

CHAPTER 5:

The Future of Collaborative Customer Relationship Management: Integrating Demand and Supply Chains

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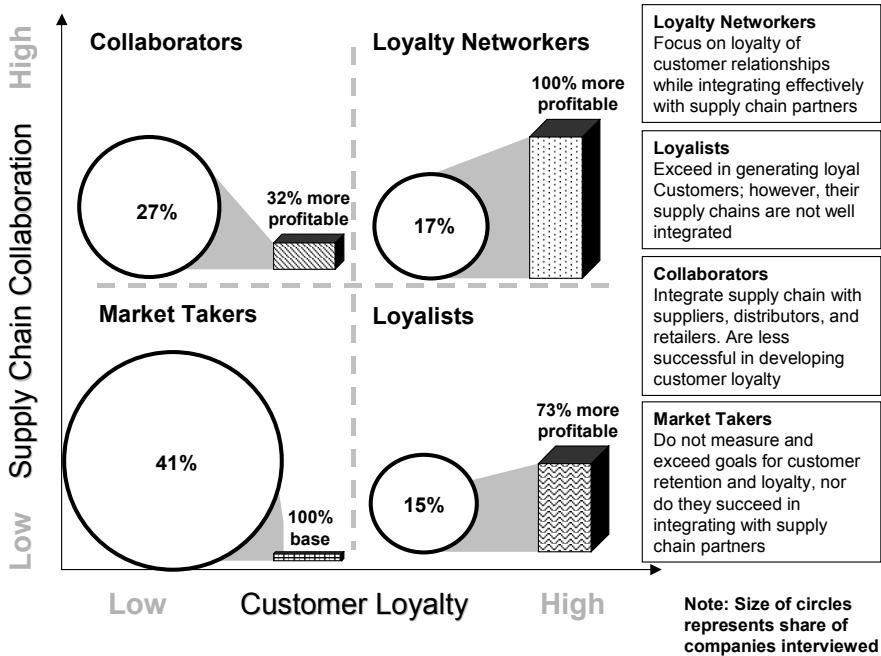
5.1 Introduction

Consumer businesses that effectively link their customer management and supply chain operations to boost customer satisfaction and profitability are twice as profitable as competitors that do not do so. They are two to five times more likely to achieve superior performance in sales, market share, customer service and other key measures, and much more likely to generate higher shareholder returns (Figure 5.1).

These are just some of the findings of an extensive global study we conducted with nearly 250 major consumer businesses and their executive teams in 28 countries throughout North America, Europe, Asia-Pacific, Latin America, and South Africa.¹

Companies such as Colgate-Palmolive and Heineken that have linked their supply chain and Customer Relationship Management activities have created what we refer to as “digital loyalty networks” – *digital* in that their demand-generating and supply-chain operations are linked through information technology; *loyalty* based in that higher customer loyalty and profitability is the objective; and *net*

¹ The first study in this series, Deloitte Research—Manufacturing Institute, Digital Loyalty Networks: e-Differentiated Supply Chain and Customer Management (New York: Deloitte Consulting and Deloitte & Touche, 2000), was conducted in collaboration with the Stanford Global Supply Chain Management Forum and launched at the joint Stanford-Deloitte executive conference at Stanford University “Creating Digital Loyalty Networks: e-Integrating SCM and CRM,” in September 2000.



Source: Deloitte Research

Figure 5.1: Loyalty Networkers and Profitability

works for when a company links its supply and demand-related functions with those of suppliers, customers and other business partners, it creates a virtual network.

Despite the inarguable benefits of digital loyalty networks, only a small number of consumer businesses have been able to build them. The challenges loom large: vastly different cultures between customer relationship (marketing, sales, service) and supply chain functions; hard-to-match information, measurements and incentives; and concerns about constantly accelerating customer expectations.

Nevertheless, our experience shows that these hurdles can be overcome. Here is what it requires:

- Mobilizing the organization toward a clear vision about how to create differentiated and profitable customer experiences.
- Creating a network partnership strategy that creates wins for all stakeholders (customers, suppliers, business partners), particularly between manufacturers and retailers that must collaborate and focus on the ultimate consumer.
- Developing an open business and technology architecture that allows prototyping and linking of disparate operations.

As Dell, Wal-Mart, and General Electric have demonstrated, the rewards for moving quickly and smartly are great. But so are the penalties for being slow at the gate. The PC industry is littered with failed companies that can attest to that. Once the leaders create the dominant digital loyalty networks in their segments, the switching costs for everyone become significant. To get started, managers need to ask a few key questions to understand just how far their organizations are along the path to building digital loyalty networks that generate loyal and highly profitable customers.

5.2 Using Digital Loyalty Networks to Boost Performance in Global Consumer Business

Countless consumer product manufacturers and retailers have overhauled the “back end” of their businesses over the last decade, instituting new supply chain processes and technologies that have lowered costs and reduced time cycles in manufacturing, distribution and procurement. Other consumer businesses have focused on the “front end” through new Customer Relationship Management practices and systems that have boosted retention and profitability. Some companies have been bold enough to launch initiatives on both sides of the house – that is, in both Customer Relationship Management (CRM) and supply chain management (SCM). Only a distinct minority, however, has effectively linked their supply chain and customer operations.

That minority reaps the majority of rewards: our study shows that consumer businesses that have integrated their CRM and SCM capabilities have dramatically and measurably outperformed their competition in virtually every critical financial and operating category (Figure 5.2 and 5.3).

To understand the degree to which companies are linking their supply chain and customer loyalty programs, we asked executives in our study to tell us – on a scale of 1 to 5 – how well-integrated their companies were in four areas: suppliers, distributors/retailers, customers and internally. We call this the collaboration index. A company that was well-integrated in all four areas scored a maximum of 20. We also asked these companies to rate themselves on key customer management metrics (again, on a scale of 1 to 5). Typical measures included customer repurchase rates and shares of purchase. High scores in this area indicated a high degree of customer loyalty that was mapped into a “loyalty index”.

We then placed each company that participated in the study into one of four categories (Figure 5.2):

- *Loyalty Networkers* – companies with high degrees of linkage between their supply chain and customer management operations – represented only 17 percent of the sample. (These companies scored 4 or 5 on customer loyalty/retention and 14 or higher on the collaboration index.)

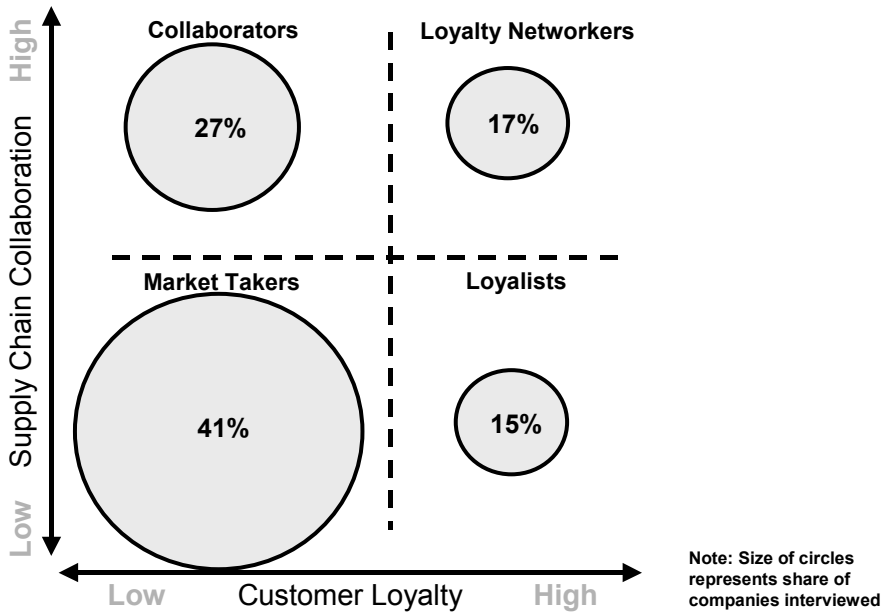
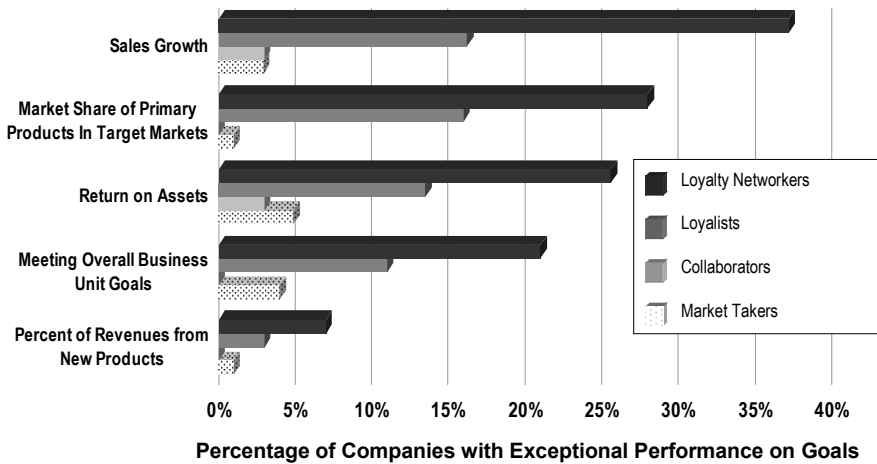


Figure 5.2: Digital Loyalty Network Quadrant



Source: Deloitte Research

Figure 5.3: Loyalty Networkers and Business Performance

- *Loyalists* (15 percent) had high scores (4 or 5) on the loyalty index but low levels of supply chain collaboration (13 or below on the collaboration index).
- *Collaborators*, comprising 27 percent of the sample, had high degrees of supply chain collaboration (both internally and with their supply chain partners) but low levels of customer loyalty. They scored 3 or less in building customer loyalty (or do not measure it), and 14 or higher on the collaboration index.
- *Market Takers* (41 percent) scored low on both the collaboration index (13 or below) and the loyalty index (3 or less, or do not measure it).

Companies such as Heineken and furniture maker Herman Miller are part of the small-but-growing number of companies that are building digital loyalty networks between themselves and their suppliers and customers. These networks have enabled them to satisfy *different* customer needs with *differentiated* supply chain capabilities.

