Creating Value through Customization

Winning through Shelf-Centered Collaboration

GMA
The Association of Food, Beverage and Consumer Products Companies

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Grocery Manufacturers Association

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Methodology and Participants

This study was jointly sponsored by the GMA Supply Chain Vanguard and Sales committees. It focused on both product and services customization in order to develop key insights into how CPG manufacturers and retailers can better address the challenges of creating win-win customization programs.

The study combined a written survey of manufacturers and retailers with detailed case examples for select manufacturers. The surveys addressed topics such as the focus of manufacturers' and retailers' current customization programs, the relative effectiveness of different forms of customization, and processes and metrics for successfully managing customization. The case studies provided additional in-depth assessment of the economics of customization programs, key breakdowns for less effective programs, and key success factors for greater program effectiveness.

The Grocery Manufacturers Association and Booz Allen Hamilton would like to sincerely thank the following companies for their participation in this study:

CPG Manufacturers		Retailers
Alberto-Culver Company	Mariani Packaging Company, Inc.	Brookshire Market
Bimbo Bakeries, USA	Masterfoods USA	CVS Pharmacy
Campbell Soup Company	McCain Foods USA, Inc.	Giant Eagle, Inc.
Clorox Company, The	McCormick & Company, Inc.	Meijer, Inc.
Dial Corporation, The	Meadwestvaco Corp.	PetSmart, Inc.
Diamond Foods, Inc.	Nestle Waters North America, Inc.	Publix Super Markets, Inc.
General Mills, Inc.	Pharmavite LLC	Rite Aid Corp.
Georgia-Pacific Corporation	Playtex Products, Inc.	Target Brands, Inc.
International Paper Company	Reily Foods Company	
Johnson & Johnson	Rich Products Corporation	
Kimberly-Clark Corporation	San Antonio Farms	
Kraft Foods, Inc.	Sara Lee Corporation	
Land O' Lakes, Inc.	Welch Foods, Inc.	

All responses to the study were treated as confidential information. Specific responses of individual participants were not identified.

Executive Summary

Retailers are increasingly demanding customized products and services from consumer goods manufacturers. Manufacturers, seeking volume growth and looking to improve their competitive position with key customers, strive to meet these demands, driving additional complexity into their businesses. The results from such efforts have clearly been mixed: *half of all customization programs fail to meet the goals of either the manufacturer or the retailer; product costs and complexity increase, yet sales do not grow enough*. Perhaps more importantly, opportunities to maximize shelf performance erode as less effective programs and proliferating SKUs compete for valuable display space and promotional resources.

As frustrating as customization can be, simply rationalizing the number of customization events will not solve the problem. The growth in customization is closely linked to efforts by both manufacturers and retailers to meet important objectives. To improve program effectiveness, retailers and manufacturers need to take a more strategic approach that better integrates *shelf-forward* efforts to drive consumer response with *shelf-back* programs to create a more efficient supply chain from product sources to the shelf.

Our report identifies a set of successful practices for *Shelf-Centered Collaboration* that significantly improves program effectiveness and enhances efforts to build market-leading merchandising and supply chain capabilities.

Four key findings:

1. Retailers and manufacturers are each driving increased customization in pursuit of category growth and cost efficiency.

Growth in customization has accelerated with the emergence of new retail formats, such as warehouse clubs and dollar stores. Eager to differentiate between their formats and competing channels, retailers asked manufacturers to create exclusive products or new sizes and packaging options such as club sizes, multi-packs, variety packs and bundled products. Manufacturers responded proactively to this changing environment, introducing a variety of customization options to promote greater in-store merchandising effectiveness. These programs seek to replicate some of the benefits of an in-store direct-store-delivery (DSD) model by creating more points of presence in a store, increasing the quantity and quality of display share, shelf-space, and signage.

In parallel, a desire to create more efficient supply chains drives customization programs. These collaborative planning efforts focus on improving the flow of products to the shelf, reducing out-of-stocks and unsaleables, and improving promotion program compliance and cost efficiency.

Not surprisingly, given these important drivers of customization, two-thirds of manufacturers surveyed said they had seen an increase in customization over the past three years and expect that trend to continue. An equal proportion of retailers polled agree that customization of products and services will also increase over the next few years.

2. Despite considerable efforts, half of customization programs fail to meet the objectives of either the manufacturer or retailer.

Manufacturers believe product and service customization programs are more likely to create value for retailers than for themselves. On average, the manufacturers surveyed estimated that product and service customization create value for retailers approximately two-thirds of the time – but less than half the time for the manufacturer.

However, manufacturers' perceptions are not supported by retailer feedback. Retailers surveyed say that most customization programs fail to deliver value that exceeds opportunity costs for space and labor. Retailers agree that the benefits of many customization programs do not outweigh the extra costs and complexity.

3. Success starts with making *strategic choices* about what to customize and where, rather than just focusing on complexity management.

We have found, across industries, that the biggest determinant of success consists of making two sets of choices: what to customize for whom, and what set of scalable capabilities to use. In a cross-industry study of 50 product and service companies, Booz Allen found that the companies we call "Smart Customizers" outperformed industry peers two-to-one in revenue growth and had profit margins five to 10 percent above their competitors.

The case studies from this report confirmed our prior findings that the most critical choice for creating shared value is what to customize, not how to manage the complexity in an existing program more efficiently. Creating a limited menu of items that can be customized turns out to be a much more efficient and cost-effective strategy than trying to accommodate ad hoc demands and then struggling to manage the resulting complexity.

4. Leaders create value through Shelf-Centered Collaboration with retailers. The power comes from developing shelf-forward insights and shelf-back enablement – together.

Customization programs based on joint insights and decisions tend to work better than those requests made to manufacturers on an ad hoc basis. Our study showed that the most successful programs are those where there is greater collaboration. Indeed, manufacturers who scored higher in our survey on a number of key dimensions for collaboration outperformed those who followed fewer of those successful practices.

Shelf-Centered Collaboration gives manufacturers the chance to not merely "do better" but also achieve substantially higher rates of success and build leading customer relationships. Getting to that level, however, requires substantial commitment to build the required data and insights, manage the collaborative process, and build adaptive capabilities that are scalable across the company's portfolio of brands and business units.

Conclusion

Clearly, the current customization boom will end in two ways – failure and success. Companies that continue on their present path of customizing without sufficient effort to create a more systematic, analytical approach will generally succeed and fail in equal measure – a track record that will crowd out other opportunities to invest as complexity increases and eats up whatever gains are made. For those companies that learn how to collaborate and plan their customization strategies, however, successes will become much more common than failures.

