A SUPPLEMENT TO CONSUMER GOODS TECHNOLOGY AND RIS NEWS

SHARED STRATEGY REPORT 2008

THE STATE OF COLLABORATION

RESEARCH INSIDE:

- Green Business
- Supply Chain
- Demand Intelligence
- Category Management
- Private Label
- Innovation

Consumer Goods Technology
RIS Retail Info Systems News
Global Retail Insights An IDC Company
Manufacturing Insights An IDC Company

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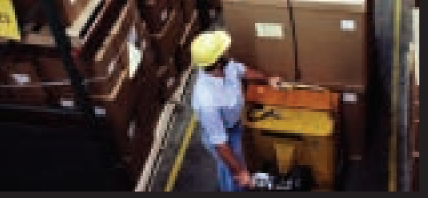

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Letter from Manufacturing Insights

Progress in the world of consumer packaged goods (CPG) has brought improved shopping experiences and unprecedented choice from branded CPG manufacturers and diversified retailers. But with progress, there's increasing complexity in the value chain, and with complexity, there's also cost. Manufacturers are facing distributed, global supply networks with longer lead times and an increasingly eclectic mix of owned and outsourced factory locations, while living with too many SKUs and not enough successful innovation. Retailers are struggling with shrinking profit margins, a general inability to eliminate out of stocks, and the enduring challenge of differentiating themselves as consumers look for value in these troubling economic times. All the while, they're attempting to provide the right product, in the right place, at a fair price with zero defects!

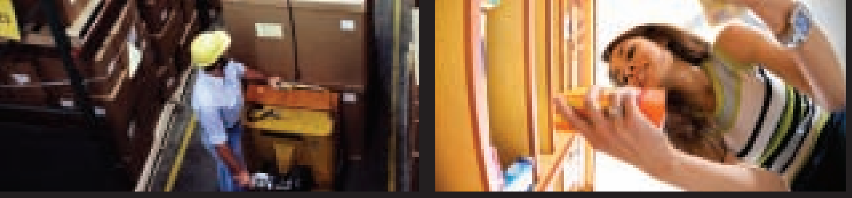
It's during tough times that collaboration is more critical. Whether it's a manufacturer's need to effectively manage a supply network, the retailer's ability to share customer-centric demand data or the willingness of both to collaborate on new products, the entire extended supply chain will realize benefits.

In partnership with *CGT* and *RIS News*, we look at the progress made in 2008 through collaboration between manufacturers and retailers. We start with some thoughts on the current economic climate, then move to the increasing impact of sustainability, the refocusing of RFID, and the ups and downs of demand management, private label and innovation. Collaboration remains one of the most effective ways of synchronizing the extended CPG supply chain, and we hope you enjoy our study and the insights it provides on progress between manufacturers and retailers.

Sincerely,

Kimberly Knickle

KIMBERLY KNICKLE
Practice Director, Emerging Agenda
Manufacturing Insights, IDC



The State of Collaboration

Our report brings expertise from two IDC businesses, Manufacturing Insights and Global Retail Insights, to review the state of collaboration in Q&A form with analysts Simon Ellis, practice director, Manufacturing Insights, and Leslie Hand, practice director, Global Retail Insights. Both Ellis and Hand have extensive experience in the CPG-retail supply chain. Ellis spent more than 20 years at Unilever. Meanwhile, Leslie's 25-plus year career in retail includes time spent at Ahold, Total Beverage, Cosmetic Center and Dart Drugstores.

>IDC: *Figure 1 details three economic indicators: consumer sentiment, consumer prices and housing starts. The economic news is definitely worse than last year. What are your thoughts?*

>ELLIS: There is no question that problems in the U.S. financial system, the credit crunch and weakness in the U.S. stock market are having a significant impact. It's the growing conservatism in spending that has us most concerned. Although we forecast a 5 percent global spending growth for 2009 year over year, manufacturers did not spend their entire budgets in 2008, and we see that as an increasing risk for 2009.

