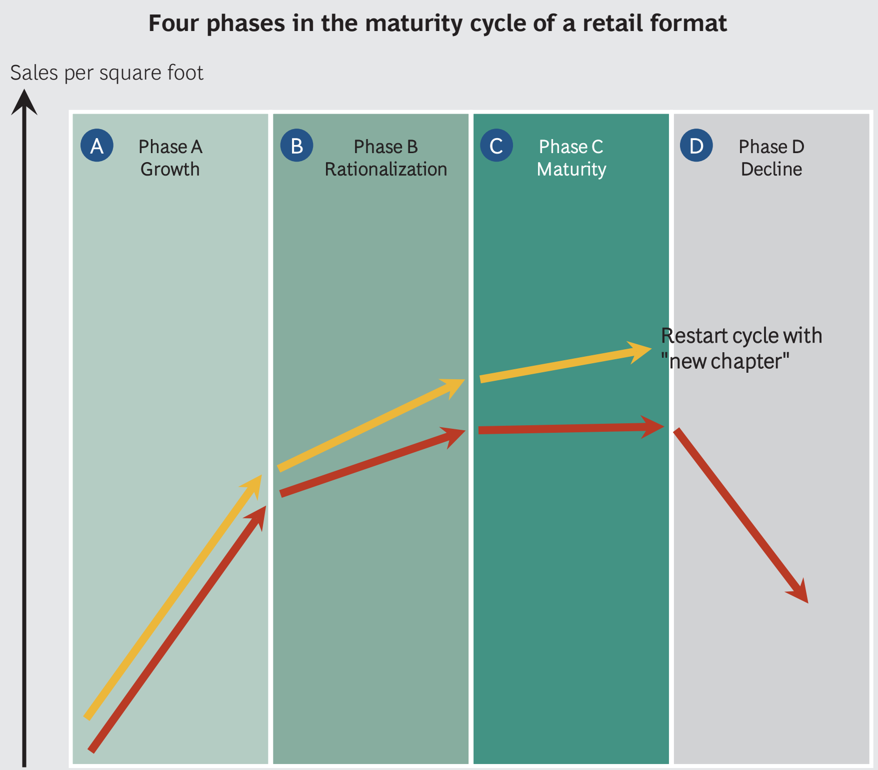
PL cost and pricing

- Input costs, time, quantity and geography for sourcing
- Working capital management
- Process optimization

Parity

- Drive cost parity across different markets of buy
- Increase sourcing from tax / logistics friendly options

Retail Requires an Identity Refresh Every Six to Eight Years



Most global examples suggest that retailers need to refresh their store concept every six to eight years depending on the maturity of the market. Whenever a retail identity is refreshed, the highest value is created in the early phase due to the newness effect and rediscovered relevance by consumers. Over time, the concept matures with lower growth caused by competition effects.

Successful retailers have demonstrated two capabilities when it comes to refreshing their concept:

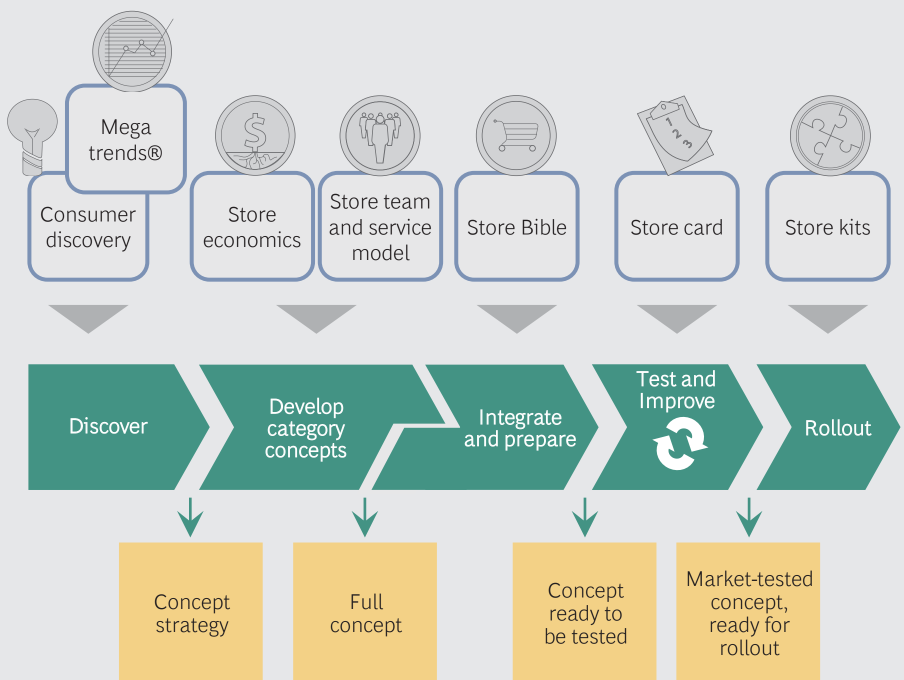
1. Identifying proactively the need for the next refresh effort well before any decline in sales is observed.
2. Constructing their store economic model such that the investment in the new concept is paid back prior to hitting the maturity phase.