In summary, we identified 10 lessons learned for more effective Shelf-Centered Collaboration:

- **#1** Understand all costs and value from end-to-end
- **#2** Manage trade-offs jointly
- **#3** Establish effective gating criteria
- **#4** Weed out losing programs
- **#5** Focus resources on the most promising strategic opportunities
- **#6** Require commitments for off-menu exceptions
- **#7** Sustain dialog throughout the program
- **#8** Measure compliance proactively
- **#9** Make-to-order for customized products
- **#10** Learn from your mistakes

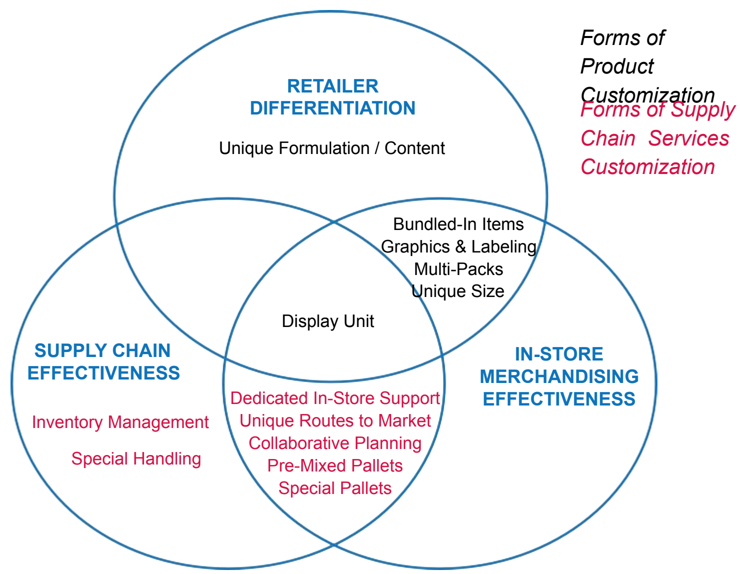
And over time, such Shelf-Centered Collaboration will become not just a generator of new revenues at lower total incremental costs, but a profound source of innovation to create shared value with retail partners.

Key Findings

1. Retailers and manufacturers are each driving increased customization in pursuit of category growth and cost efficiency.

Consumer packaged goods manufacturers used to face far less complexity in their businesses. They enjoyed fewer requests to customize products and services, and could focus on managing for greater scale and cost efficiency. Over the past decade, however, customization has increased dramatically. Much of the increase in customization has been driven by increased retail format competition. However, manufacturers' own go-to-market strategies have been a contributing factor as well, as they seek to create shared value with key retailers. Together, CPG manufacturers and retailers have pursued three basic strategies – complementary strategies, conceptually, but often tugging in different directions in reality – and the pursuit of those strategies has caused an unprecedented increase in complexity.

Exhibit 1: Customization Program Strategies



The current customization boom began with the introduction of new sizes and packaging options designed to create a closer fit with particular shopping occasions and create unique value for consumers. Retailers were looking for greater exclusivity on the shelf, both through their own investments in store brands, as well as through customized offerings from manufacturers.

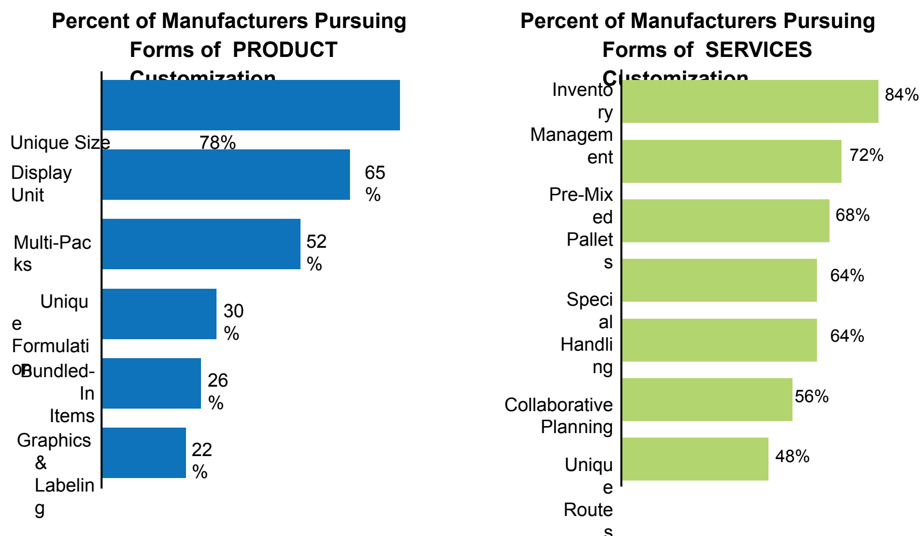
Today, the appetite for customized goods and services continues to grow. Manufacturers face demands for customized products across club, dollar, mass merchants, drug, grocery and specialty retail channels alike. Retailers request an increasing number of exclusive SKUs, ranging from unique formulations, sizes, and packaging options such as multi-packs (the selling of the same item in bulk), variety-packs (mix of flavors of same item), and bundle-ins (the bundled packaging of complementary, but different, items). At the same time, manufacturers and retailers each see customized displays and pallets as a way to increase the effectiveness of promotional events in store.

Lesson #1: Understand all costs and value from end-to-end.

One manufacturer worked closely with a retail partner to develop better forecasts for incremental volume from customized end-cap displays and special packaging, including estimates of cannibalization from baseline sales. At the same time, the manufacturer worked carefully to manage complexity from the program and resulting costs. The result: product customization options that were subsequently approved drove sales lift of 25 percent and 8 percent higher profits after taking into account cannibalization and all incremental costs.

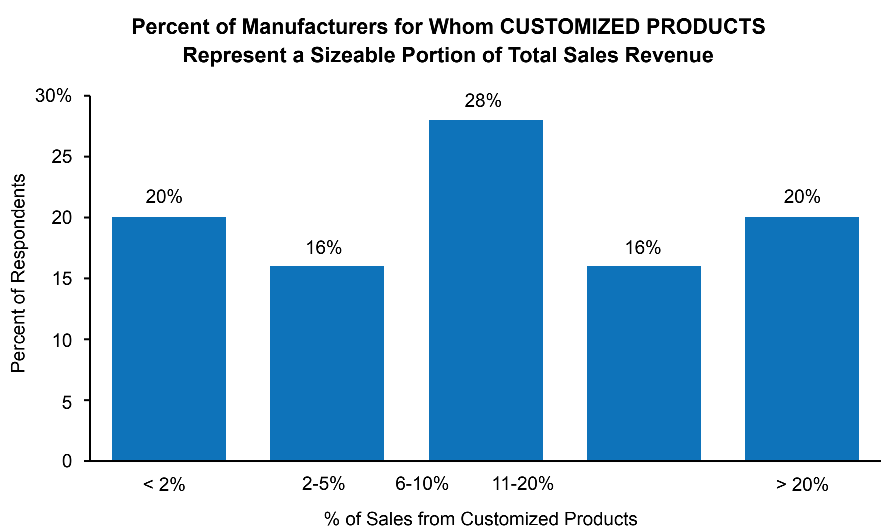
Manufacturers and retailers have also jointly pursued a growing set of customized services. They have made investments in stronger category management, trade promotions, and shopper marketing insights capabilities in order to improve the effectiveness and efficiency at the shelf. They have also collaborated on a growing set of supply chain services to accommodate the ever-increasing variety of products that need to be brought from the plant floor to the shelf. Seeking to reduce stock outs and inventory investment, manufacturers and retailers have experimented with new ways to drive shorter order lead-times, more rapid replenishment, and better collaborative planning for promotions and custom displays.

Exhibit 2: Types of Product and Services Customization



As a result, customization represents a growing proportion of industry sales volume. As Exhibit 2 shows, the vast majority of CPG manufacturers provide a broad scope of product and services customization. Today, the largest proportion of manufacturers report that customization accounts for six to 10 percent of sales, with more than one-third of of manufacturers reporting that customized product sales are greater than 10 percent of their sales.