Heineken, for example, has implemented an Internet-based system that provides distributors access to information on pending orders, forecasting data and promotions. This has allowed the company to cut its order fulfillment cycle by 75 percent and has accelerated its sales growth.

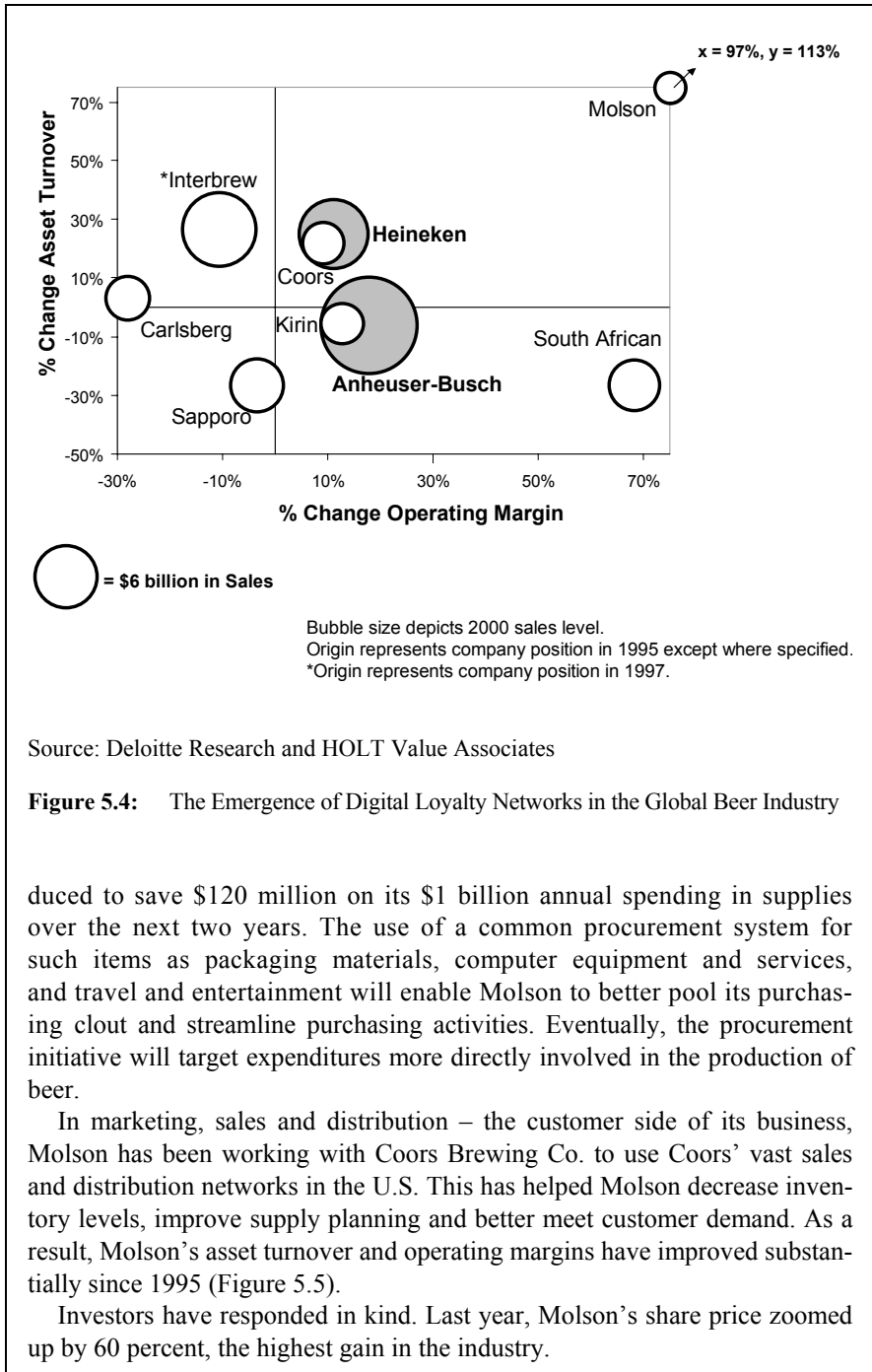
(See Box 1, “The Emergence of Digital Loyalty Networks in the Global Beer Industry”)

Box 1: The Emergence of Digital Loyalty Networks in the Global Beer Industry

In the beer industry, companies like Molson and Heineken demonstrate the impact of digital loyalty networks (DLNs). (See Figure 5.4)

To understand the shareholder value impact of DLNs, we looked at how companies performed in customer management and supply chain effectiveness and looked for any correlation with their stock performance. Using asset turnover as a key measure of supply chain collaboration and operating margin as a primary yardstick of customer loyalty, both companies have made major strides in improving customer management and supply chain processes over the last five years – gains that have also correlated with increasing shareholder value.

Take Molson Inc., the 215-year-old Canadian brewer that accounts for nearly half of the beer sold in its home country. Last year the company launched a private online exchange to cut procurement costs – one of a number of initiatives that the \$2.5 billion Montreal-based company intro-



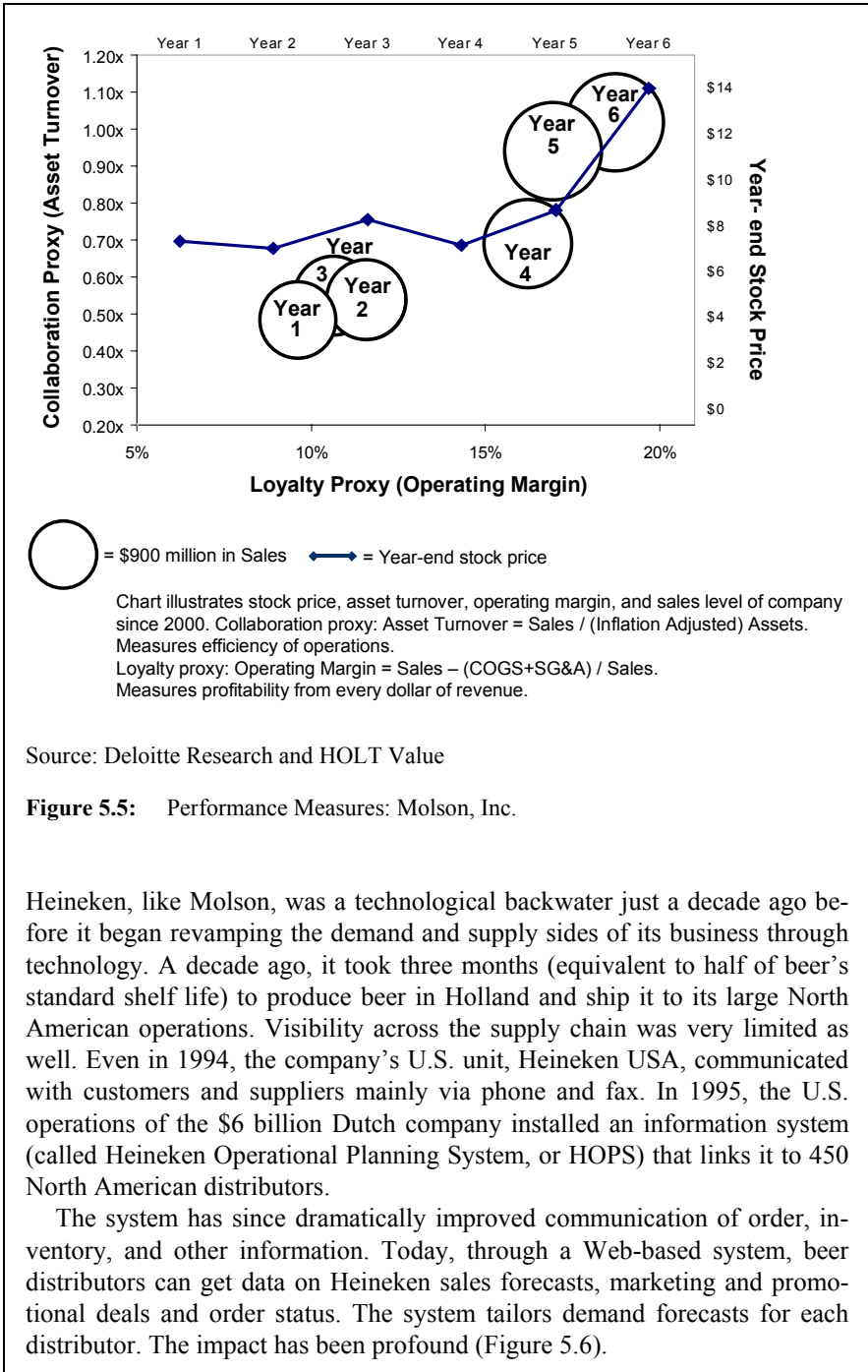
Source: Deloitte Research and HOLT Value Associates

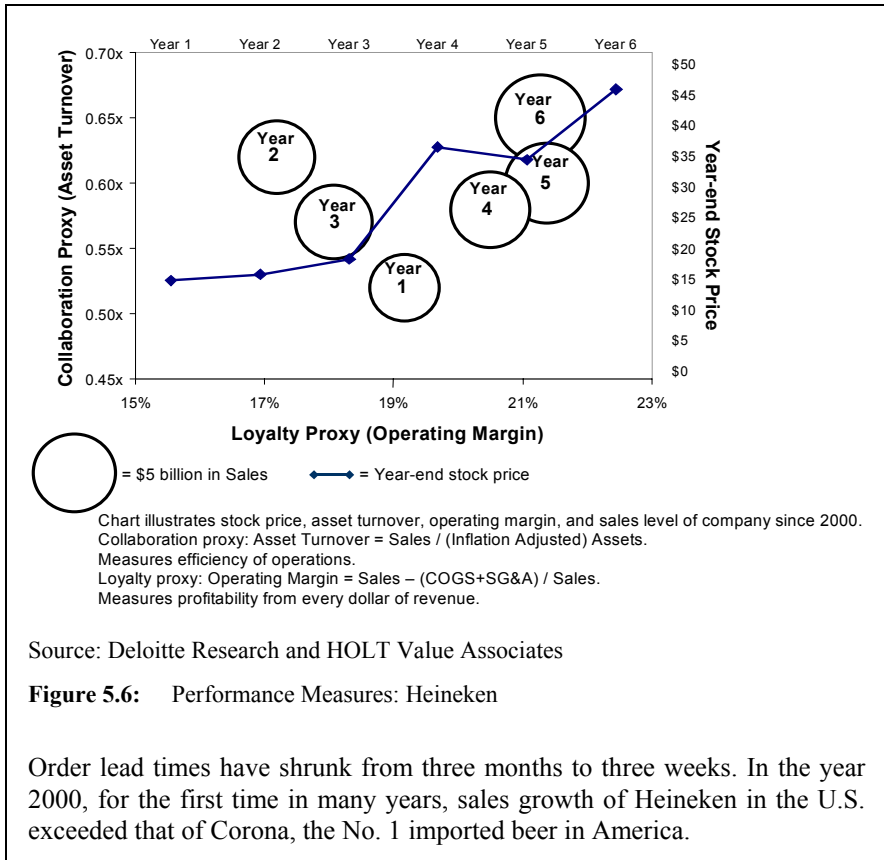
Figure 5.4: The Emergence of Digital Loyalty Networks in the Global Beer Industry

duced to save \$120 million on its \$1 billion annual spending in supplies over the next two years. The use of a common procurement system for such items as packaging materials, computer equipment and services, and travel and entertainment will enable Molson to better pool its purchasing clout and streamline purchasing activities. Eventually, the procurement initiative will target expenditures more directly involved in the production of beer.