A five–step approach for reinventing retail concepts needs to be adopted:

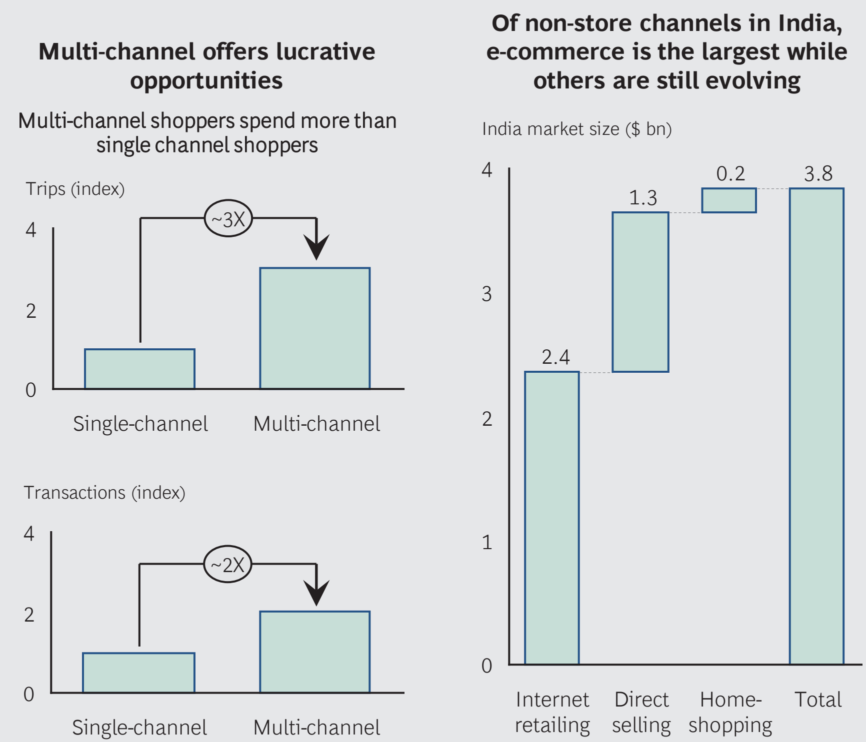
1. Discovering latest shopper insights.
2. Developing the store category concepts.
3. Integrating into a full store identity, proposition and commercial model.
4. Conducting pilots; and
5. Refining the design, finally rolling–out to the complete fleet.

A critical 'watch–out' in this process is how well a retailer actually uses the fresh consumer insights and converts them into category building blocks without corrupting the thinking with existing practices and ways of working.

Leading Retailers Take a Completely Consumer–in View When Refreshing the Concept



Multi–channel is Emerging Strong Internationally, Gaining Importance in India



Sources: Euromonitor; MagnaGlobal; BCG ananlysis.

Multi–channel retailing is increasingly becoming the norm globally. Retailers who satisfy consumer expectations when it comes to multi–channel shopping, and also encourage their own customers to shop across channels, have much to gain. Consumers who shop in multi–channels are more profitable and more loyal than single–channel shoppers.

In India, alternative channels are still small. Online shopping (the largest of all alternative channels) is still limited and a majority of customers still rely on traditional channels to discover, research and purchase products. However, these channels are currently showing robust growth which is expected to continue over the next few years.

Retailers who are accustomed to traditional business models and unfamiliar with the multi–channel process often make the mistake of simply transferring old ways of operating into the new environment and therefore fail to capture scale economies across channels.

Creating a multi–channel advantage is not just about selling online. Customers don't distinguish online and physical channels; they expect a seamless experience when they shop, purchase, receive deliveries and request after–sales service across channels of interaction.