>HAND: Until a couple of months ago, I was confident retailers would continue to increase technology investments to differentiate and create better foundations for future growth. In fact, our annual retail technology spending guide forecasted 7.2 percent year-over-year growth. But buyers are clearly shaken, and discretionary spending is down. Retailers are responding by freezing 2008 capital expenditures and lowering 2009 budgets.

>THE BOTTOM LINE: With capital investment budgets likely to fall in the first half of 2009, the concern is that collaboration may stall, since collaboration improvements often require technology underpinnings. We're hoping confidence in the new government will reinvigorate spending in 2009.

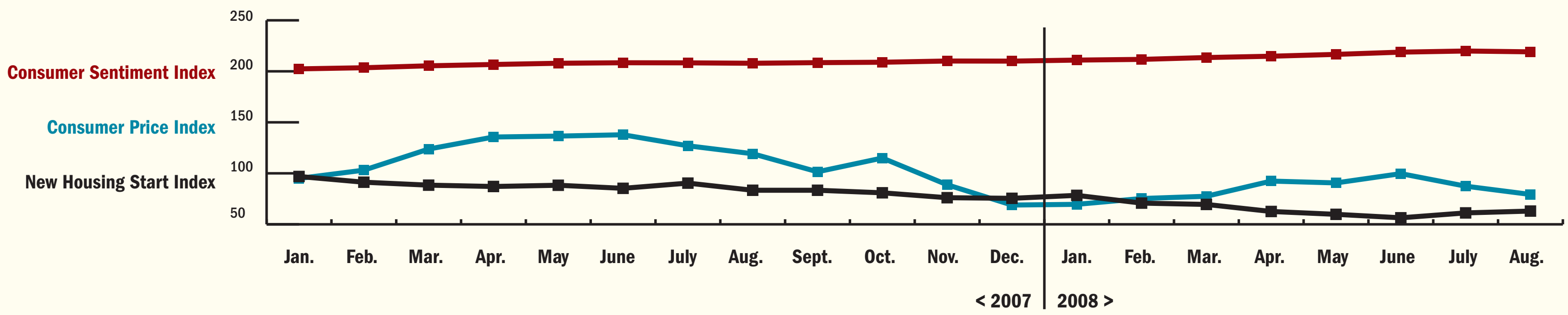
>IDC: *Our data continues to show a gap between the profit margins of each segment (see Figure 2 and Figure 3). How does this uneven distribution affect their relationship?*

>ELLIS: Historically, CPG manufacturers have maintained margins almost twice that of retailers, and this results in the kind of cost-shifting behaviors we've seen over the past few decades. Think of smaller case sizes and more frequent deliveries that lower retailers' inventory costs or manufacturer-paid customization to drive retail differentiation. Given 2009's economic instability, we expect to see collaboration efforts that lower or remove unnecessary extended supply chain costs.

>HAND: These figures are proof of why retailers think suppliers should incur a higher proportion of the costs in collaborative endeavors. Retail has become more competitive, and frankly, a fight to maintain relevance and margins means manufacturers will be squeezed as a result. Retailers would like more support from their suppliers — they'd like to see them bearing a fair share of the costs to get to the customer.