In marketing, sales and distribution – the customer side of its business, Molson has been working with Coors Brewing Co. to use Coors' vast sales and distribution networks in the U.S. This has helped Molson decrease inventory levels, improve supply planning and better meet customer demand. As a result, Molson's asset turnover and operating margins have improved substantially since 1995 (Figure 5.5).

Investors have responded in kind. Last year, Molson's share price zoomed up by 60 percent, the highest gain in the industry.

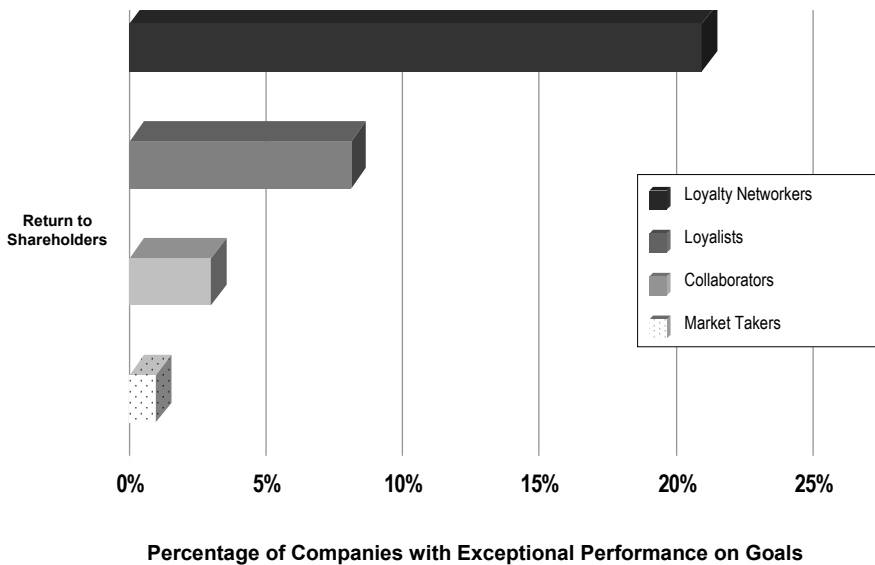




Herman Miller's is an example of a true digital loyalty network in action. They are starting to differentiate products and services for customers according to the value the latter bring to the company. Herman Miller has redesigned its Web pages to target and service its most important customers on the front end. This redesign simultaneously improves operations at the back end, streamlining manufacturing and allowing order information to flow from more than 500 suppliers worldwide. The company has reduced shipment errors by 20 percent. In addition, it has cut a full week off the time it takes to fill most orders and has boosted on-time shipments from 75 percent to nearly 98 percent between 1995 and 2000. These and other capabilities have enabled the company to outperform its peers in stock performance by nearly four times over the last five years.²

² According to Dow Jones & Co.'s DJ Furnishings Index, Herman Miller's five year stock appreciation was about 89 percent (as of October 2001) vs. 23 percent for the other companies that comprise the index.

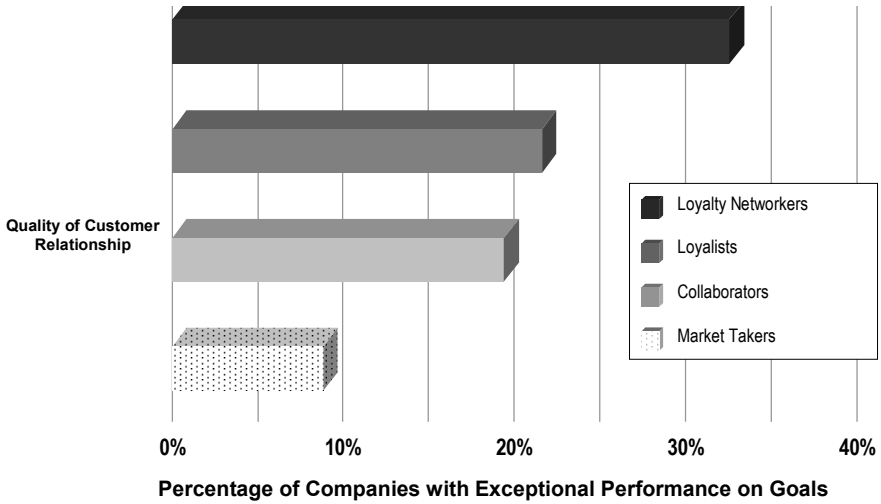
Loyalty Networkers outperform their competitors because of several strategic capabilities they are developing. For one thing, they are able to identify their most valuable customers and adjust their service based on customer requirements, lifetime potential and an intimate understanding of total supply chain cost on a customer-by-customer basis. This enables supply chain managers to know which orders should get preferential treatment based on real-time knowledge about the importance of their customers and the products, services and supply chain capabilities that are most important to those customers. As a result, it is not surprising that Loyalty Networkers are 100 percent more profitable than the Market Takers (Figure 5.1), are two to five times more likely to achieve exceptional performance in sales growth, market share, customer service, return on assets and other goals (Figure 5.3), and are much more likely to meet their goals for generating shareholder returns (Figure 5.7).



Source: Deloitte Research

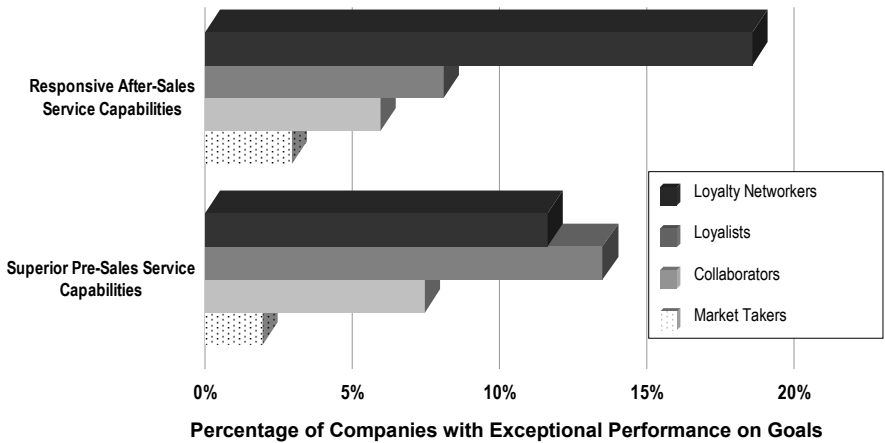
Figure 5.7: Loyalty Networkers and Shareholder Returns

Furthermore, Loyalty Networkers proactively address emerging customer needs before competitors have an opportunity to discover them. As shown in Figures 8-10, Loyalty Networkers outperform their competitors on most customer relationship goals. In addition, to satisfy their most important customers, Loyalty Networkers are building supply chain operations that can move in lock-step with their suppliers' operations. Some can even alter pricing, product mixes, and offerings in real time.



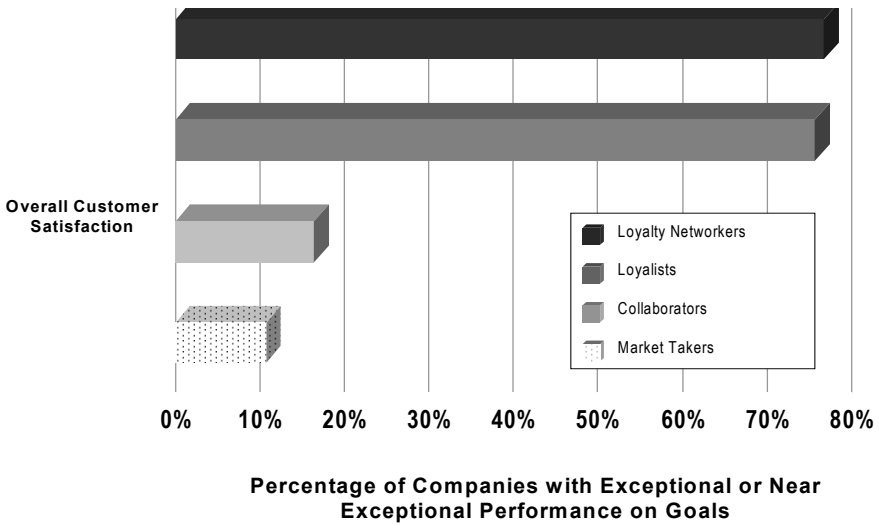
Source: Deloitte Research

Figure 5.8: Excellence in Managing Customer Relationships



Source: Deloitte Research

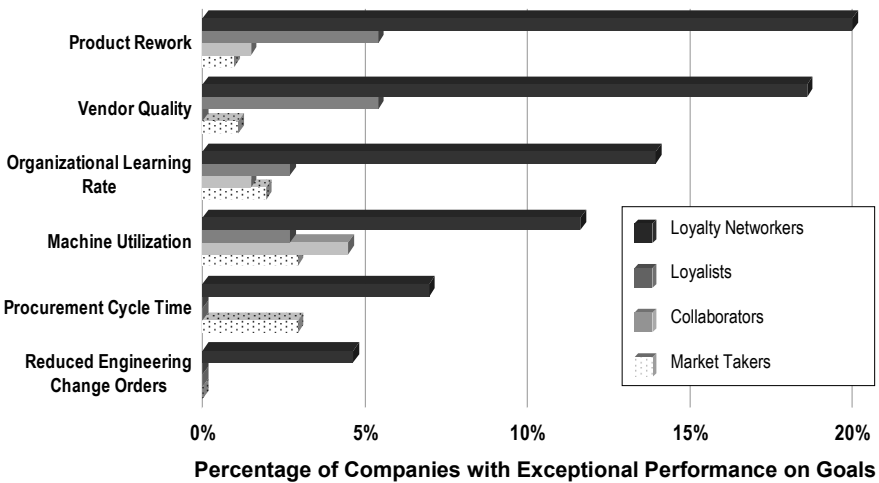
Figure 5.9: Loyalty Networkers and Customer Service



Source: Deloitte Research

Figure 5.10: Loyalty Networkers and Customer Satisfaction

Quite simply, the impact of integrating demand and supply chains can be profound. Our research shows that Loyalty Networkers are far ahead of their competitors in key measures of supply chain performance (Figure 5.11).