Exhibit 3: Customization of Products

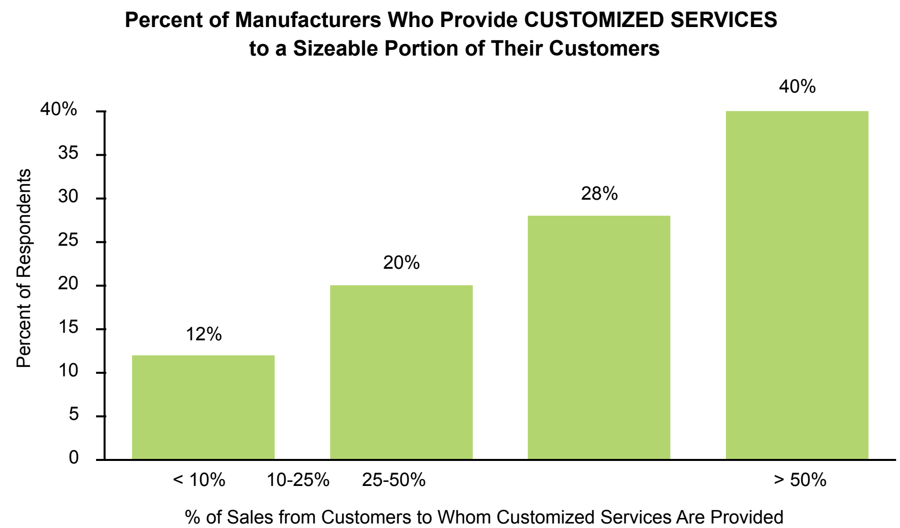


Lesson #2: Manage trade-offs jointly.

A CPG manufacturer faced growing demands for customized SKUs to support more differentiated trade promotions for retailers. These demands often took the form of customized displays with special product offers, such as unique sizes or bundle-ins of complementary goods. Recognizing the opportunity to engage the customer in a more proactive dialog around what forms of events are most effective, the manufacturer instituted a "one fund" approach. Under the new model, customization program costs are charged against trade funds. In addition to this simple change, the manufacturer's sales teams also have a set of fact-based tools they can use to frame more productive collaboration.

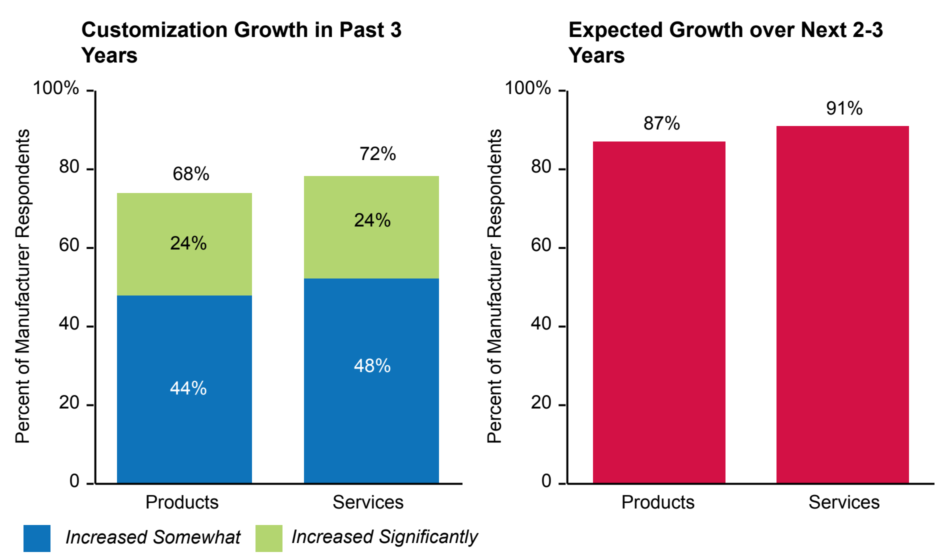
Customization of services is even more widespread. Four out of 10 manufacturers say that customized supply chain services are provided to retailers accounting for more than 50 percent of their current sales volume, and nine out of 10 provide customized supply chain services to retailers representing at least 10 percent of their volume.

Exhibit 4: Customization of Supply Chain Services



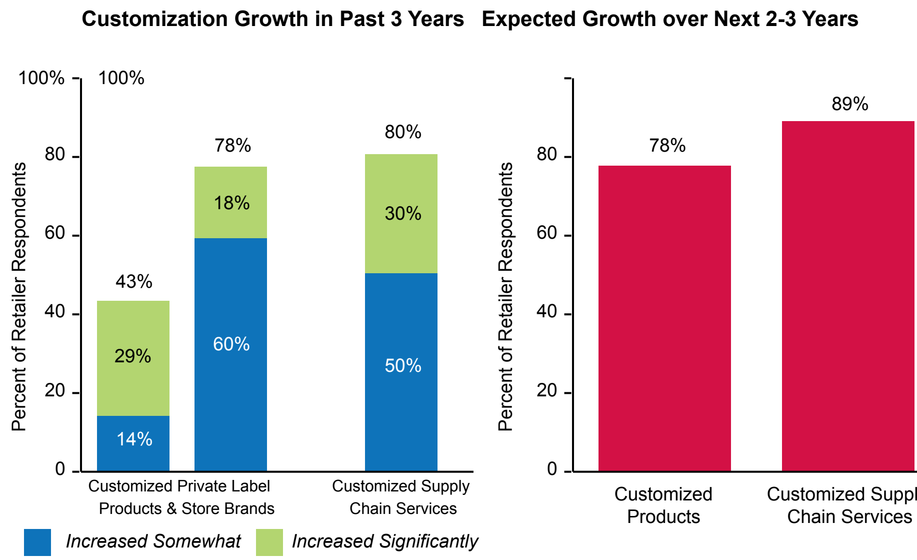
Over the last three years, customization has risen substantially – and manufacturers and retailers both expect that the trend will continue. More than two-thirds of manufacturers saw the percentage of their sales from customized products increase over the past three years, and a comparable number saw the same for customized supply chain services. Looking forward, an even greater proportion expect further growth in customization over the next three years.

Exhibit 5: Growth in Customization for Manufacturers



Retailers also noticed that customization is spreading. Their perceptions are most in alignment for services, where a comparable percentage of retailers saw customization programs grow over the past three years.

Exhibit 6: Growth in Customization for Retailers



Retailers did not perceive the growth of product customization quite as strongly as manufacturers, perhaps because their attention is often focused on private label and store brands. Moreover, for retailers, product customization provided by manufacturers can be seen as something of a "free good." A branded packaged good requires less direct investment compared to store brands, where retailers are more actively involved in managing the brand and the supply chain. Similarly, for supply chain services, greater investments are required by retailers for changes to processes and IT systems.

While customization has grown, the success rates of customized projects are quite low. One reason is that all this customization has created an enormous new source of additional complexity for both manufacturers and retailers, particularly as the varieties of customization continue to multiply. Many manufacturers now receive hundreds (some, even thousands) of requests for customization each year – either directly from customers and customer teams, or arising from programs launched by the sales leadership, supply chain organization or brand marketing teams. Often, once these programs begin, they become an ingrained part of the business.

Customization makes the manufacturer's task more complex in a variety of ways. Forecasting, for example, becomes increasingly complex, as analysts face the challenge of predicting the lift from a promotional event and the cannibalization of base volume as special displays, unique sizes and packaging are added to the equation. Lead times to manage supply chain partners efficiently grow as well, as the manufacturers struggle to better manage co-packers and graphics, and face a greater challenge capturing procurement efficiencies.

Lesson #3: Establish effective gating criteria.

Recently, one CPG manufacturer created a tiered menu for customized programs, more clearly specifying what aspects of the offering could be customized with what lead times and parameters. As a result, the company has created a much more efficient set of customization menu options that add value for the company and its customers, while focusing customization on growing and profitable brands and addressing root causes of underperformance.