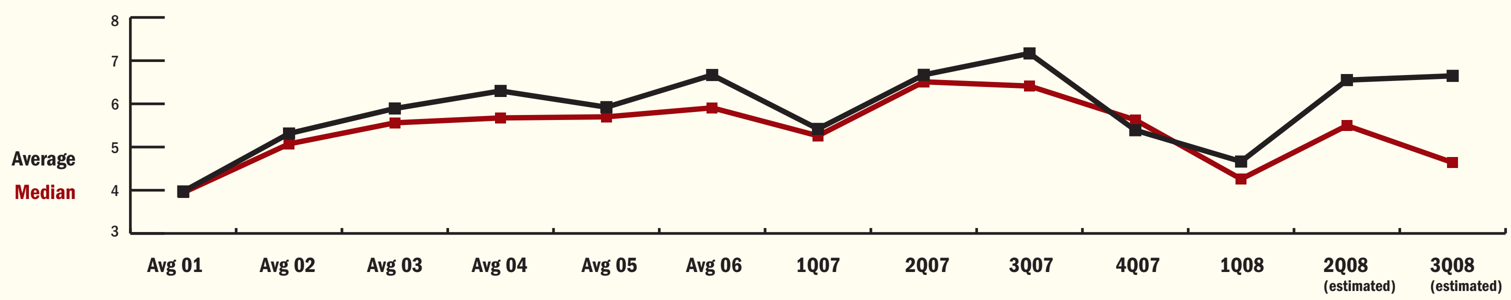
>THE BOTTOM LINE: Manufacturers and retailers overwhelmingly indicate they want to collaborate more — but collaboration must provide a mechanism for retailers to improve these sagging margins.

FIGURE 1: Economic Indicators, Jan. 2007 – Aug. 2008



Source: U.S. Bureau of Labor Statistics Data, U.S. Census, and University of Michigan, 2008

FIGURE 2: CPG Manufacturing Industry Median and Average Net Profit Margins, Avg 01-3Q08



Source: Manufacturing Insights' Global Performance Index (GPI), 2008

>IDC: *As both manufacturers and retailers try to control costs, why is managing inventory still such a challenge (see Figures 4 and 5)?*

>ELLIS: Most manufacturers realize there is a complex relationship between inventory and service levels — too much inventory can be just as negative on service levels as too little inventory. Better management of inventory types can be a way to drive efficiency in inventory management. But SKU proliferation remains one of the main culprits of inventory level increases over time because of the ongoing push for differentiation and customization.

>HAND: Retail inventory levels have risen for three reasons: retailers strive to satisfy consumer demand and reduce out-of-stocks; product lead times mean higher inventory levels to satisfy demand; and fears of rising costs drive retailers to increase forward buys. These inventory levels are not sustainable and will start falling potentially at the expense of consumers, especially if collaboration doesn't improve.

>THE BOTTOM LINE: The solution requires value chains to be smarter about their capacity and inventory planning, perhaps making better use of the increasing availability of demand forecast data and tools such as multi-echelon inventory optimization, with an eye on better SKU management.

>IDC: *Can you share final thoughts on 2009's economic challenges?*

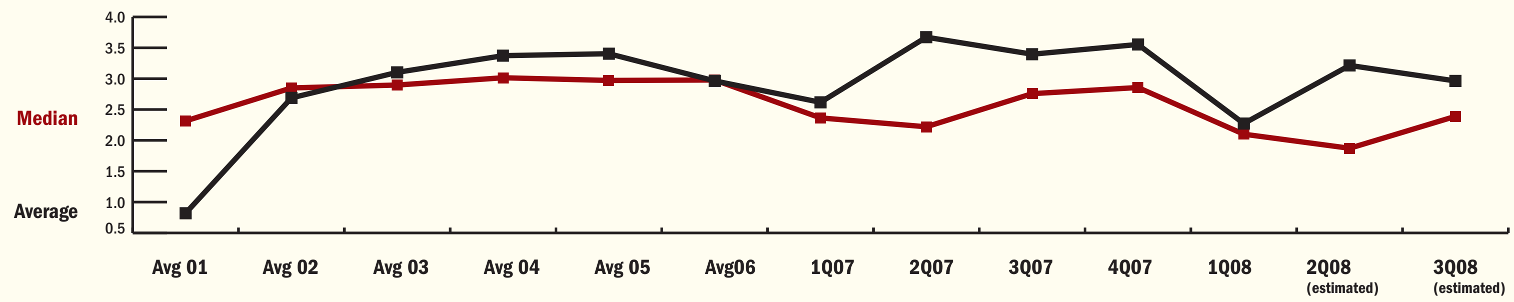
>ELLIS AND HAND: There is little question that collaboration needs to be a cornerstone of retail and supplier strategies as we move through a tough economic climate. As consumer confidence erodes, we see market share shifting to retailers that can satisfy consumer needs with differentiated products and service at value prices. We anticipate retailers will put even more efforts into private label given their margins and lower prices. Collaboration will be even more important in 2009 to ensure the proper mix of innovative manufacturer brands and cost-conscious private label products.