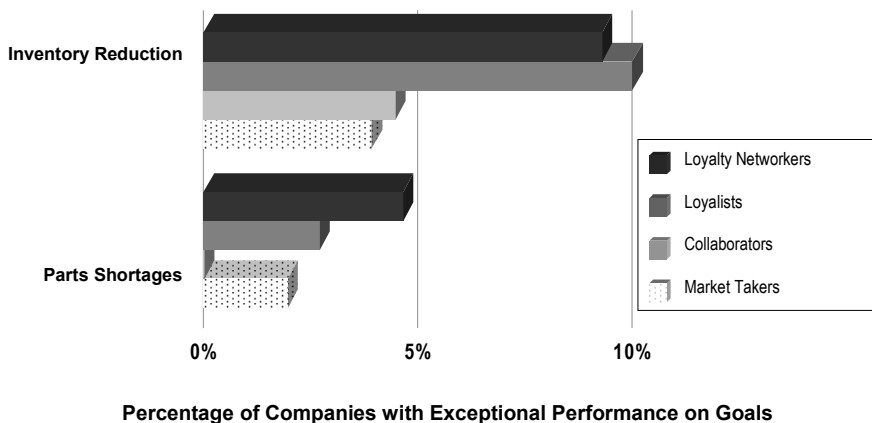


Source: Deloitte Research

Figure 5.11: Loyalty Networkers and Supply Chain Performance

Unlike most manufacturers, retailers have direct contact with consumers. They can collect detailed sales information and thus are in a much better position to monitor consumer buying patterns. This creates significant opportunities for companies that are vertically integrated and control both the manufacturing and retailing ends of the value chain. Consider one such company: Spanish apparel-maker Zara. A \$2 billion unit of Spain's Inditex SA, Zara uses the Internet to gather real-time information on the needs and changing tastes of consumers – changes that are dictated by fashion shifts as well as seasonal transitions. But that information would be of little use if the company didn't control its supply chain. By controlling the entire retail, manufacturing and distribution chain, Zara has been able to design and produce its new clothing lines in five or six weeks, a quarter of the average time its competitors³ take. That means that Zara can introduce three to four clothing lines every fashion season, compared with one for most of its competitors. This capability has also enabled the company to charge higher prices while being able to better serve its customers at the same time. This has also made it possible for its supply chain managers to better manage their assets. Figure 5.12 shows how a company's focus on loyalty can drive the effective utilization of its assets.

So far, no company – not even Herman Miller or Zara – has developed and fully leveraged its digital loyalty network. This means that a number of opportunities remain – even for the leaders.



Source: Deloitte Research

Figure 5.12: Loyalty Networkers and Asset Management

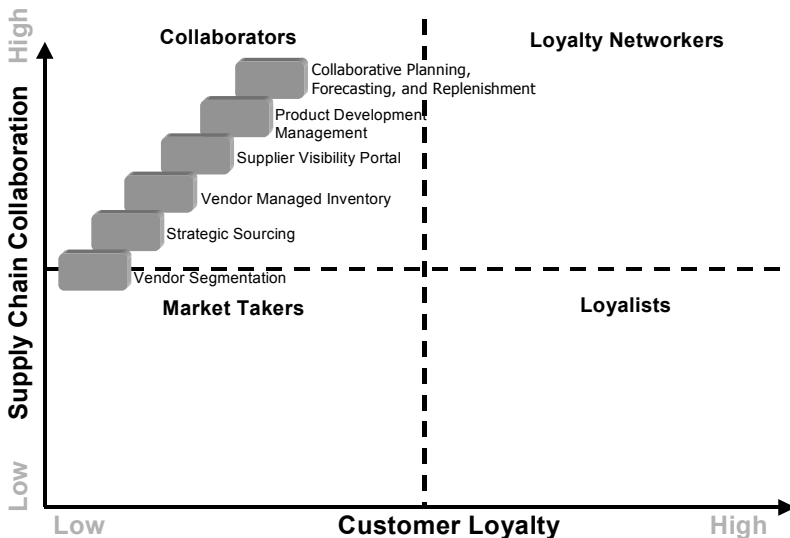
³ C. Vitzthum, "Just-in-Time Fashion," *The Wall Street Journal*, May 18, 2001, p. B1.

5.3 Understanding the Barriers to Building Digital Loyalty Networks

The fact that only a small minority of consumer businesses have digital loyalty networks, and that the ones that do are just scratching the surface of their full potential suggests that significant barriers to the creation and success of digital loyalty networks exist. Understanding these barriers is crucial before setting out on the digital loyalty network journey. We have identified three such barriers.

5.3.1 The Divide between Supply Chain and Customer Management Operations

This challenge springs from the big successes many companies have had in supply chain and customer management initiatives. Supply chain managers in most consumer businesses have made significant strides in reducing time and costs in manufacturing, procurement, and distribution, while improving product and service quality. Many have moved up from being Market Takers to Collaborators by using Pareto analysis of suppliers to identify their importance in terms of spending, quality and delivery performance; creating strategic sourcing processes to move away from antagonistic supplier relationships; managing customer inventory; making supplier information available on the Web; and introducing collaborative planning, forecasting and replenishment (CPFR) (See Figure 5.13).



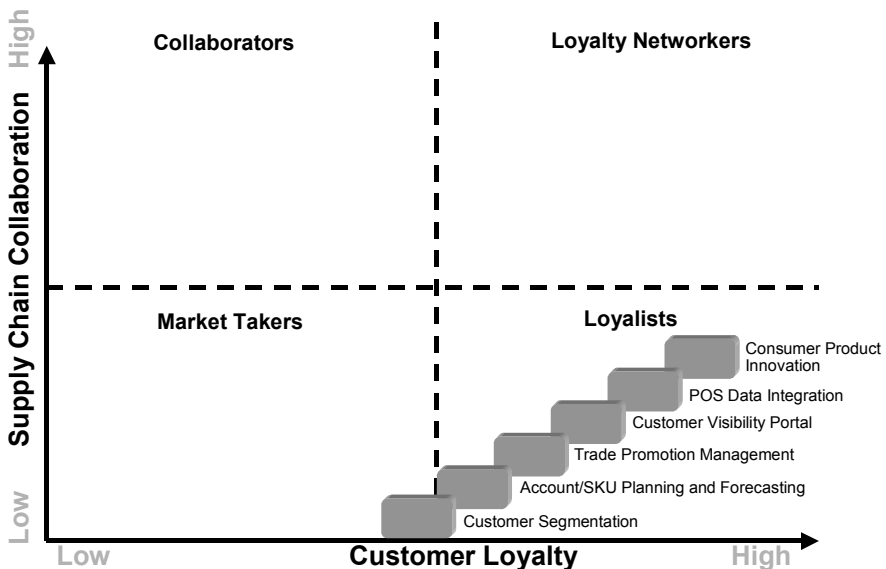
Source: Deloitte Research

Figure 5.13: Digital Loyalty Network Matrix: Collaboration Usually Comes First

At the same time, managers in customer-facing functions such as service, marketing and sales have been improving customer relationships markedly through CRM initiatives. Through better customer service, capturing and integrating of customer purchasing data, segmenting customers, personalizing solutions and integrating across channels, they have taken steps to become relationship-oriented Loyalists (Figure 5.14).

However, these supply chain and CRM initiatives typically tend to operate independently. In part, this is due to the long-established practice of functional excellence – manufacturing directors, warehouse managers, distribution heads and other executives focus on improving their piece of the overall value chain. They are therefore often sceptic of cross-functional initiatives. They think that tampering with already existing mechanisms that have been refined over time might result in operational deterioration. Further, differences in working styles sometimes amplify the gap between the supply chain and customer sides of the house.

Because they are continually measured on improving the way goods are produced and delivered, supply chain professionals are process-oriented and thus more receptive to diving into operational details and rooting out workflow inefficiencies. On the other hand, marketing and sales teams – while poring over ever more data on customer segments, buying patterns and promotion lifts thrive in a less predictable world of changing customer demands, creativity and experimentation.