Typically, the handling of this complexity is made more on an ad hoc basis, without a fully fact-based analysis. Often, manufacturers have few guidelines and fewer analytical tools to help decide which requests to fulfill, and only rarely do businesses evaluate the full impact of their customization choices within the broader context of their entire program offering. And in part because of all the busy-ness customization brings about, a key question generally goes unanswered: with all this increased complexity, is customization creating enough shared value for manufacturers and retailers to offset the added costs?

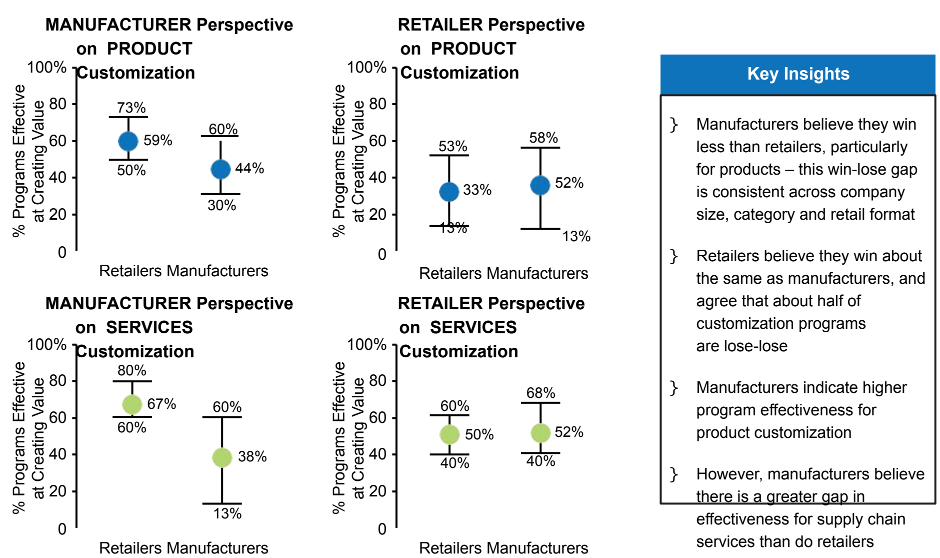
2. Despite their strategic importance, half of customization programs fail to meet the objectives of either the manufacturer or retailer.

Unfortunately, despite the significant investments both manufacturers and retailers are making in customized products and services, roughly half of all customization programs fail to create shared value.

Manufacturers believe that the cost of the failures falls on them. Asked to estimate who wins and loses in customization, manufacturers estimate that product customization programs create value for retailers roughly two-thirds of the time. In contrast, manufacturers believe that the same programs create value for themselves less than half the time, on average.

Manufacturers have the same view of supply chain services. They believe that retailers benefit from customized supply chain program roughly two-thirds of the time. Again, manufacturers believe that retailers benefit more than they do. Manufacturers estimate that they "win" only one-third the time, or roughly half as often as they believe retailers do.

Exhibit 7: Manufacturer vs. Retailer Perceptions for Product and Services Customization



Note: Bubbles indicate averages; ranges show the 25%-75% quartiles

Lesson #4: Weed out losing programs.

A manufacturer faced more than 1000 customized display requests across its divisions. To better manage the complexity of this proliferating customization, the manufacturer decided to create a centralized display team, and put in place hurdle guidelines based on sales volume and profit margin requirements. Centralized capabilities enabled the company to learn from its mistakes and its successes. Today, there is more visibility into the total costs and benefits of display programs, and at the same time, display execution is more efficient at a lower overall cost.

Many manufacturers believe retailers have an informational advantage that helps them avoid losing propositions for themselves. They perceive customization programs to be similar to their experience with win-win and win-lose trade promotion events. Many manufacturers, having spent years building stronger capabilities to engage the trade in a better dialog about how to create a better mix of win-win promotional events, now believe they face the prospect of pushing the rock back up the hill.

Yet retailers are evidently not profiting as much as manufacturers like to think. As Exhibit 7 shows, retailers believe product customization benefits them half as often as manufacturers estimate. And retailers' were only slightly more optimistic about the value being created from customized supply chain services: in fact, they thought that manufacturers and retailers both succeeded in service customization only about half the time.

Some might see this as a sign that there is something inherently wrong with product and services customization. They might point to the fire of increased complexity which they perceive to be burning out of control and look solely for ways to put out the blaze, or at least significantly contain it and prevent it from spreading again in the future. Moreover, customization of SKUs runs against the grain for most category management initiatives, which tend to focus more on reducing SKU proliferation and consumer confusion at the shelf. Customized services, in turn, would be more effective if they were more scalable across a broader number of customers.

However, it is worth emphasizing that when customization programs do work, they create significant shared value for both manufacturers and retailers, as our case studies demonstrated. Moreover, good customization programs can serve as an important laboratory where manufacturers and retailers collaborate to find new ways to get consumers to purchase the product (shelf-forward collaboration) and to find better ways to bring products from the plant floor to the shelf (shelf-back collaboration).

Therefore, leading manufacturers cannot risk passing up such an opportunity altogether. Not only would they miss the chance to capture the benefits available, but they would provide a greater opening for competitors to take their place in forging more collaborative relationships with retailers.

3. Success starts with Shelf-Centered Collaboration. Making strategic choices about what to customize and where, rather than just focusing on complexity management.

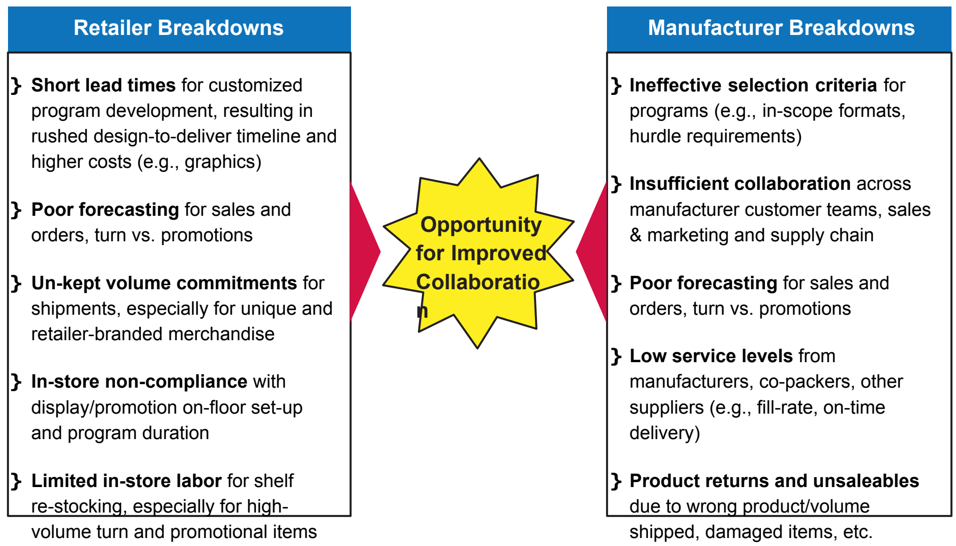
The fact that retailers feel they fare as poorly as manufacturers suggests a significant opportunity for greater collaboration exists.

Indeed, in the cases studied for this report, we found a consistent set of breakdowns that erode the performance of customization programs.

Why do so many projects go wrong? Most of the problems stem either from insufficient communication or insufficient commitment – problems that tend to become exacerbated over time as complexity grows.