SIMON ELLIS
Practice Director, Manufacturing Insights

LESLIE HAND,
Practice Director, Global Retail Insights

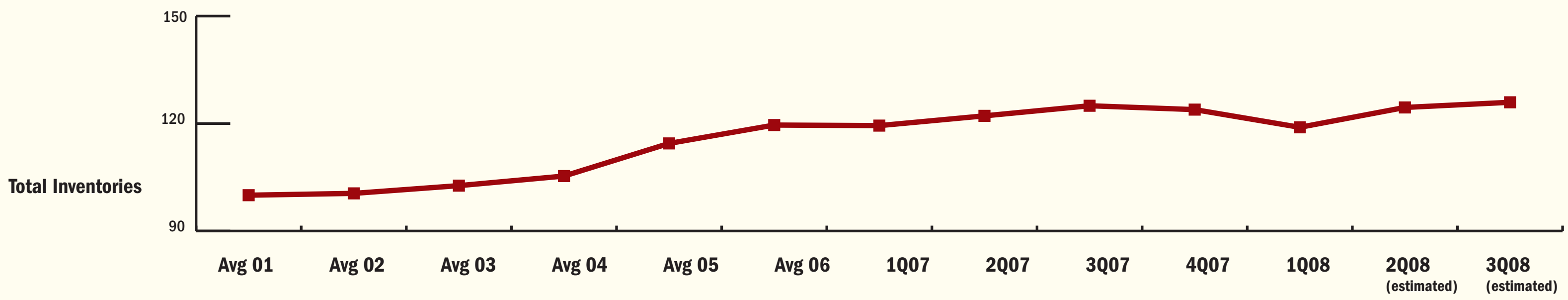
Footnote: The Manufacturing Insights GPI tracks growth metrics from 800+ publicly-traded global firms in the manufacturing and retail industries. Estimates by Reuters.

FIGURE 3: Retail Industry Median and Average Net Profit Margins, Avg 01-3Q08



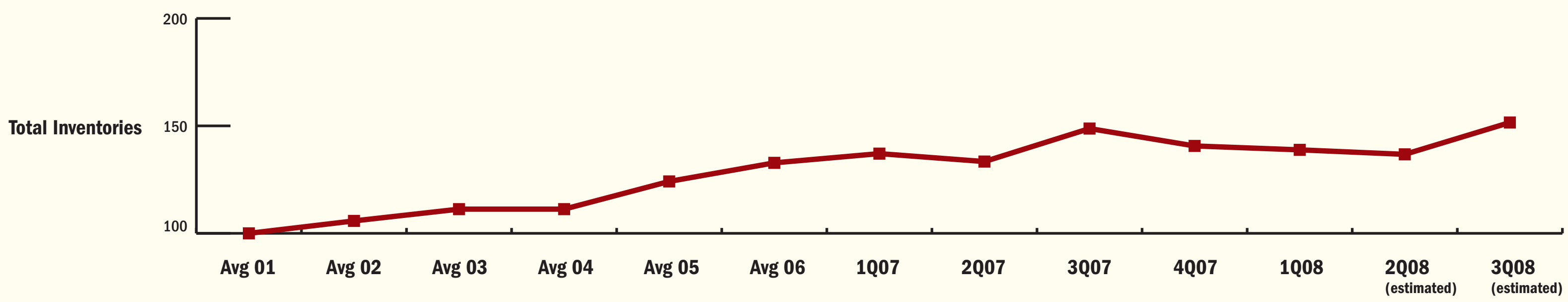
Note: Index average in 2001 equals 100.
Source: Manufacturing Insights' Global Performance Index (GPI), 2008