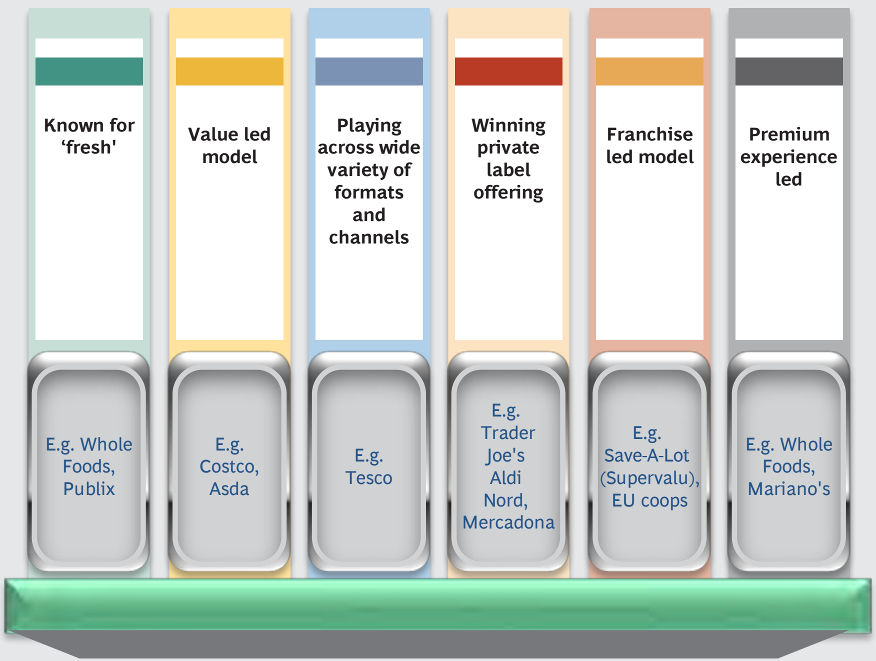
Need to Design Seamless and Connected Customer Journey as they Migrate Across Channels

		Inspire the customer	Make them aware	Help them decide	Sell them the product	Support the customer	Reward their loyalty
Physical stores		• Recipe cards • In store advertising	• Product info flyers • Staff inquiries	• In-aisle promotions • In-store testing	• Self pick • Click 'n' collect / reserve	• Returns policy • In-store advisors	• Loyalty cards
Digital in store	Store device	• Smart trolleys with 'model' shopping lists	• Product info kiosks • Product simulator	• Tweet mirrors • Product locators	• Self check out • Scan and shop (store device)	• Product information kiosks	• Loyalty kiosk for managing account
	Own device	• Next best product marketing	• Personalized product info	• Store / product info	• Scan and shop • NFC payments	• Online product support	• Mobile based loyalty card
Digital out of store	On the go	• Recommen-ded recipes • Cloud-based shopping	• Product reviews on Twitter / Facebook	• Store info / availability apps	• Click 'n' collect	• Product refunds based on photo	• e-Loyalty vouchers • Mobile points
	At home	• Recipe functionality • Personalized shopping list	• Product reviews • Personalized recommen-dation	• 1-to-1 marketing and • Inventory checks	• Market place • Range extension • Click 'n' deliver	• Social media support • Twitter	• Loyalty website • Online redemption
Physical out of store		• Promotional catalogues • TV sponsorships	• Call centre product inquiries	• Physical coupons	• N/A	• Telephone support centre	• Loyalty newsletter/ magazines

Source: BCG analysis.

Internationally, Retailers Opt for a Variety of Propositions and Orient their Operating Model to Deliver Consistently

Illustrative for grocery retail



Source: BCG analysis.

Alignment of the core banner proposition and the operating model is critical to ensure consistent experience for the consumer. There are several examples of successful models where retailers have communicated and reinforced banner identities through consistent execution.

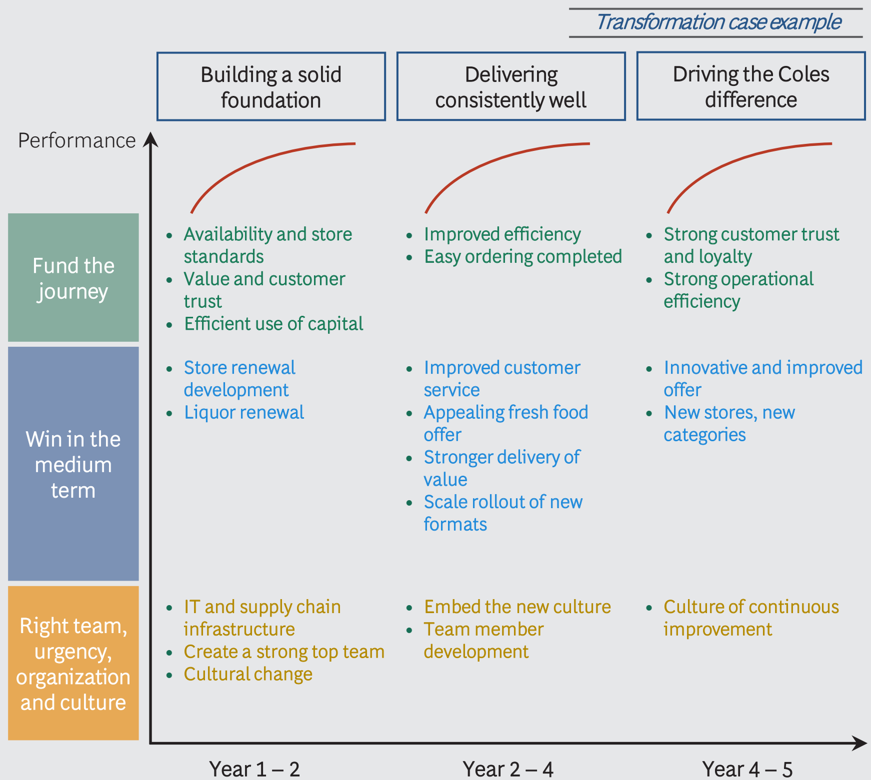
In many of these, one finds that retailers have over indexed efforts and resources towards elements that deeply influence their core consumer proposition.