Source: Deloitte Research

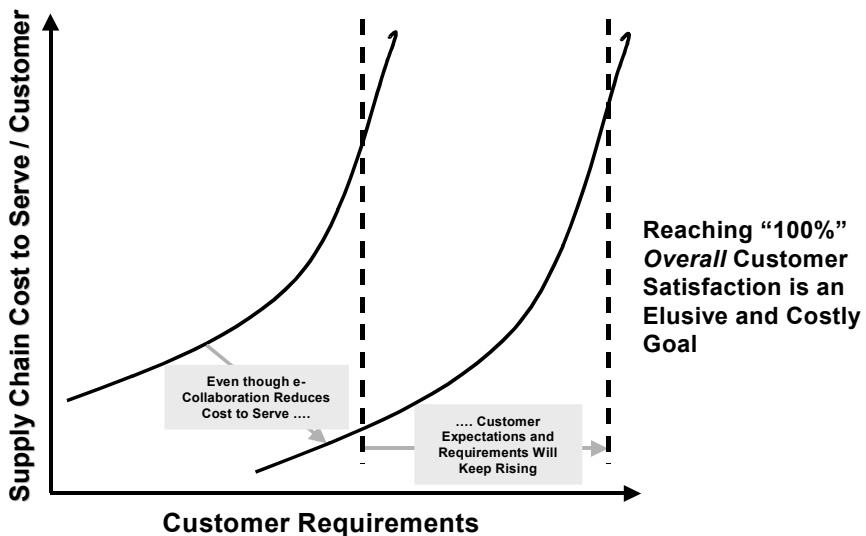
Figure 5.14: Digital Loyalty Network Matrix: Customer Loyalty Is Tougher but More Important

5.3.2 Incompatible Information, Measures and Rewards

The information, performance measurement and incentives of supply chain and customer management-related functions often don't match. Manufacturing and distribution managers tabulate and control their own information on customer orders and shipments; marketing, sales and service people keep their own records on those customers in different systems and computer formats that can't be integrated easily with the data that supply chain managers possess. Incompatible information technologies are perhaps the least of the differences. Measurement and reward systems can be so contradictory that both sides won't even broach ways of creating mutual benefits. For example, manufacturing and distribution managers rewarded on achieving rock-bottom costs will view customization of products and delivery options as a threat to their performance. On the customer-facing side, the monthly incentives that drive higher sales also drive huge artificial spikes in demand, which are followed by severe drop-offs as the next cycle gets under way. The result is higher logistics cost and over production in the supply chain.

5.3.3 Continually Rising Customer Expectations

We call this the “customer paradox” (Figure 5.15). The concern is that customers might get overly accustomed to customized products and delivery options, faster delivery times and other key benefits of digital loyalty networks – and continually ask for more.



Source: Deloitte Research

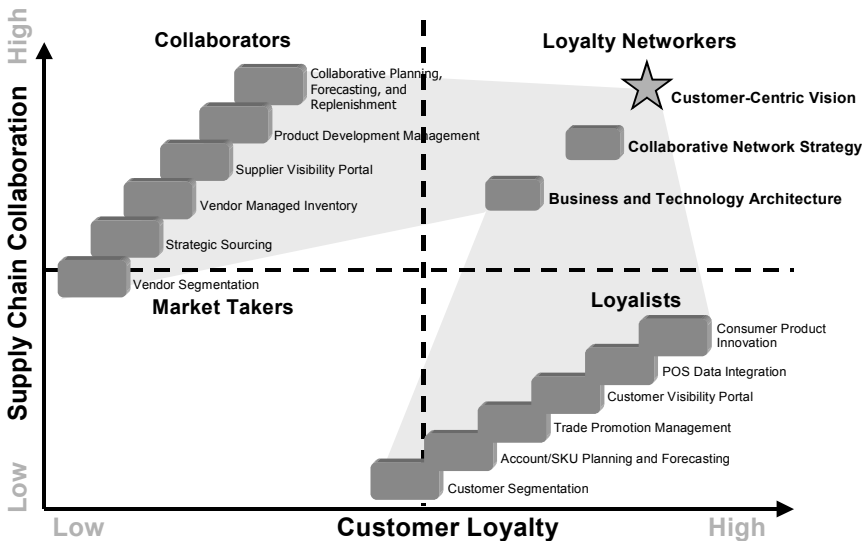
Figure 5.15: e-Collaboration and the Customer Paradox

So despite improving customer service and overall delivery, customer satisfaction may, paradoxically, deteriorate because the basic “table stakes” for service have risen. What was once seen as “great service” can come to be viewed as simply “doing what was promised”. Since linking electronically with customers is part of the game, many managers can’t fathom giving all customers a perpetually updated scorecard on product quality, on-time shipments and other measures. In having to provide ever more information to customers, managers worry about whether they are handing over proprietary information on costs and other data that might later be used against them for, lets say, wringing price concessions. Thus, to some managers, this appears to be a treadmill that they can never get off.

While the challenges in developing digital loyalty networks are significant, they’re not insurmountable. We have uncovered a number of techniques that Loyalty Networkers have used, without disrupting day-to-day operations, in bridging the gap between SCM and CRM and achieving breakthrough performance.

5.4 The Digital Loyalty Network Journey: Seizing the Opportunity

The majority of companies today have launched initiatives to help them more effectively collaborate with suppliers and customers. Collaborative planning, forecasting and replenishment (CPFR) pilots and forays into public or private online marketplaces are two of the most prominent examples. From our research,



Source: Deloitte Research

Figure 5.16: The Path to Digital Loyalty ... Don't Control

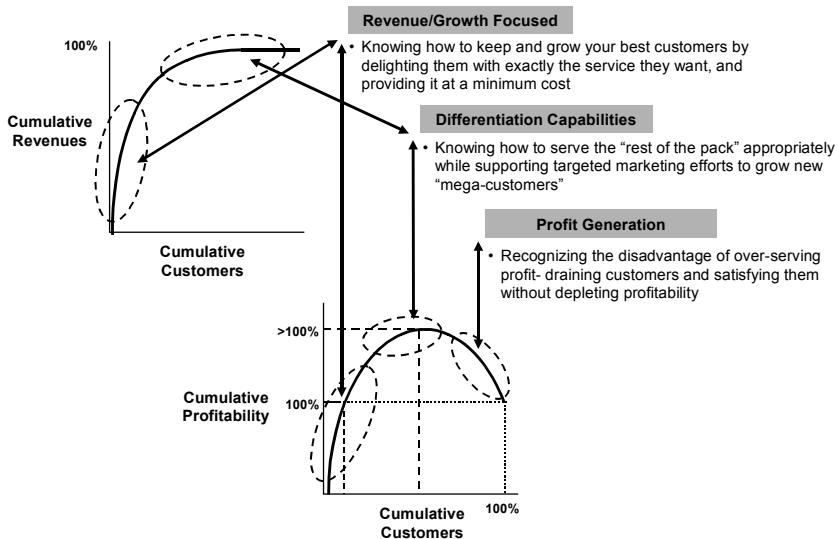
we've found that overcoming the challenges to building digital loyalty networks does not begin with a huge business process overhaul or the creation of a new top-heavy corporate bureaucracy. Rather, it starts with the creation of key linkages between the supply and demand sides of the house (Figure 5.15).

By connecting and sharing collaboration-based performance indicators, supply chain and customer management functions can take several big first steps toward aligning themselves with overall business goals and creating effective digital loyalty networks. Three elements play major roles in establishing and maintaining these CRM-SCM connections: a customer-centric vision, a network partnership strategy and an open business and technology architecture.

5.4.1 Establishing a Consumer – and Customer-Centric Vision

Digital loyalty networks in consumer businesses begin with a clear picture of not only the retailer but also the consumer. This picture shows how to differentiate the product and service offering for different retailer and consumer segments and it is shared across key business functions. As such, customer-centric companies realize that a small number of customers account for a very large proportion of profits. In fact, for individual major customers, the “segment” size may be one.

Customer-centric companies do cost analysis of individual customers or customer segments through Activity-Based Costing (ABC) and other methods. The key to creating and developing digital loyalty networks is in understanding customer requirements that can be served profitably (Figure 5.17 and 5.18).



Source: Deloitte Research

Figure 5.17: A Change of Focus is Needed

Digital Loyalty Networks Resolve the Paradox by Optimizing on Customers':

- ***DIFFERENT*** lifetime values
- ***DIFFERENT*** costs to serve
- ***DIFFERENT*** requirements

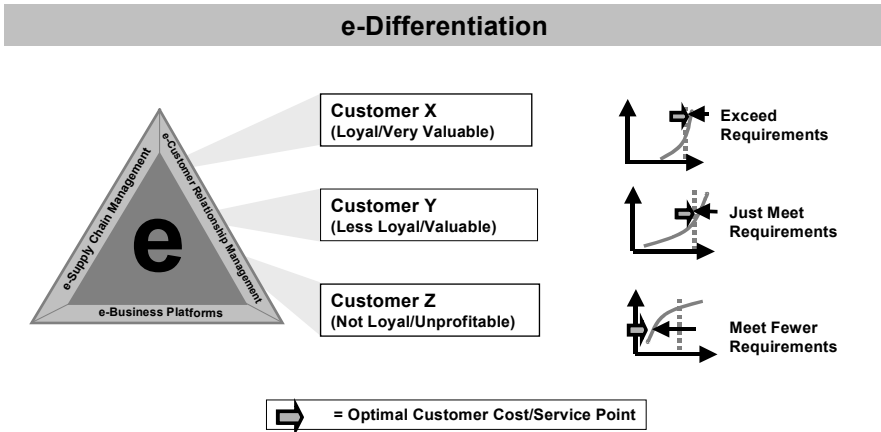


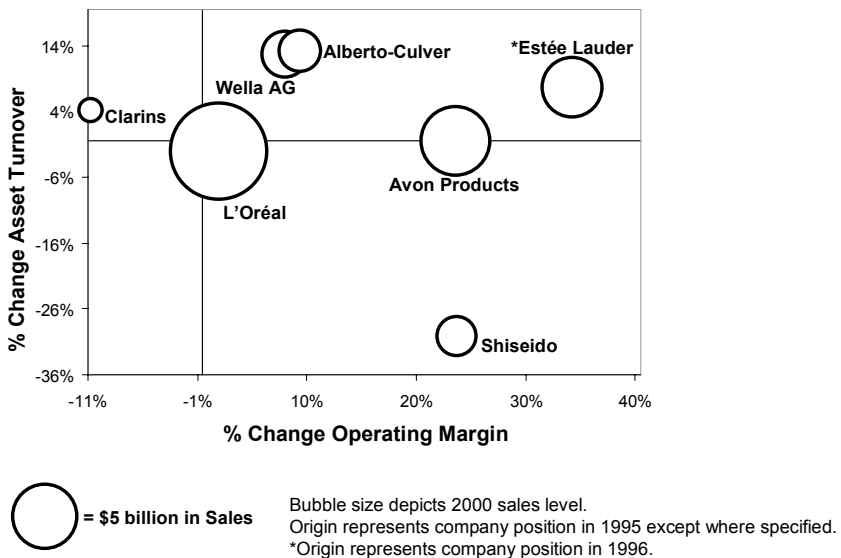
Figure 5.18: e-Differentiation and the Customer Paradox

Herman Miller is a case in point. The Michigan-based furniture maker provides red carpet service to different customer groups by tailoring its Web pages for them and letting them order at special rates. On the supplier side, Herman Miller has streamlined order processing and accounting via the Internet to speed up delivery time and reduce costs. The company then shares this data with its network of suppliers around the world. Suppliers can minimize their inventory costs and make available just-in-time supplies, materials and parts to Herman Miller for final assembly. Herman Miller has recognized the substantial profit impact and customer loyalty benefits from providing the right offerings to the right customers.