FIGURE 4: CPG Manufacturing Industry Inventory Index, Avg 01-3Q08

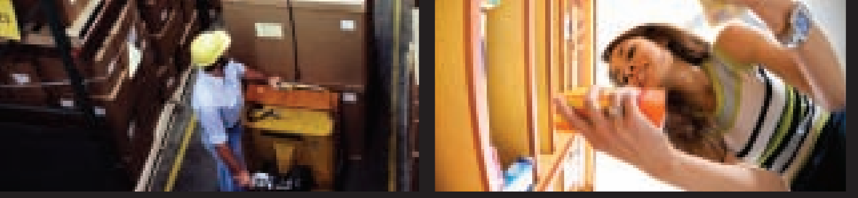


Note: Index average in 2001 equals 100.
Source: Manufacturing Insights' Global Performance Index (GPI), 2008

FIGURE 5: Retail Trade Industry Inventory Index, Avg 01-3Q08



Note: Index average in 2001 equals 100.
Source: Manufacturing Insights' Global Performance Index (GPI), 2008



Green Business

Going green is a familiar goal in the CPG industry. There are plenty of reasons to move ahead with environmental excellence. A company's green reputation increasingly impacts the brand, and our research shows sustainability leaders have higher product margins than their peers. We maintain that truly green products and services require a value chain perspective, and we want to underscore the fact that this is an area of collaboration that deserves attention — it's good for the environment *and* your business.

But successful collaboration requires overcoming hurdles *(see Figure 1)*. Our weighted survey results show that manufacturers are very concerned about how to change their manufacturing processes, which tells us that they recognize the longer-term perspective that is needed. This is followed closely by concern over the lack of green standards, and retailers feel a similar level of frustration. This is an opportunity to come together and define exactly how to make products greener. We're already seeing important steps being taken, and while some retailers (and CPG manufacturers) respond by changing suppliers to solve the problem, we believe that's often a short-sighted perspective.

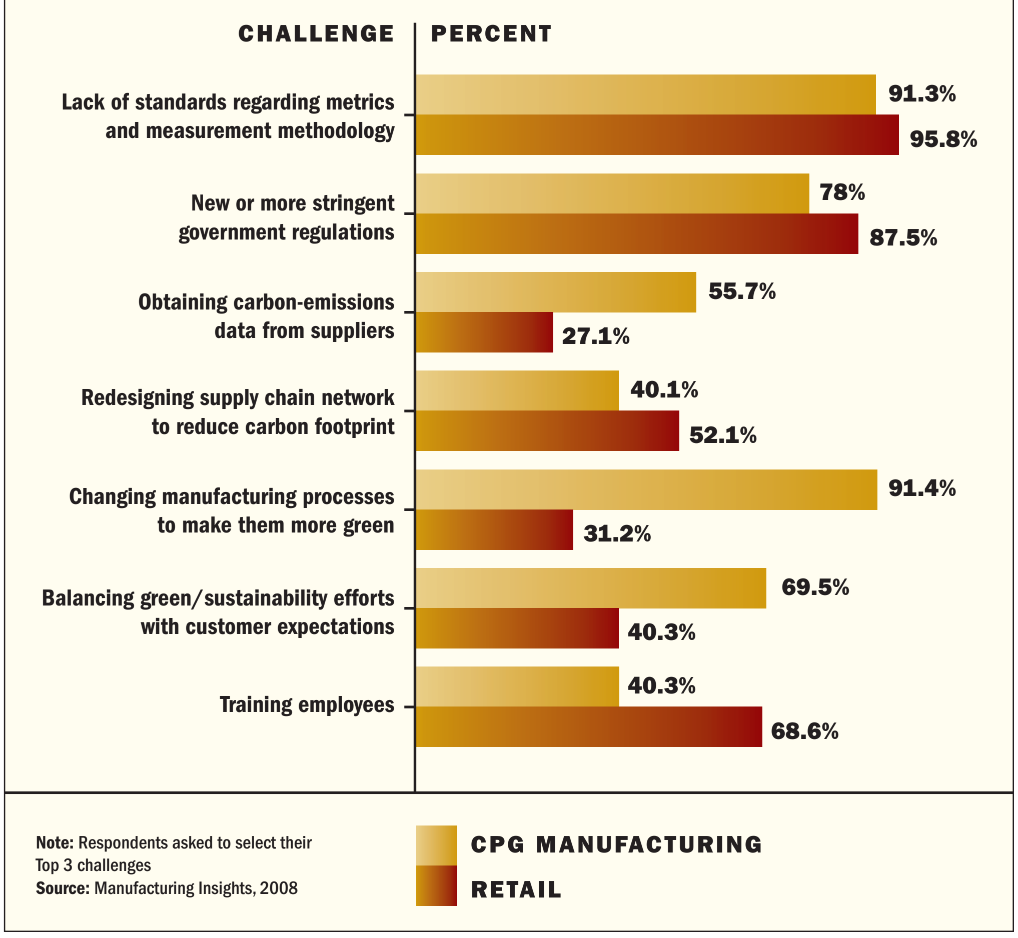
There is a cost element in how manufacturers are measuring the success of their green initiatives, but more importantly, retailers and their suppliers generally agree that they want to reduce their energy consumption as well as improve waste recycling and/or the use of recyclable materials *(see Figure 2)*. That is a good sign that they won't just push inefficiencies around in the supply chain.