Internationally, many retailers have undertaken transformation journeys; but few have been as successful as Coles, the Australian grocery retailer. The Australian grocery retail space has been dominated by Woolworths and Coles for many years. Towards the end of 2008, Coles was at the lowest market share.

A new management took charge of Coles at that time, and started a massive transformation exercise of—strategic, operational and organizational turnaround. The journey was broken into three phases: building a solid foundation; delivering consistently well; and finally, driving the Coles difference.

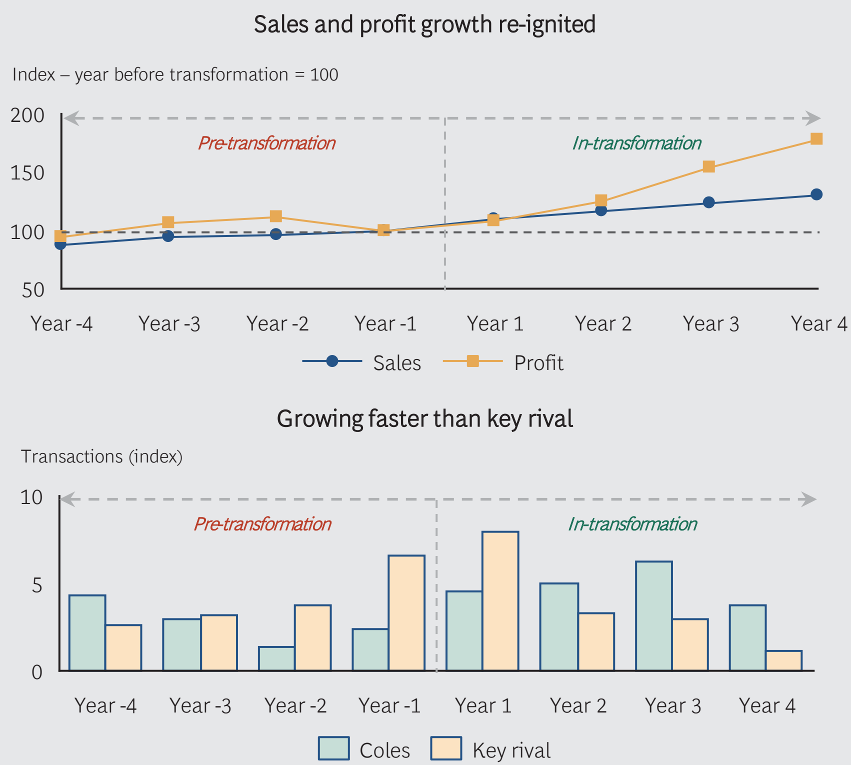
The team took a lot of initiative in making the new Coles store design more contemporary, and then ensured that all related elements of the business were synchronised to deliver the envisaged experience consistently.

Case Example of Successful Retail Transformation: Coles in Australia



Sources: Coles website; BCG analysis.

Impact of the Transformation: Consistently Growing Sales, Profits and Market Share



Source: Company reports.