However, catering to the most profitable customers isn't enough. A company must develop and institutionalize a mindset that puts customers' needs first. It can then use that perspective to help shape how the company interacts with its customers. For example, seeking to ride the wave of Efficient Consumer Response (ECR) in the early 1990s, one food manufacturer began revamping its operations by looking at its activities from a customer's point of view. This led to a pioneering CRM implementation that enabled the company to serve its key customer accounts in ways that maximized their profits as well as its own. In another example, cosmetics giant Estée Lauder has started uses its own website, "smart" cards and a massive database to drive customers to department stores that sell its products. This enables the company to spot purchasing trends, better forecast manufacturing requirements and reward its best customers, thereby increasing their loyalty. (See Box 2 "Global Cosmetics Industry Makeover: On the Path to Digital Loyalty Networks?") Such a "customer-centric" mentality is critical to a successful digital loyalty network.

Box 2: The Global Cosmetics Industry Makeover – On the Path to Digital Loyalty Networks?

Competition in the cosmetics industry has been fierce over the last five years. However, companies such as Estée Lauder and Avon have made significant operating and financial improvements by better matching supply and demand through digital loyalty networks (Figure 5.18). The stock of Estée Lauder, a \$4.3 billion New York-based Company, has outperformed the industry by a wide margin since 1996 – its price has appreciated 70 percent in four years.



Source: Deloitte Research and HOLT Value Associates

Figure 5.19: Global Cosmetics Industry Makeover: On the Path to Digital Loyalty Networks?

In order for this to happen, Estée Lauder has made aggressive moves on the customer management side of its business. The company's brands – which include Estée Lauder, Clinique and Aramis – each have developed their own websites. Clinique.com alone boasts over a million users, 28 percent of whom never had used the products before. The site helps customers determine which products they should use, often by asking them questions about their skin (color, degree of oiliness etc.). Online sales are but a tiny sliver of total sales today for the Clinique brand. But the World Wide Web serves a much larger

purpose: getting customers to the store. A massive data warehouse enables the company to spot purchasing patterns in days instead of months, and more accurately predict sales and production requirements.

Realizing the power of the Web to connect with women on beauty issues, and their desire for a one-stop shopping experience, Estée Lauder has launched a website called Gloss.com with rivals Clarins and Chanel. The website gives consumers online access to their favorite brands.

Estée Lauder is starting to make strides on the supply chain as well. In the summer of 2001, the company announced a major initiative to build new supply chain systems and overhaul its warehouses. In distribution centers in Pennsylvania and New Jersey, the company has invested heavily in software and business process changes to improve inventory management. Such improvements on both the customer management and supply chain sides of its business have enabled Estée Lauder to outperform many competitors in both asset turn and operating margin improvements (Figure 5.20).

Avon Products Inc., the \$5.7 billion cosmetics company, has moved aggressively on both the customer and supply fronts to boost its industry position. On the customer side, Avon is spending \$60 million on an Internet initiative to increase consumer loyalty by partnering with its 3 million independent sales

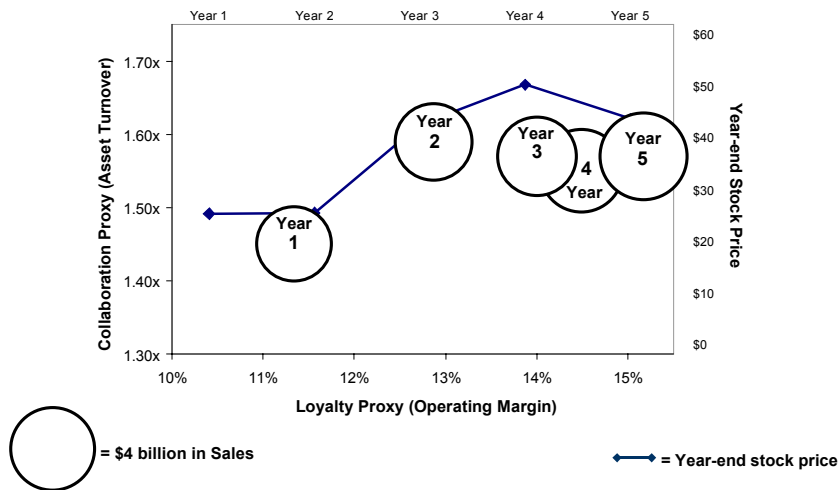


Chart illustrates stock price, asset turnover, operating margin, and sales level of company since 2000.
 Collaboration proxy: $\text{Asset Turnover} = \text{Sales} / (\text{Inflation Adjusted}) \text{ Assets}$.
 Measures efficiency of operations.
 Loyalty proxy: $\text{Operating Margin} = \text{Sales} - (\text{COGS} + \text{SG\&A}) / \text{Sales}$.
 Measures profitability from every dollar of revenue.

Source: Deloitte Research and HOLT Value Associates

Figure 5.20: Performance Measures: Estée Lauder

representatives. Recently, the company launched a website that lets “e-Representatives” place orders, check product availability and order status, and market to new and present customers. The system has slashed the cost of taking an order from \$3 to 50 cents. As important, the system relieves sales peoples’ frustrations over constantly changing stock codes, onerous order forms and fulfillment delays. By reducing the huge turnover rate of sales reps, Avon’s district sales managers can spend more time helping seasoned reps and far less time searching for new ones.

Further, the websites eventually will help Avon build a consumer database enabling visibility of key marketing trends and individual consumer preferences and buying behaviors. If a rep quits, the company can easily pass the names and contact information to another rep in that territory, thus perpetuating consumer loyalty.

Avon recently announced the launch of “Teen Business,” a unit that will recruit teenage girls as “e-Reps” and use the Internet and techniques such as viral marketing to establish fierce loyalty with teen consumers.

To reduce lead times and inventory levels, Avon is also overhauling its supply chain by installing advanced planning and scheduling software and an ERP system. Over the last five years, asset turnover has increased while operating margins have improved significantly (Figure 5.21).

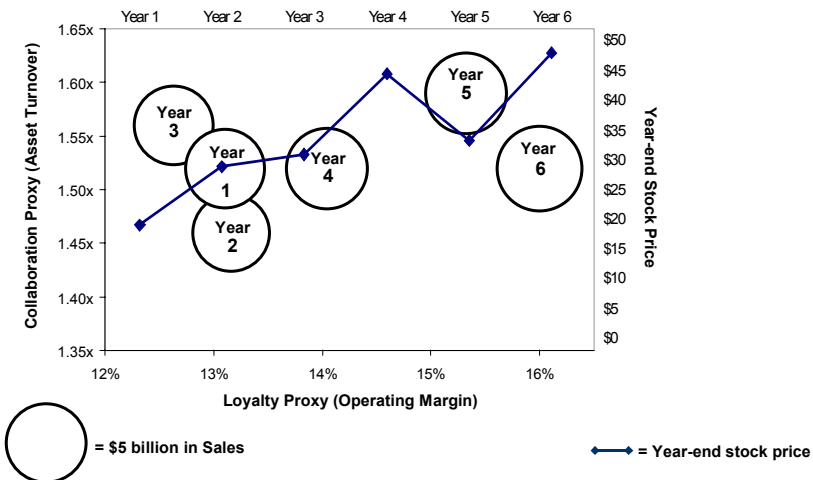


Chart illustrates stock price, asset turnover, operating margin, and sales level of company since 2000.
 Collaboration proxy: Asset Turnover = Sales / (Inflation Adjusted) Assets.
 Measures efficiency of operations.
 Loyalty proxy: Operating Margin = Sales – (COGS+SG&A) / Sales.
 Measures profitability from every dollar of revenue.

Source: Deloitte Research and HOLT Value Associates

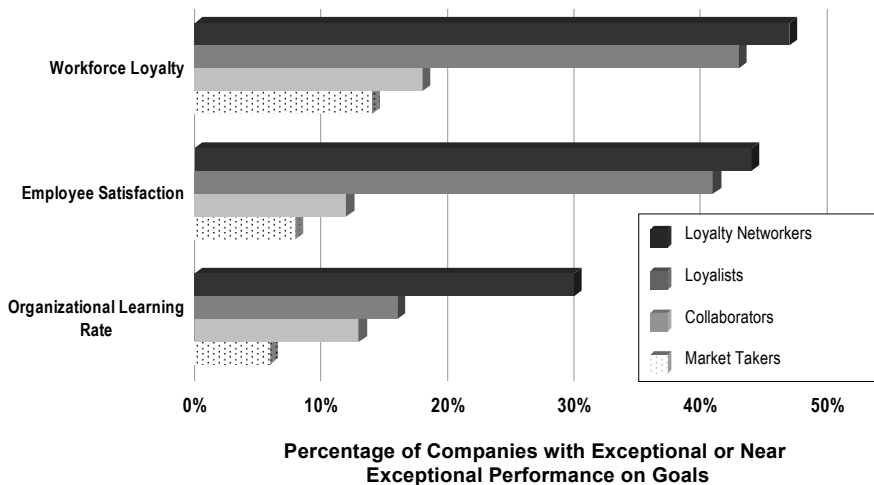
Figure 5.21: Performance Measures: Avon Products

Over the last decade, the Internet and other technologies have shifted power from manufacturers and retailers to consumers themselves by greatly simplifying their shopping and comparison process. However, some consumer businesses still lack a customer-centric culture. Without this, trying to institute a digital loyalty network is like embarking on an intense exercise program without a profound desire to get healthy. In other words, the program won't "stick." This is not surprising given the high failure rate of CRM initiatives, due in large part to the unwillingness of companies to change the values, attitudes and beliefs of their people around the importance of profitable, loyal customers.