Spending in this area is still tight, with many companies not sure how much that they will have to spend *(see Figure 3)*. We're also surprised that many companies don't expect to calculate a return on investment on green projects *(see Figure 4)*, but those are most likely the ones that have to be funded, spending to satisfy publicly-stated corporate goals and regulatory or customer mandates. Many projects will require a return on investment or a different type of justification. We suggest that a collaborative approach to green business will focus on lowering costs, some in the short term and some in the long term.

> "We encourage retailers and suppliers to work together to take a big picture perspective, not just by measuring their carbon footprints, but also in the corporate social responsibility aspects such as economic and community development."

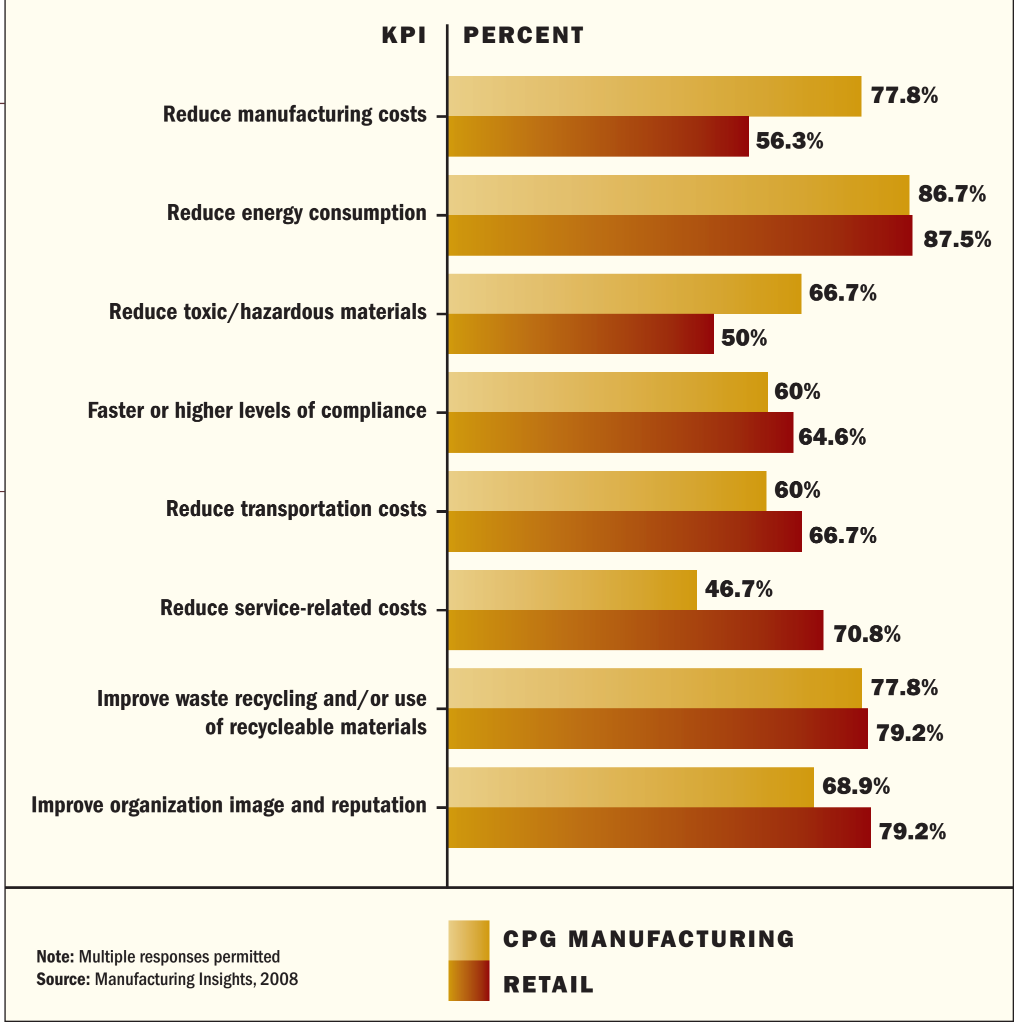
Unfortunately, there are many poor decisions being made in the name of being "green". It is not easy, and there is definitely a learning curve. Retailers continue to evaluate what consumers expect from them. Consumer needs will ultimately dictate the retailer's stance on green business. We encourage retailers and suppliers to work together to take a big picture perspective, not just by measuring their carbon footprints, but also in the corporate social responsibility aspects such as economic and community development. And collaboration, and the willingness to collaborate, is definitely going to make a difference. As we pointed out in our 2008 predictions — this is a case of "your suppliers' problems become your own," so collaboration is going to ensure everyone's on the same page.

FIGURE 1: Top Green Challenges



Note: Respondents asked to select their Top 3 challenges
Source: Manufacturing Insights, 2008