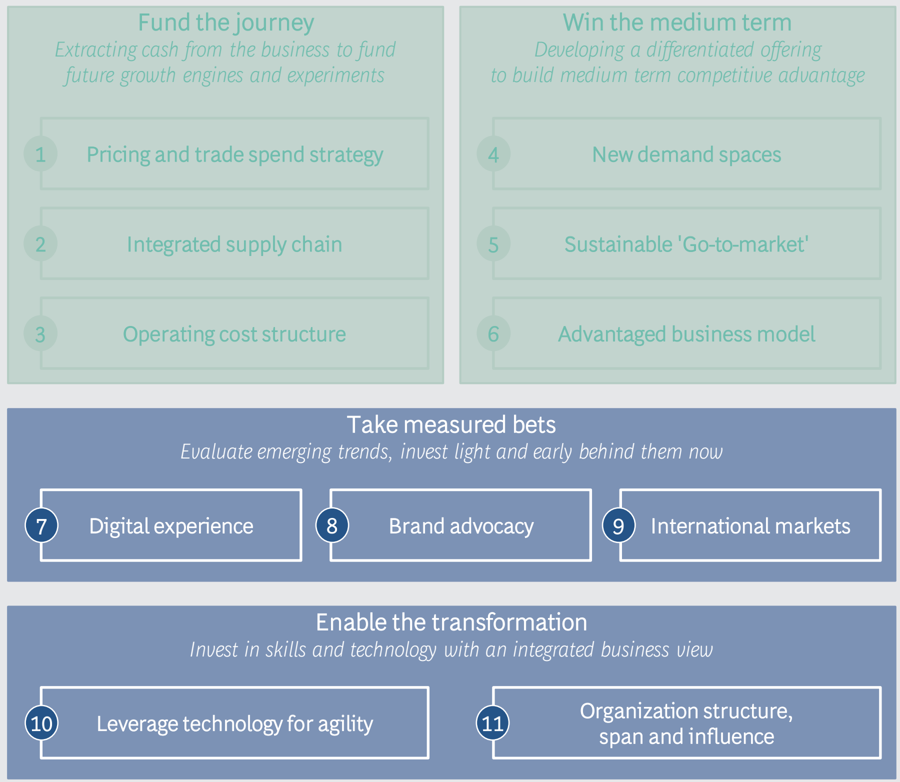
Coles' market share and performance post the transformation launch has been stellar. They have continuously performed better than their key competitor on like–for–like growth for three years. More important, they have re–established the critical consumer connect that had been declining for quite a few years. Interestingly, the senior team still believes the journey is only partly done as they continue to aspire for more, and at a greater pace.

Measured Bets and Enabling Transformation

There are two elements that are common to both FMCG and retail transformation. The first is related to spotting emerging trends that will define successful business models in the future. These trends may be nascent today, but have high upside potential for the future. BCG experience suggests that digital experience, advocacy marketing and cross border opportunities are three important themes going forward.

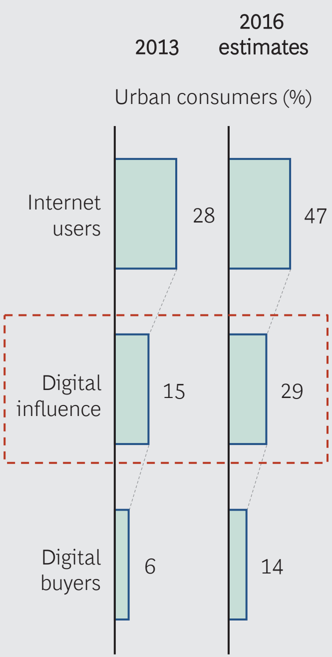
The second element relates to the institutionalization of change. A strong foundation for the transformation through wider technology access and superior people management processes is equally critical to define success.

Five Common Levers for Taking Future Bets and Enabling the Transformation



Digital is Becoming Critical for Influencing Purchase Decisions

More consumers are being influenced by digital



Need to challenge digital reality in India

Who is online?
- 34% of internet users are from small urban towns and 25% from rural areas
- 57% of urban internet users are ≥25 years of age

How do users access internet?
- 45% of urban consumers use only a mobile device to access the internet

Why are they online?
- It's not just discounts that drive online purchase (30%)
- Convenience (37%) and variety (29%) also critical

What drives the online traffic?
- Search engines drive traffic in >40%
- Social media impact limited to 25%

Sources: BCG CCCI India Digital Influence Study 2013-14; BCG analysis.

Digital is increasingly influencing the purchase decisions of consumers. Recent BCG research suggests that the digital influence for urban consumers is expected to double from the current levels over the next three years.

BCG's recent research also objectively demonstrated that the use of digital was much wider and deeper than previously believed. Digital influence has been fast expanding to small urban towns and rural areas, being largely mobile–led. It is also interesting to note that discounts were not the only reason people were shopping on–line; convenience and wider assortment / access turned out to be fairly strong drivers of shopper choice.

The digital marketing task for different categories is quite different in today's world. For low penetration categories, the primary purpose is around creating a base footprint and trials whereas for categories with high presence, compelling sales propositions will be required to make the best out of the channel.

The true commercial potential of this channel has been demonstrated in some select categories–travel and tourism leading the way, where 25 percent of the total sales are digitally driven. Traversing the journey of creating a basic footprint to making it a channel of commercial significance requires time and resilient focus.

Important to Choose Which Battle to Fight

2013 category	Digital footprint	Digital influence	Digital buyers
Air travel	71% *of air travel buyers have internet access*	48% *buyers used internet in the purchase process*	25% *buyers bought it online*
Cars	55%	32%	6%
PC and mobile accessories	68%	28%	8%

Source: BCG analysis.

What Will it Take to Win in the Digital World?