For digital loyalty networks to take hold and thrive within a consumer business and across its customers and suppliers, the company must create a culture of customer loyalty by changing values, performance measures and reward systems. Given that the way a company treats its customers is a function of how it treats its employees, it does not come as a surprise that companies with digital loyalty networks have more loyal, satisfied and higher-skilled employees (Figure 5.22). The rate at which people learn new skills is much higher in these companies, in part because they have been among the first to adopt Internet-based "e-learning" technologies and have, in turn, been able to dramatically increase the speed of deployment and drastically cut the cost of training for their companies.

5.4.2 Creating a Network Partnership Strategy

Very few consumer businesses control every aspect of the value chain from the raw materials up to the finished products that are delivered to retail outlets or



Source: Deloitte Research

Figure 5.22: People and Organizational Learning

consumers themselves. Even Zara relies on outside suppliers and distributors. To get every critical party to play a role in a digital loyalty network, a company must create a strategy that considers, and provides wins for all players in the value chain.

Consumer manufacturers with digital loyalty networks are partnering with retailers to focus on demand-pull rather than supply-push. In the past, retailer and manufacturer have conducted totally separate inventory-planning activities, often resulting in oversupply or undersupply of products. But with the emergence of digital loyalty networks, replenishment decisions are done through collaborative retailer/manufacturer efforts that balance sales with store and warehouse inventory data.

The importance of such a customer orientation cannot be overstated. Through demand and supply chain integration, digital loyalty networks promise to significantly cut on billions of dollars that manufacturers otherwise spend on trade promotions to even out supply imbalances in the retail supply chain. (See Box 3, “Trade Promotion Management: A Ticket to Digital Loyalty Networking”).

Box 3: Trade Promotion Management: A Ticket to Digital Loyalty Networking

You say you don’t know where to start your digital loyalty network journey and how to produce immediate financial results? Well, look no further than an area ripe for taking on – Trade Promotions Management (TPM). With American consumer packaged goods companies collectively spending \$470 billion annually and certain firms spending as much as 16 percent of sales, trade spending is larger than the combined gross domestic product of more than half of the world’s countries.

Despite this massive investment, the TPM process is wrought with several inefficiencies. Sales and marketing functions are not in synch (sales is focused on volume, marketing on brand equity). Manufacturers lack understanding of consumers and their behavior, and rarely collaborate with retailers in developing more effective joint promotions. Many companies make poor selections in promotion tactics, and fail to evaluate promotions after they are run. Promotions are often not factored into demand planning; and failure to monitor results means that retailers often get discounts without performing according to the terms of the promotion.

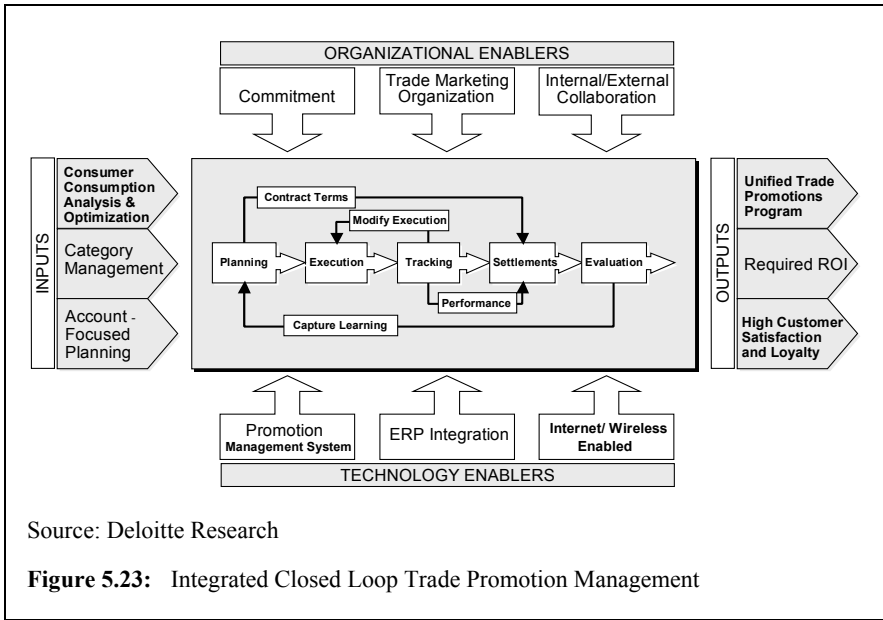
These issues have challenged even the best consumer packaged goods companies. However, leaders such as Procter & Gamble, Kraft, General Mills, and Coca-Cola have taken TPM head on and are dramatically improving their capabilities – leveraging the tenets of true digital loyalty network performance. These companies are actively building their capabilities in three distinct areas:

- *Understanding the Consumer.* Through digital loyalty networks, companies are learning to strike the appropriate balance between trade, consumer and advertising spending. They better understand what promotional tactics target which consumer segments. They also know how promotions impact the brand perception of various consumer segments. Further, they are learning how certain promotional tactics cannibalize sales or margins during and after the promotion.
- *Understanding the Effectiveness and Profitability of Promotions.* Companies with digital loyalty networks are more likely to know how well retailers participated in promotions and how consumers responded. Thus, they are much more likely to know if the promotion met their ROI and other goals.
- *Understanding Operational Execution in the Entire Supply Chain.* Digital Loyalty Networks enabled companies incorporate incremental consumer lift projections into their demand planning processes. They are good at collaborating with top customers on incremental demand projections. They are better at coordinating collateral materials with product shipments and merchandising promotional items according to guidelines.

Companies that use advanced technologies and information (e.g., syndicated data, retailer data) to create disciplined, closed-loop processes for TPM (Figure 5.23) are dramatically improving their TPM performance. For example, a leading consumer products company cut trade spending by 10 percent and boosted volume a year after implementing new TPM processes and technologies. The company also augmented its TPM foundation by adding predictive modeling and analysis tools, thereby generating over a 50 percent internal rate of return on the project in 18 months.

Ideally, once TPM foundations are in place, companies can start achieving breakthrough performance. Imagine tailoring promotions at the store level within the same retail chain for the same period of time – e.g., TPM in urban store location vs. end aisle display with no TPM in upscale store location during the same promotional period. In other words, this approach allows companies to achieve true micro-marketing/merchandising and all of the associated benefits – increased volume, enhanced profitability, increased consumer satisfaction and high levels of brand equity in those segments where it counts.

Implementing this model is no small feat. Addressing trade promotion management through “point-in-time” analytics alone will not solve the issues at hand and will not create an advantage that is sustainable. It is the combined principles of digital loyalty networks – namely the focus on the consumer, the integration of operational excellence and the emphasis on measurements and profitability – that allow companies to capture share and profits away from age-old category leaders.



Source: Deloitte Research

Figure 5.23: Integrated Closed Loop Trade Promotion Management

Examples of such collaborative network strategies are growing by the day. Tesco, UK’s largest grocery retailer, makes available to its 1,000 suppliers complete, reliable point-of-sale data from more than 800 stores. Combining point-of-sales data and internal analytics at key suppliers has enabled reductions in forecasting errors and supply chain costs.

Wal-Mart and Procter & Gamble have better balanced demand and supply over the years through electronically stitching together their sales, forecasting and inventory systems.

Kraft Foods allows suppliers like Universal Packaging to peek at its Jell-O sales forecasts so that the box maker can efficiently prepare for future orders.

General Mills uses the Web to collaborate with 20 other companies from other industries that ship products on the same routes. On test runs, General Mills has saved 7 percent on shipping costs – or about \$2 million in the first year alone. Heineken’s U.S. unit has worked closely with distributors over the last decade to dramatically cut order delivery times and costs. (See Box 1, “The Emergence of Digital Loyalty Networks in the Global Beer Industry”)

To get all stakeholders in a digital loyalty network on board, it is important to forecast the outcomes for each participant. The prospect of quantifiable gains for everyone is what increases participation in the network.

The fear that there will be inequitable sharing of benefits is often cited as the most frequent barrier to retailer/manufacturer collaboration. Companies that harbor this fear often see cost reduction as the primary benefit and assume that parties closest to the end customer (i.e., retailers) will capture those benefits. But this view is too narrow. Cost reductions are only a fraction of the total potential bene-

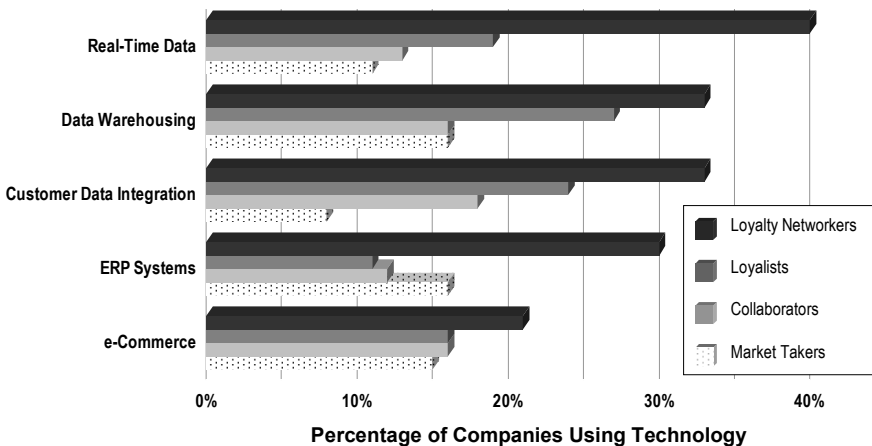
fits. Companies usually find dramatic improvements in fill rates and sales from synchronizing forecasts with promotions and tend to funnel greater spending and new product development efforts to their closest loyalty network partners.

5.4.3 Building an Open Business and Technology Architecture

Participation in a digital loyalty network is a major investment in time for every player. Getting into the network will be far easier if companies can begin with small initiatives and see the benefits before jumping in with both feet. As these pilot initiatives progress, successful companies begin to standardize their policies, business processes, software applications and data architectures to create an open platform that is scalable and secure for network participants.