On the retailer side, short lead times for customized program development often leads to rushed design-to-deliver timelines and higher costs on such elements as graphics. Poor forecasting also sets projects on the wrong path. Failure to maintain volume commitments, especially for exclusive merchandise, leads some programs to fall short, as does non-compliance with agreements to set-up on-floor displays and promotions or to keep displays up for a certain time period – a problem often traceable to labor shortages or poor communications.

Exhibit 8: Examples of Retailer and Manufacturer Breakdowns



On the manufacturer side, there are similar problems. Often, there are ineffective selection criteria for customization programs, including a lack of attention to hurdle requirements. A lack of collaboration within the manufacturer itself is another source of expensive mistakes, as many companies have customer teams that don’t interact well enough with marketing, finance and the supply chain. Inadequate service levels from co-packers and suppliers also compromises many projects, as do product returns and products that are unsaleable because they were damaged en route.

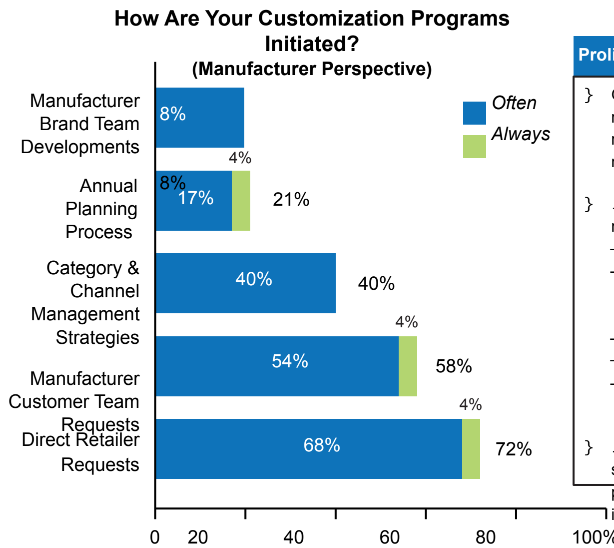
These are symptoms of a bigger issue. The underlying driver of these breakdowns is that customization programs are too often managed at the event level, rather than as a strategic capability that is well integrated into the overall set of capabilities that are being developed in collaboration with retailers. Indeed, while customization heavily intersects a broad array of capability areas — for example, category management, trade promotions, shopper marketing and supply chain integration — customization programs are typically not elevated to the same strategic level as these other capabilities.

The ad hoc nature of customization management is evident from the way most programs are initiated. As Exhibit 9 shows below, the vast majority of customization requests flow “bottom up” out of a myriad of interactions with customers, often through customer teams. Our survey shows that between half and two-thirds of manufacturers’ customization programs originate from either a retailer or a customer team making a request as opposed to a more “top-down” planning process or strategy.

Lesson #5: Focus resources on the most promising strategic opportunities.

One company sought to meet or exceed its national accounts' customer service expectations by targeting specific improvements in its unit fill rate and on time delivery. By creating a single point of contact for each customer, and then making adjustments to fit the retailers' projected needs, through added safety stock levels, use of the retailers' preferred carriers, and customer-specfic service level tracking and monitoring, unit fill rates rose from 85 percent to 98 percent, earning the company the vendor of the year award with two of its largest and fastest growing national accounts. This good will in turn translated into faster growth and higher profits.

Exhibit 9: How Customization Programs are Initiated



Proliferation of Customization Programs

- Growing number of customization requests originating across a broad range of touch-points between manufacturers and retailers…
- …Resulting in heightened complexity to manage the category, e.g.,
  - SKU rationalization efforts
  - Managing extended supply chain (e.g., graphics, co-packers, contract warehouse)
  - Order/replenishment cycles
  - Picking/assembly
  - Shelf re-stocking (and rotation for perishables)
- …And adding complexity to delivery of supply chain services (e.g., lead times, process changes, warehouse and in-store labor)

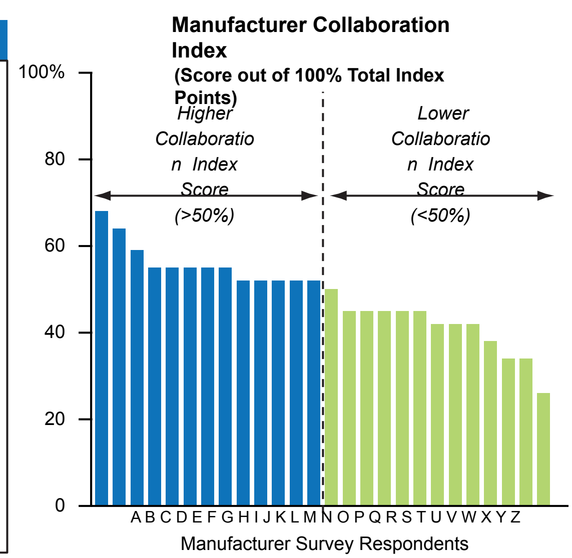
Given the tactical, bottom-up nature of how programs are initiated, it is not surprising that all too often collaboration between manufacturer and retailer falls well short of their desired practices, such as having a highly standardized process for making customization requests or driving decision-making about customization programs through multi-functional teams. Even the highest scorer on an index for such key elements of collaboration earned only seven out of 10 points on our collaboration index.

Exhibit 10: Collaboration Index

Collaboration Index Definition

Composite measure of how well manufacturers collaborate to initiate, evaluate and pursue customization programs with retailers – based on following survey questions:

- How are your customization programs initiated?
  - Category/channel management strategies
  - Annual planning process
  - Manufacturer customer team requests
  - Manufacturer brand team developments
  - Direct requests from customers
- How formalized is your process for evaluating customization requests?
  - Ad hoc
  - Highly standardized
- How do you decide which customization programs to pursue?
  - Unilateral decision
  - Multi-functional team



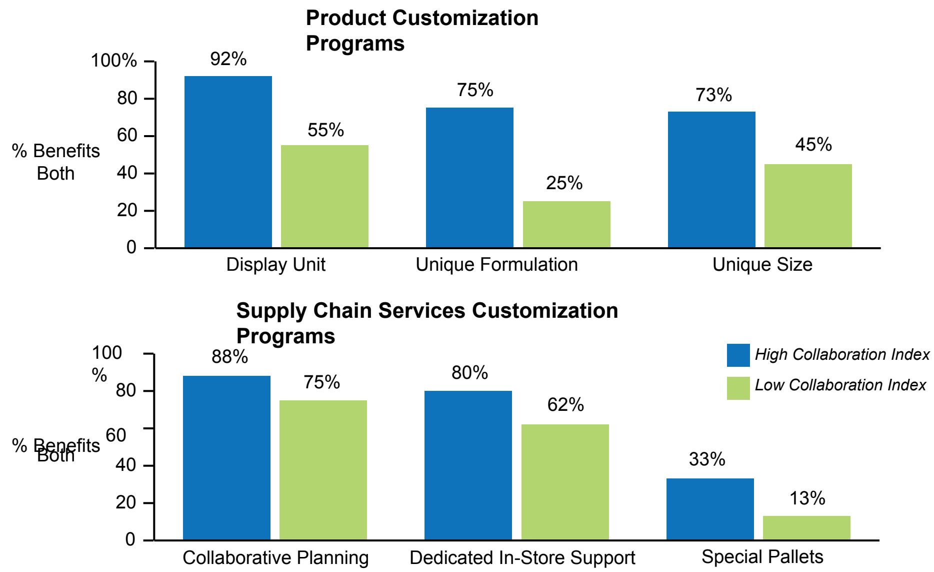
Customization programs based on jointly made strategic decisions tend to work much better than those based on ad hoc decisions. Manufacturers who scored higher on our survey on a number of key dimensions for collaboration outperformed those who followed fewer of those best-practices by significant margins.