FIGURE 2: KPIs Used to Measure Green Initiative Effectiveness



Note: Multiple responses permitted
Source: Manufacturing Insights, 2008

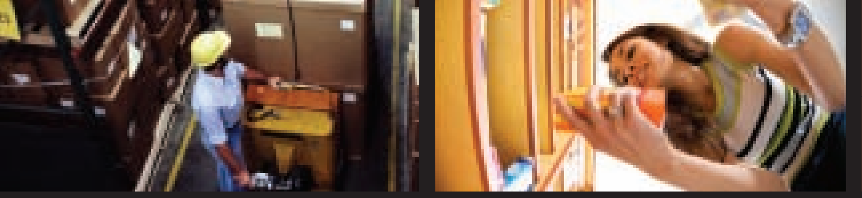
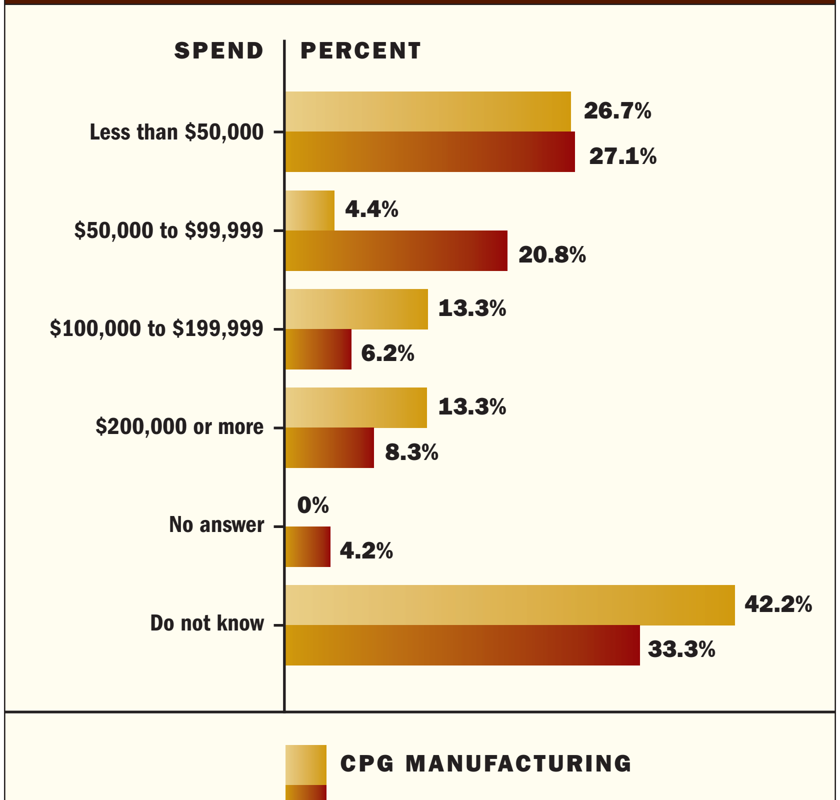