We refer to these and other elements of the ways companies in a digital loyalty network could work together as the business and technology architecture. In the last year, the prevailing form of this architecture has been private Internet-based exchanges in which a company transacts business with suppliers and customers. Such private exchanges are quickly displacing all but a few of the venture capital-funded public Internet exchanges that proliferated during the late 1990s dot-com boom. As shown in Figure 5.24, Loyalty Networkers have taken a lead in using technology for competitive advantage.

Nevertheless, each of the companies that lead the way in the creation of digital loyalty networks began with small steps. In 1995, Colgate-Palmolive began phasing in its digital loyalty network by standardizing its hodgepodge IT infrastructure and increasing supply chain visibility among its global divisions. It is now in the



Source: Deloitte Research

Figure 5.24: Loyalty Networkers and Technology Adoption

process of extending this visibility to suppliers and retailers using an advanced planning optimization software. (See Box 4, “How Colgate-Palmolive Brightened its Standing through Digital Loyalty Network Strategies”)

Box 4: How Colgate-Palmolive Brightened Its Standing through Digital Loyalty Network Strategies

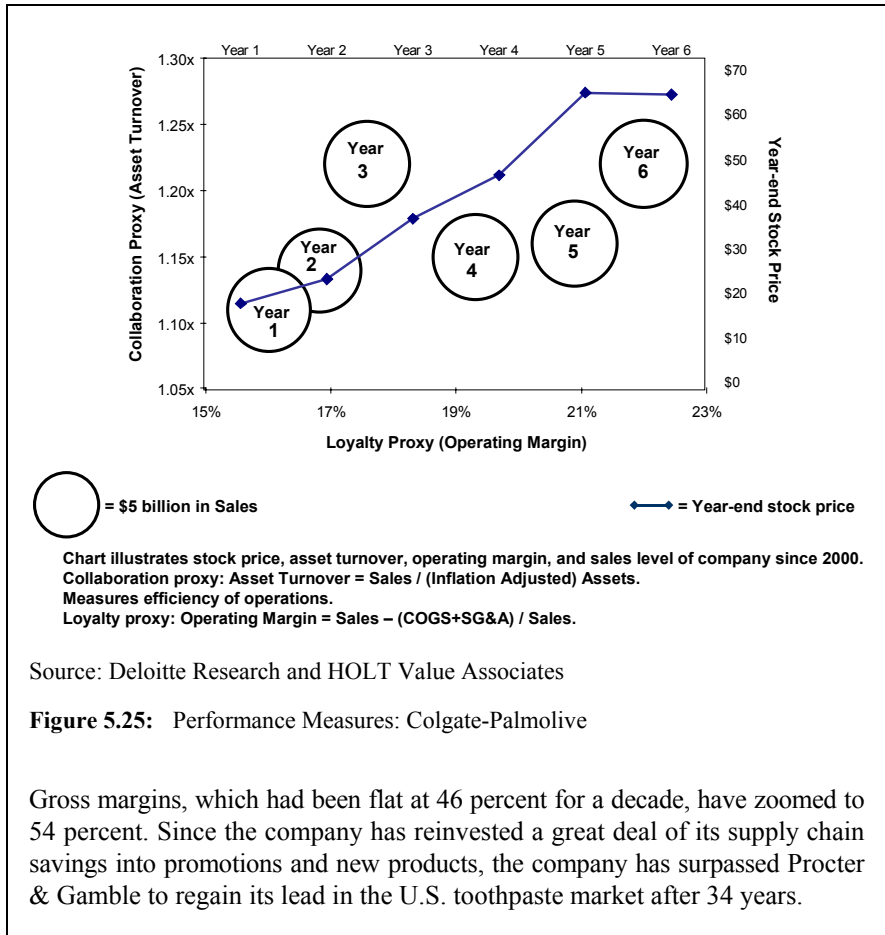
The creation of a digital loyalty network has propelled Colgate-Palmolive Co. to new heights. The journey began in the mid-1990s, after the \$9.4 billion global manufacturer of such households brands as Mennen, Softsoap, Ajax and Hill’s had watched two years of stagnant sales and narrowing operating margins in key North American product lines such as toothpastes, detergents and other personal care products. Its stock price was in the doldrums – below \$20 a share by the end of 1995.

Colgate decided it had to overhaul its inefficient supply chain and technology infrastructure. The company wanted to slash \$150 million in supply chain costs and reduce manufacturing and delivery times. It was taking an average of 120 days for Colgate to convert raw materials to finished products and deliver them to store shelves – a number that it wanted to reduce by more than 80 percent. To reach those goals, the company had to invest 60 percent of its capital expenditures into revamping its onerous supply chain.

In the end, it took only three years to get its money back and the return has kept on growing. How did Colgate do it? First, it had to radically change the way it manufactured, distributed and accounted for its products – changes that would call for much greater coordination of plants, distribution routes and warehouses and planning activities. This demanded standardized information systems rather than the hodgepodge of systems that could be found in each of the 200 companies in which Colgate operated. As a result, Colgate launched a four-year reengineering initiative that made SAP software the nerve center of a new, streamlined supply chain. A central database let sales forecasts drive materials purchases, production scheduling, labor scheduling and other activities. The movement of finished product was then tracked all the way from plants to the grocery stores through devices such as radio frequency-operated communications in warehouses.

Colgate also moved quickly to improve its customer-facing processes. It was an early participant in CPF in 1996. From successful pilot projects, it saw the potential payback in linking the customer-related processes of planning and forecasting with supply chain processes of replenishment. Planning became far more precise; errors in forecasts went down from 61 percent to 21 percent. Moreover, case fill rates – a measure of the accuracy of shipped orders – nudged up from 94 percent to 97 percent.

Today, Colgate is thriving. Asset turnover and operating margins have been the highest since five years (Figure 5.25).



Wal-Mart began its digital loyalty network by capturing point-of-sale data. It then initiated links with suppliers and created CPFR standards that it ran through a private exchange called RetailLink.

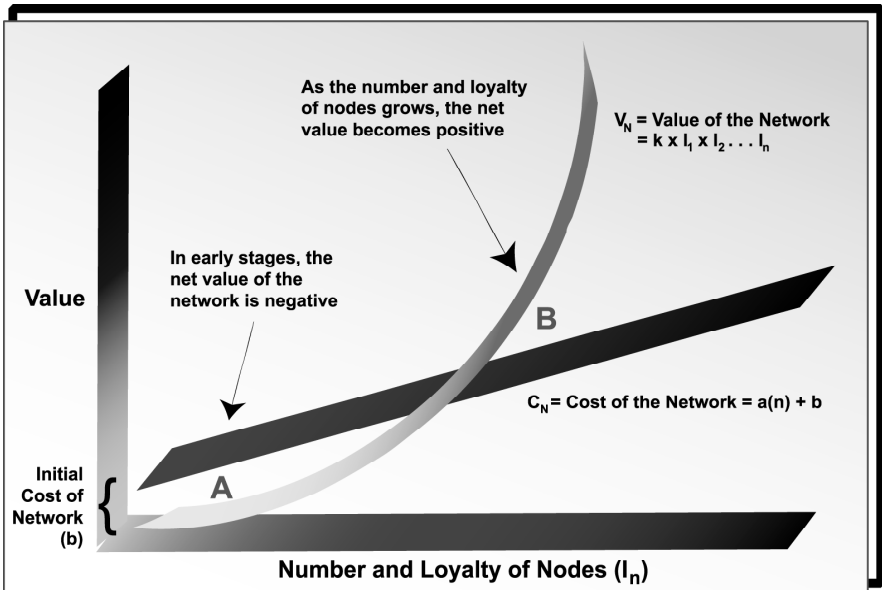
In the implementation of a ‘closed’ architecture – where every company has its own definition of key terms, its own data formats and so on – it is more difficult to link demand and supply chains.

5.5 Conclusion: The Digital Loyalty Network Effect

If the prospect of profit improvements of as much as 100 percent is not enough to motivate a company to build a digital loyalty network, the fear of watching companies like Avon Products, Dell, General Electric, Intel and Southwest Airlines dominate their industries should. Failing to react quickly, many of their competi-

tors are dying a long, painful death of a thousand cuts. Don't believe it? Remember that the PC industry once had dozens of competitors? Today, Dell effectively has reduced the competition to a handful of players and is essentially the only one making money on PCs.

We believe that now is the right time for consumer businesses must to start examining the feasibility of digital loyalty networks. As the network grows in loyalty and the number of participants increases, its value increases exponentially. We call this the “digital loyalty network effect” (Figure 5.26), building upon Metcalfe’s Law on the economics of loyalty and supply chain collaboration.



Source: Deloitte Research

Figure 5.26: Digital Loyalty Network Effect

Furthermore, once these network relationships are established and investments made in infrastructure and collaboration, switching costs become substantially higher – as do the costs for late-arriving competitors hoping to mimic the business model. Competitors will always find ways to copy new products and quality standards, new services, individual marketing and sales efforts, supply chain operations, production models and sourcing strategies. However, it will be virtually impossible for competitors to copy the way in which a digital loyalty network differentiates the entire supply chain response for each customer or segment in real time.

Now is the time for consumer business executives to ask themselves some key questions:

- Do you know who your **most valuable customers** are, what their requirements are, and what it costs to serve them well?
- Are your supply chain managers getting customer information on changes in **lifetime value** and customer requirements on a real-time basis?
- Are you leveraging new e-business technologies to manage customer and supplier relationships in real-time?
- Are you **collaborating with strategic customers** and sharing deep customer information with your critical suppliers?
- Are you dynamically committing plants, capacity, logistics, and other supply chain resources according to the **value of individual** customers or segments?
- Can you differentiate and optimize order lead times according to customers' lifetime value and requirements?
- Are you and your network partners optimizing the entire customer value proposition for each customer – price, quality, delivery, service, brand, technology?
- Can you **continually improve** how your network responds to new customer demands?

Answering these questions will reveal to organizations how far they need to go in order to gain the capabilities required for success, or perhaps even survival, as the decade plays itself out. They will also help organizations determine how far down the path of deploying digital loyalty networks they have gone and how much further they need to go.