Lesson #6: Require commitments for off-menu exceptions.

A CPG company won the right to participate in a special cross- manufacturer display in the health/ wellness section of a major retailer that conducts an auction where manufacturers bid for end-cap displays. To help build program commitment for its unique size and package product, the manufacturer worked with the retailer's buyer to agree on order and shipment volumes and review display design elements. While the company met the retailer's desire for compelling product differentiation, the retailer shipped only 50 percent of factory orders, leaving the manufacturer stuck with the remaining unique inventory.

For example, better collaboration led to a 92 percent success rate for display customization, compared to 55 percent for respondents who ranked in the bottom half. The results were even starker for unique formulation, where 75 percent of high-collaborators succeeded in creating shared value from customization programs, compared to only 25 percent for low-collaborators. And in unique size, 73 percent of high collaborators succeeded compared to 45 percent of the low collaborators.

Exhibit 11: High vs. Low Collaborators for Products and Services

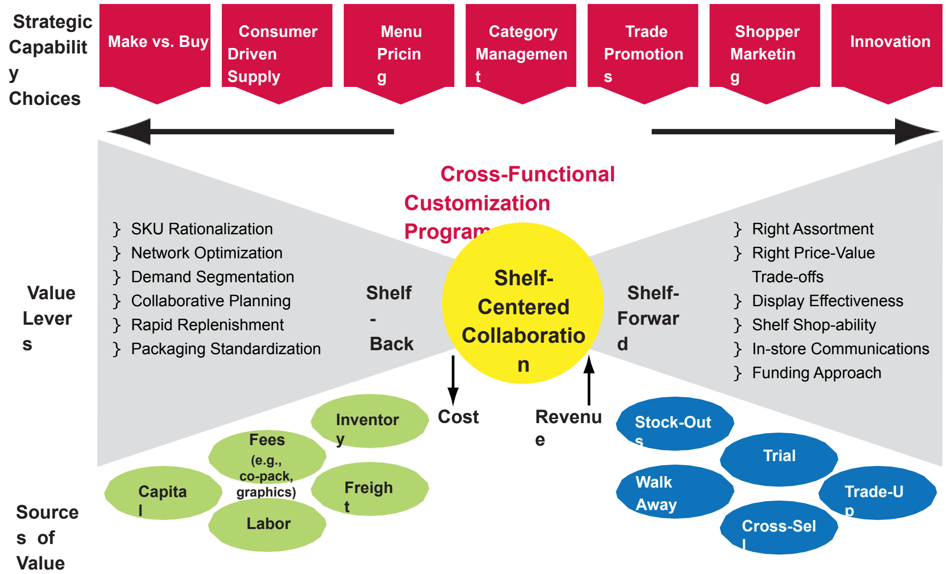


The lesson is clear: to create mutually positive, sustainable results, strategies for collaboration need to be *shelf-centered*. By *shelf-centered*, we mean programs that encourage both *shelf-forward* consumer response and greater *shelf-back* efficiencies. Part of that holistic view is learning to see customization not as an exceptional event, but as a regular activity, and just one tool in a larger tool kit that manufacturers can use to create shared value with their retail partners.

This is far from how most customization programs are executed today. Typically, customization efforts are either shelf-forward, focused on a market opportunity, or shelf-back, in which case the supply chain is the main concern. Only rarely are the two considered in a single context, although almost every serious customization program must have an impact on the other side of what is ultimately, after all, a single program.

There are a number of reasons this tends to be the case. Manufacturers' customer teams, the place where many customization requests originate, often lack the depth of supply chain expertise to assess a request's impact on the supply chain. Often, capability programs – projects within which customization is a supporting strategy or which address key issues that intersect with customization choices – are typically managed by distinct groups within the organization, such as the trade promotion or category management teams. Also, company-to-company dialogs typically still occur along functional lines, with category managers meeting retail merchandisers, or retail supply chain teams meeting manufacturer's supply chain teams.

Exhibit 12: Shared Value Through Shelf-Centered Collaboration

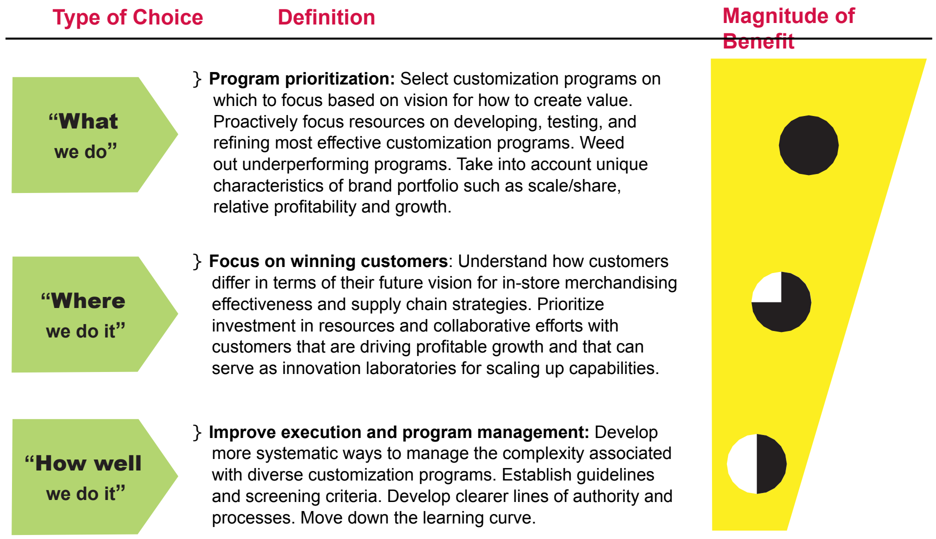


Finally, true cross-functional, Shelf-Centered Collaboration is simply hard to do in a large organization, for analytical, political, and staffing reasons. The analytical challenges are daunting, in that Shelf-Centered Collaboration requires building a new and more precise fact base. It requires creating more precise metrics, such as ensuring that an SKU is not marked “in-stock” when its really sitting on a pallet in the back room. It requires more careful hurdle rates and it demands more systematic research to assess whether a program is meeting its objective, whether to encourage trials, up-sells, or up-selling or cross-selling.

Politically, cross-functional management involves prescribing the decision rights of various departments. Staffing challenges are not insignificant either, since executives in a truly cross-functional organization need to be available to weigh the facts and make the right decision. Especially at first, reaching a useful level of insight requires a number of people to step back from day-to-day pressures and focus solely on the issue at hand.

Fortunately, although the problems consumer product manufacturers and retailers face might seem daunting, addressing these challenges yields significant benefits. In a cross-industry study of 50 product and service companies, Booz Allen found that the set of companies we identified as “Smart Customizers” outperformed industry peers two-to-one in revenue growth and had profit margins five to 10 percent above competitors.

Exhibit 13: Types of Choices for Shelf-Centered Collaboration



In our experience, the most critical choice for creating shared value is what to customize rather than where to provide a given form of product or service customization or how to manage the complexity in an existing program more efficiently. As with any investment, much of the outcome in a customization program is determined by the initial decision of where to invest. Unsurprisingly, such strategic decision-making turns out to be a much better strategy than accommodating ad hoc demands and then struggling to manage the resulting complexity.