Adopt a long-term perspective
- Have a multi-year horizon and execute towards longer-term goals
- Efforts should remain undiluted and targeted

Have a top-down approach and senior-level mandate
- Align leadership with strategic intent and rally resources around central mandate

Start small to go big and start slow to go fast
- Pilot things at a manageable level
- Show results and then scale up

Implement a structured, systematic decision making process
- Use a consistent and systematic approach to set budget and objectives
- Track concrete actions against plan

Find the right talent
- Tap the variety of talent pools that exist in the space
- Look outside more than you normally do

Participating in digital India is no longer an option or a wait–and–watch game. Active digital presence and consumer engagement through this channel will be a base market expectation. It is clearly an arena of business that requires a well thought–out move–in now to ensure strong participation for the future.

Success in this channel will need:

- The organization to make a long term commitment to resource the initiative internally.
- Adoption of a test–refine–scale up approach rather than starting too fast.

Another interesting bet for the future within the marketing function is to take a close look at media to create greater advocacy for your brand. The modern world creates more information every year than has been created throughout its history. However, people actually find more and more of this information less credible and relevant. Conventional communication media has become less effective, while recommendations from friends and family have increased their influence along every dimension of choice that consumers make.

Creating advocacy is becoming a critical lever for a company to win in the highly socialized customer space. Rise of social networks, expansion of interactive websites and rapidly spreading smart phones are generating new opportunities and challenges for creating and sustaining advocacy.

Consumer Advocacy Critical in an Age of Mistrust

Advocacy is the most effective source of sales leads and rapid growth

Brands always need to be reinforced with consumers

Advocacy is the most trusted source for recommendations; traditional media influence declining

Advocacy importance increases even more with offline, digital expands

Best-in-class marketing companies have started to use this tool aggressively

Sources: Nielsen Report–Global Trust in Advertising and Brand Messages, April 2012 (3Q 2011 data) 28,000 internet users from 56 countries participated in the study.

Consumer Advocacy Can be Developed Systematically

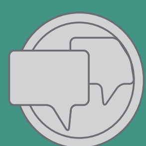
1

Recruiting effective advocates

Identify target communities
- Communities that share the same value as your brand and aligned with your brand's marketing goals

Within the communities, focus on people with highest advocacy potential

2



Powerful messages

Build a powerful message around product experience
- Message should deviate from original expectations to pique people's curiosity, make them want to talk

Engage with consumers altruistically expecting nothing in return
- Increase affinity with the brand

3

Continuous relationship and viralization

Develop sustainable relationship between brand and consumers
- Campaigns should be treated as a means to develop relationships

Leverage both offline and online channels to target consumers and maximize advocacy effectiveness

Source: BCG analysis.

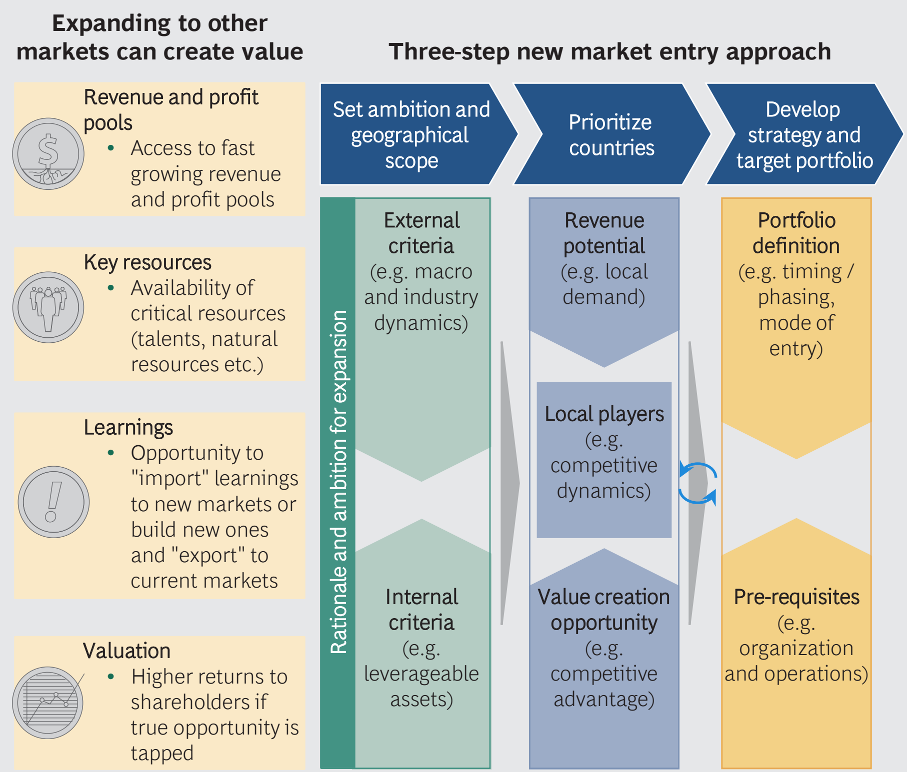
Conventional marketing wisdom believes that strong word–of–mouth promotion is ultimately driven by the consumer's experience and cannot really be influenced. Recent work in this space has shown that not only can advocacy be created, but it can also have a strong long term effect on brand relation with consumers.