Clearly, performance benefits from well executed programs, but only if the economics of customization are already in place. Manufacturers must first understand the true cost impact from customization, such as whether a custom display substantially raises the program cost base or cannibalizes open stock. Once manufacturers determine what to customize, as well as what not to customize, they can then drive improved value from efforts to improve execution.

4. Leaders are creating the greatest shared value by jointly building new capabilities in partnership with retailers. The power comes from understanding and addressing shelf-forward opportunities and shelf-back enablement together.

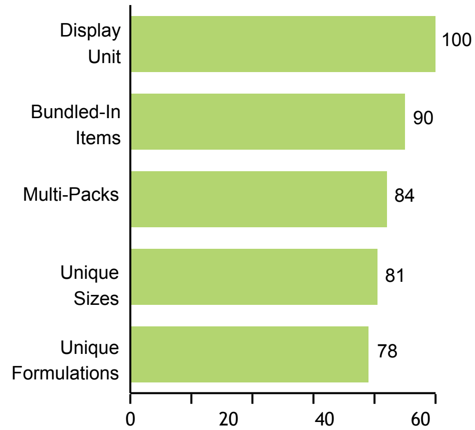
Some kinds of customization are clearly more effective than others, a fact that should be considered when requests are made. Asked what kinds of in-store promotional support are most effective, manufacturers surveyed believed that display units were the most successful form of customization, followed by bundled-in items, multi-packs and unique sizes. Unique formulations were viewed as the least effective form for product customization.

Lesson #7: Sustain dialog throughout the program.

Poor communication at each link of the value chain led to costly mistakes for one manufacturer launching a promotion for five new SKUs with a major retailer in a customized display. Given the complexity of the event, the SKUs needed to be shipped from multiple locations to a co-packer and then shipped on to the retailer. One day before the scheduled start of the program, the vendor discovered a graphics error resulting in seven days' lost service and a $150,000 expediting charge. Packs were delivered late, and then poor in- store compliance exacerbated late delivery. Some displays were on the floor for four to six weeks instead of the agreed eight weeks while others were broken down to shelf.

Exhibit 14: Manufacturer Perceptions for Products Customization

Relative Effectiveness of Product Customization Programs Creating Value[1] (Indexed to Most Effective Form)



Overview of Custom Displays

- Opportunity to gain incremental in-store points of presence and weeks of display
- Often linked to new launches, though also used to create more unique events or respond to retailer-specific opportunities (e.g., auctions)
- Multiple objectives include building consumer awareness, incenting trial and cross-promoting brands
- Often leveraging unique packaging (e.g., twin packs, bundled-in items)
- …Using an array of display formats (e.g., end-cap, sidekicks, pallet displays, shelf-ready displays)
- Sometimes linked to retailer category merchandising objectives (e.g., all items are $9.99, "health/wellness" theme)

Retailer survey respondents reported the same rank orderings[1] indicating a stable hierarchy across forms of product customization

Note: (1) Middle-tier customization forms shift rank order based on manufacturer segmentation and retailer perceptions of value delivered to manufacturers vs. retailers

Case Example: Winning Through Focused Product Customization

Winning Through Focused Product Customization

At one diversified CPG company, management discovered that each of its product divisions had a different process for selecting product customization programs, with varying degrees of effectiveness. Many approved programs failed to meet retail customer needs and/or deliver satisfactory financial results due to high discount usage and a poor understanding of total cost-to-serve.

Company executives decided to develop a new product customization approach that improved upon past inefficiencies and delivered better overall results. Management selected one of their household products divisions to pilot this new approach, and established a task force across sales, marketing, finance and supply chain to support the initiative.

The team developed a targeted list of key issues to solve, and identified three major improvement opportunities: 1) develop a new corporate governance process that separated product customization from new product development; 2) create category-specific decision guidelines with clear selection parameters that reduce ambiguity and inefficiencies; and 3) streamline corporate design-to-fulfillment processes into common platforms in order to lower costs, improve quality, enable speed to market and drive scale.

A key element of the new approach was the creation of a tiered menu of product customization offerings designed to meet a broad range of customer needs while simultaneously improving the manufacturer's financial returns. The team identified four tiers of customization vehicles with varying benefit levels to better address retailer needs. Next, they instituted specific requirements for lead times, order volumes, packaging/design elements and discount usage to help keep costs in line with expected program value.

These tiered offerings were limited to only strong performing brands within the category in order to ensure program results. The team eliminated inefficient offerings based on category-specific cost, profitability and sales lift parameters, and offered the product customization menu as a pre-approved option that retailers could select for use of existing trade funds. Lastly, the manufacturer instituted economic-value based metrics for continued pre-screening and post-program performance review.

The result: a clear set of pre-approved customization vehicles that the manufacturer could confidently offer its retail partners, and with improved financial success. Retailers were also empowered to make the right trade-offs regarding how to best use their trade funds against product customization vs. other value-add initiatives.

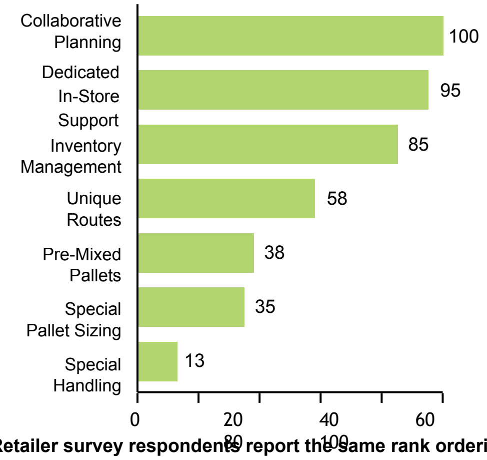
In supply chain services, manufacturers believe that collaborative planning, dedicated in-store support and inventory management are the three best tools while at the other end of the scale, special handling rated last. In addition, retailers agree with manufacturers about what works best – an indication that manufacturers and retailers share similar perceptions about which kinds of customization work and which do not.

Lesson #8: Measure compliance proactively.

A manufacturer launching a new product approached a retailer to participate in a custom display promotion to secure additional points of presence throughout the store. Compliance was ensured through an aggressive sell-in program to individual store managers and, where available through a concurrently running pilot program, an RFID tag that could verify if the display was actually in place. The result: 60 percent in-store compliance, nearly double the baseline rate of 33 percent compliance. Some stores even left the display up several additional weeks beyond the agreed display period.

Exhibit 15: Manufacturer Perceptions for Services Customization

Relative Effectiveness of Services Customization Programs Creating Value[1] (Indexed to Most Effective Form)



Overview of Supply Chain Services

- Taking a more consumer-driven approach to forecasting and replenishment
- Segmenting demand to standardize the routine and focus collaboration on root causes of demand variability (e.g., promotional events, new launches)
- Rationalizing SKUs for improved category management
- Improving business results via better service levels and increased on-shelf availability
- Driving more scaleable solutions across retailer and supplier partners (e.g., co-packers, other vendors)

Retailer survey respondents report the same rank orderings[1], indicating a stable hierarchy across forms of services customization

Note: (1) Middle-tier customization forms shift rank order based on manufacturer segmentation and retailer perceptions of value delivered to manufacturers vs. retailers

Yet these general areas of agreement mask considerable variability in specifics. In particular situations, some forms of customization that have lower than average effectiveness do quite well. In general, customization programs need to reflect both the needs of the retailer and those of the manufacturer, along with the insights regarding the shoppers of that particular category. For example, for a manufacturer with a greater mix of a low-impulse purchase product, custom displays are much more likely to cannibalize sales in the open stock.