Managing consumer advocacy requires working on three levers in a careful sequence:

1. Recruiting and connecting with people within influential and effective communities.
2. Producing impactful messages by deviating from original expectations and establishing an altruistic connect.
3. Continuous relationships and viralisation.

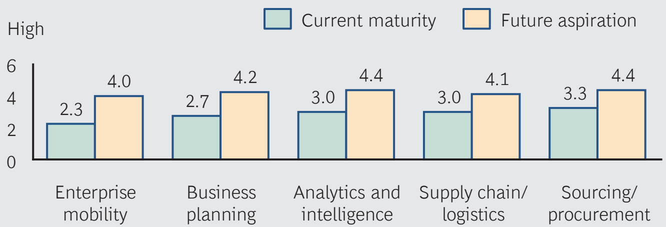
There are many markets in the developing world, where consumer behaviour, especially in some categories, is similar to that in India. These markets, with slightly less evolved structure and a less intense competitive environment, can provide a sound base for profitable growth especially in some FMCG categories and speciality retail. Keeping a keen eye on such markets, where a proven model of India can be extended, should be an area of regular consideration for the leadership team. Many Indian FMCG companies have successfully taken their product range, operating model and skill sets to other developing countries to create sizeable businesses in a seven–ten year time frame.

Companies Should also Explore Opportunities in other International Markets



Favourable Access to Technology Creates Ripe Opportunity to Absorb it into Everyday Business

Indian companies still need to address gaps in desire to adopt technology



Many options to extending technology across organizational functions to 'link-in'

Procurement	Manufacturing	Supply chain	Sales and distribution
• Reverse auctioning platforms • Daily price discovery from suppliers • Real-time inventory and purchase situations	• Integrated equipment and production cell operations • Remote controlling of machinery / trouble shooting	• End to end replenishment control • Warehouse and order management	• Outlet level sales and inventory • Key customer / partner data • Commercial status
Common portals and wider connectivity	Equipment based industrial automation	Perpetual inventory management algorithms, code readers and handheld devices	Hand held devices with high connectivity and easy data inputting interface

Sources: Research reports; BCG analysis.
CII–BCG IT End User Survey 2013. Responses on a scale of 1 to 5; 1–lowest, 5–highest.

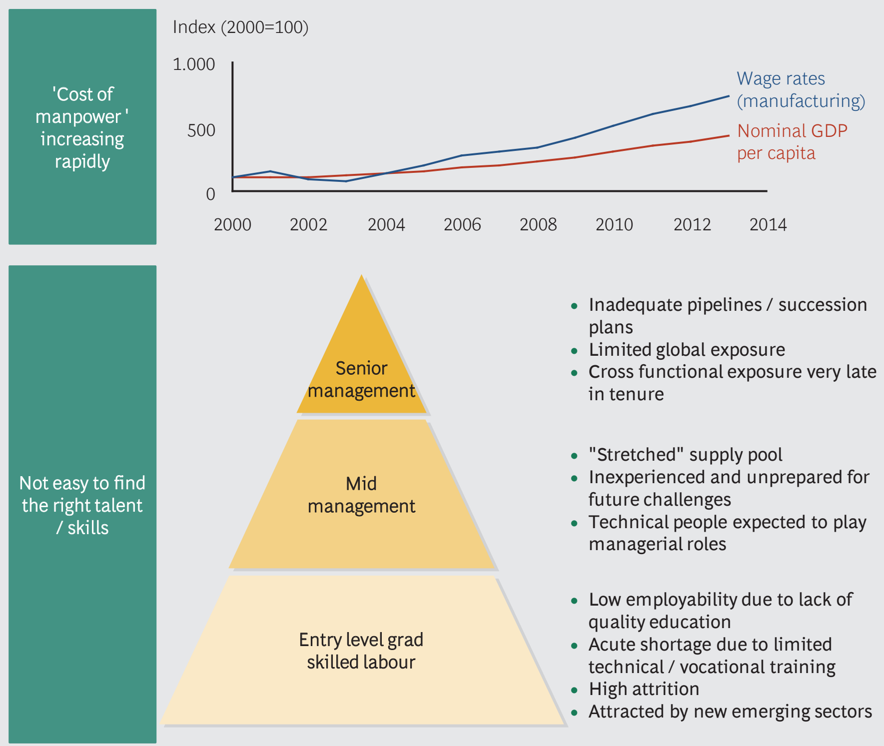
Technology's role in business continues to expand exponentially. Big data, digitization, the industrial Internet and multiple other technologies are reshaping the retail and consumer goods industry at a pace that stretches the imagination. Technology is widely regarded as a critical enabler of most business outcomes.

India ranked 48th out of 148 countries on 'Firm–level tech adoption'. As the Indian market opens up to global FMCG and retail players, Indian companies need to leverage technology across the value chain to be able to match them on scale and skill. What will be critical for CEOs and CIOs is how companies think about democratizing technology to make its advantages felt by every stakeholder in the business.

Indian companies are witnessing a surge in the opportunities available to them. However, they face an uphill task in finding and retaining the right talent due to several factors such as fierce competition, misalignment of skills, legacy systems and processes and limited leadership development opportunities.

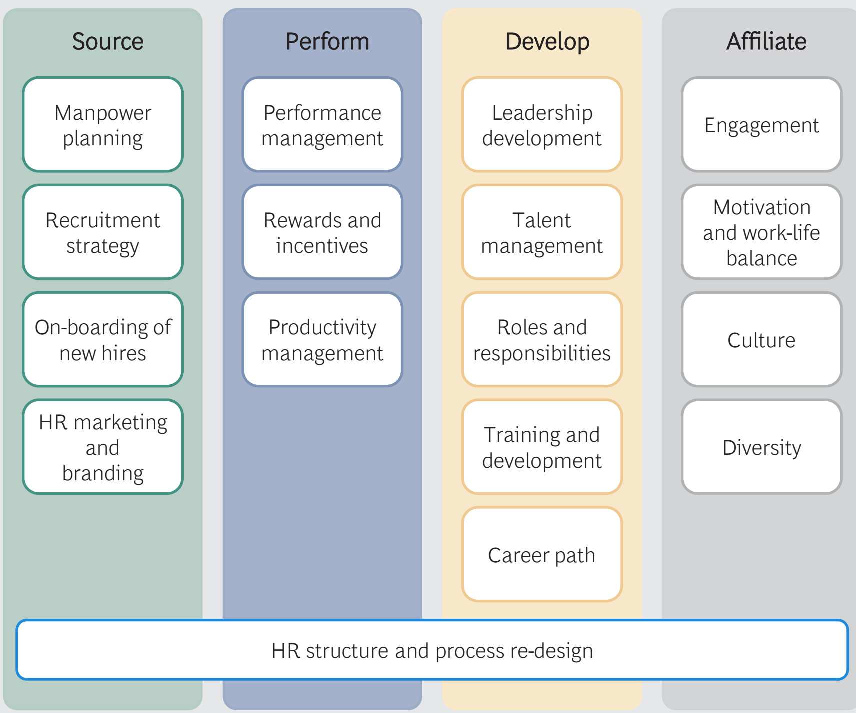
Moreover, the problem will become even more acute as revenue growth outpaces quality talent supply. In order to address this, companies need to take a re–look at their strategy along the entire employee life–cycle from recruiting to employee development and retention.

Most Companies in India Concerned With an Increasing 'People' Challenge



Sources: EIU; BCG analysis.

Focus Required Across a Wide Variety of Human Resource Topics to Drive Talent Acquisition and Retention



The people challenge, though complex, can be addressed with a holistic HR and talent management strategy. The approach needs to recognise and accommodate functional / regional variations, but also maintain an enterprise–wide view.

What is important is that as an organization's business changes shape with changing times, some core people–related policies stay consistent and confirmative.

FOR FURTHER READING

The Boston Consulting Group publishes other reports and articles on related topics that may be of interest to senior executives. Recent examples include those listed here.

How Millennials Are Changing the Face of Marketing Forever—The Reciprocity Principle
A focus by The Boston Consulting Group, January 2014

One Size Does Not Fit All: A Tailored Approach to Creating Value
The 2013 Consumer Value Creators Report, December 2013

Staying Ahead of the Customer: Retail Transformation and Reinvention
A focus by The Boston Consulting Group, September 2013

Winning With Uncertainty
A report by The Boston Consulting Group, in association with The Confederation of Indian Industry (CII), June 2013

From Buzz to Bucks—Capitalizing on India's "Digitally Influenced" Consumers
A focus by The Boston Consulting Group, April 2013

India is Trading Up and Down
A white paper by The Boston Consulting Group, October 2012

Retail 2020: Competing in a Changing Industry
A focus by The Boston Consulting Group, August 2012

Indian Agribusiness—Cultivating Future Opportunities
A report by The Boston Consulting Group, July 2012

The Tiger Roars—An In–Depth Analysis of How a Billion Plus People Consume
A report by The Boston Consulting Group, in association with The Confederation of Indian Industry (CII), February 2012

Digital India: The Rush to Mobile Money
A white paper by The Boston Consulting Group, July 2011

Building a New India: The Role of Organized Retail in Driving Inclusive Growth
A report by The Boston Consulting Group, in association with The Confederation of Indian Industry (CII), February 2011

Digital India: The $100 Billion Prize
A white paper by The Boston Consulting Group, January 2011

NOTE TO THE READER

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