Case Example: Winning Collaboration for Supply Chain of the Future

Winning Collaboration for Supply Chain of the Future

Executives at one CPG manufacturer were already evaluating whether to make some major changes to their distribution system when executives of a key retail partner asked them if they would consider teaming up to create a next-generation supply chain.

The retailer had experienced substantial process inefficiencies and high costs due to problems of poor forecasting, high inventory count for low-turn SKUs, high out-of-stocks and high damage and loss rates – problems the manufacturer's executives also needed to solve. The manufacturer jumped on the offer.

Together, senior teams from both the retailer and the manufacturer developed a vision of what they called "the supply chain of the future" – a consumer-driven supply chain that separated the flow of SKUs with stable "turns" from those that were more promotion-driven. By taking this step, they hoped to reduce current inventory levels while simultaneously improving service levels – and at the same time, reduce cycle time from 14 days to less than 24 hours. Moving forward, they hoped to create a scalable template that would help other partners of the retailer and the manufacturer and their suppliers.

These high-level goals were only the beginning. To create some more concrete plans, the two companies each provided dedicated, cross-functional teams to work on the project. Together, the teams mapped an end-to-end supply chain, examining places where there were inefficiencies and noting where improvements could be made. They developed a process that reduced order-to-receive time to 13 hours, as well as automated turns, and separated promotional volume. Finally, they agreed on a scorecard to track key performance metrics, which they later used to quantify their success.

The result: a win for the manufacturer, a win for the retailer – and a win for the shopper. The supply chain program successfully improved sales and order forecast accuracy, lowered inventory levels and reduced warehouse-to-store out-of-stocks. Overall, both the manufacturer and retailer achieved sustained share growth that has continued to outpace the market, and are currently expanding the program to include other customers and suppliers.

Lesson #9: Make-to-order for customized products.

One CPG company won an end-cap display with a major retailer. One of the ground rules for participation was that the manufacturer had to create a larger package size with higher unit margins for the retailer. As a result, the manufacturer counted on higher volume. Problems arose when the retailer placed a request for the promotional order, then ended up shipping only 50 percent of its initial order, leaving the manufacturer stuck with unique, branded inventory as unsaleables that required further markdowns.

The next most important factor is making a strategic decision about which customers are the right candidates for customization. This sounds simple, but in many cases, such prioritization efforts must take into account the relative growth and the true profitability of different products and customers. Creating that segmentation requires a clear understanding of the full costs of complexity, and a focus on rooting out some of those costs.

Leadership in customization is not just a question of deciding where not to customize – that is just a good way to avoid failure. As the case example above shows, creating a customization program that has a potentially transformational impact demands proactively picking partners who will be good to collaborate with not only on a given project, but on an entire new generation of shelf-forward and shelf-back capabilities. Executed well, such strategic partnerships then become a new source of innovation in themselves, and their insights can eventually be shared among a wider range of customers.

Ultimately, capturing the full potential for mutual benefit requires first paying attention to the strategic issues. It also requires close attention to execution detail. In fact, a number of lessons can be drawn from the cases of CPG manufacturers' customization projects that were analyzed for this report:

Exhibit 16: Lessons Learned

	Lessons Learned	Sample Elements	Lessons Learned (cont'd)	Sample Elements
WHAT	1 Understand all costs and value from end-to-end	} Breakeven volume } Cannibalization of base volume } "Hidden" costs	2 Manage trade-offs jointly	} One fund } Clear menu options } Aligned incentives
	Establish effective gating criteria	} Selection guidelines } Hurdle requirements } Scorecard metrics	Weed out losing programs	} Post-event analysis
WHERE	5 Focus resources on the most promising strategic opportunities	} Tiering } Menu pricing } Exclusivity guidelines	6 Require commitments for off-menu exceptions	} Negotiated commitments } Joint teams } Scorecard metrics
HOW	7 Sustain dialog throughout the program	} Joint program teams } Scorecard metrics	8 Measure compliance proactively	} Audits } Investments in technology (e.g., RFID)
	Make-to-order for customized products	} Demand segmenting (e.g., turn vs. promo) } I/T investments	Learn from your mistakes	} Design to value } Root cause analysis

Today, too many manufacturers remain focused on "doing incrementally better." Trying to solve the problem through a shelf-forward or shelf-backward approach, they typically fail to set rigorous metrics, or to understand the true value they have created. Nor have they attempted more than limited coordination of programs across their full portfolio. Instead, they focus almost exclusively on the project management that accommodates complexity rather than the underlying causes and value of that complexity.

Lesson #10: Learn from your mistakes.

One manufacturer found, upon closer examination, that one of its customization programs would require more than double the average sales lift it usually achieved from customized displays, when taking into account all incremental costs, price discounts, and cannibalization of open stock. However, the shipper was viewed as important to meeting brand goals. Rather than discontinuing the program however, the company identified opportunities to take 60 percent of the costs out of the original design. The new and improved shipper exceeded its break-even sales lift hurdle, which is now below the average of other customized displays.

Meanwhile, some manufacturers are proactively engaging retailers in jointly developing improved merchandising and supply chain strategies. As complex as their strategies are, however, these companies do share three common best practices:

Exhibit 17: Emerging Best Practices

Approach	Examples
Tiered Approach to On/Off Menu Customization	Establish consistent governance process for customization programs Build simple rules for what forms of customization are on menu Limit some forms of customization based on investment criteria “Weed the garden” of win-lose customization programs through upfront analysis and ongoing pre/post event analysis
Focused Customization Strategy	Focus on fewer forms of customization (e.g., displays, unique sizes, unique formulation) Leverage company-wide governance and development of metrics around this narrower set of customization priorities Build centrally managed capabilities to achieve greater scale and maximize learning curve benefits
Customization Centers of Excellence	Build centrally managed “R&D” capability to manage select retailer partnerships for use as test beds to then scale-up across brands, categories, divisions Goal to scale up successful customization programs more broadly, but have multiple models continue to co-exist

Conclusion

John Wannamaker, the department store pioneer, quipped more than a century ago that he knew half the money he spent on advertising was wasted – he just did not know which half. The same might be said of customization. The difference, however, is that we do know which half is wasted – it is the half in which the manufacturer did not collaborate closely with the retailer, and did not really think through either what needed to be customized or how to do it.

There are a lot of reasons why many programs deliver poor results, most of which stem from the fact that the challenge of customization is a new one for manufacturers and retailers alike. Yet, as this report shows, it is not necessary for the CPG industry to continue this way. There is a viable, tested alternative.

Clearly, the current customization boom will end in two ways – success and failure. Companies that continue on their present path of customizing without any effort to create a more systematic, analytical approach will generally succeed and fail in equal measures – a track record that will crowd out other opportunities in which to invest in the as complexity increases and eats up whatever gains are made. For those companies that learn how to collaborate and plan their customization strategies, however, successes will become much more common than failures. And over time, such Shelf-Centered Collaboration is bound to become not just a generator of new revenue now but a profound new source of innovation to create shared value across with retail partners.

Selected References

Selected Booz Allen Hamilton publications on Smart Customization:

– “Custom Fit: One Size Does Not Fit All” Advertising Age, Fall 2005;

– “Virtual Scale” Strategy & Business, Fall 2005;

– “The Five Principles of Smart Customization” Booz Allen Viewpoint, Spring 2005;

– “The Challenge of Customization: Bringing Operations and Marketing Together” joint Strategy & Business and Knowledge@Wharton white paper, Summer 2004;

– “Smart Customization” Strategy & Business, Fall 2003

– GMA Brands - www.gmabrands.com