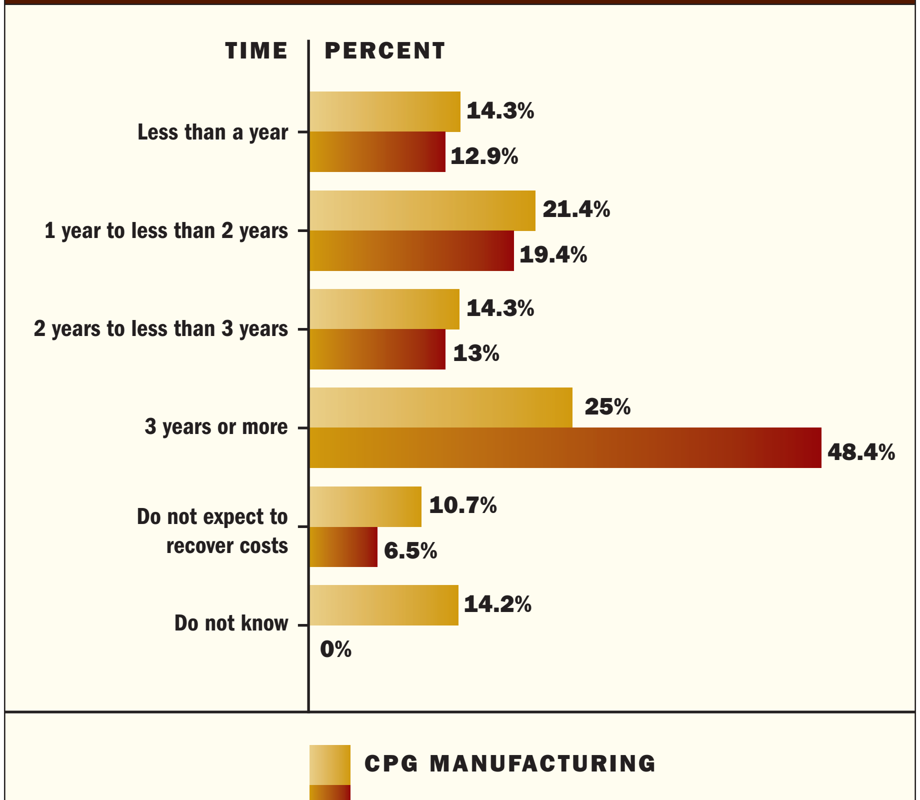


FIGURE 3: Planned Spending on Green-Related Initiatives over Next 12 Months



Source: Manufacturing Insights, 2008

FIGURE 4: Time to Recover (or Recoup) Green-Related Costs



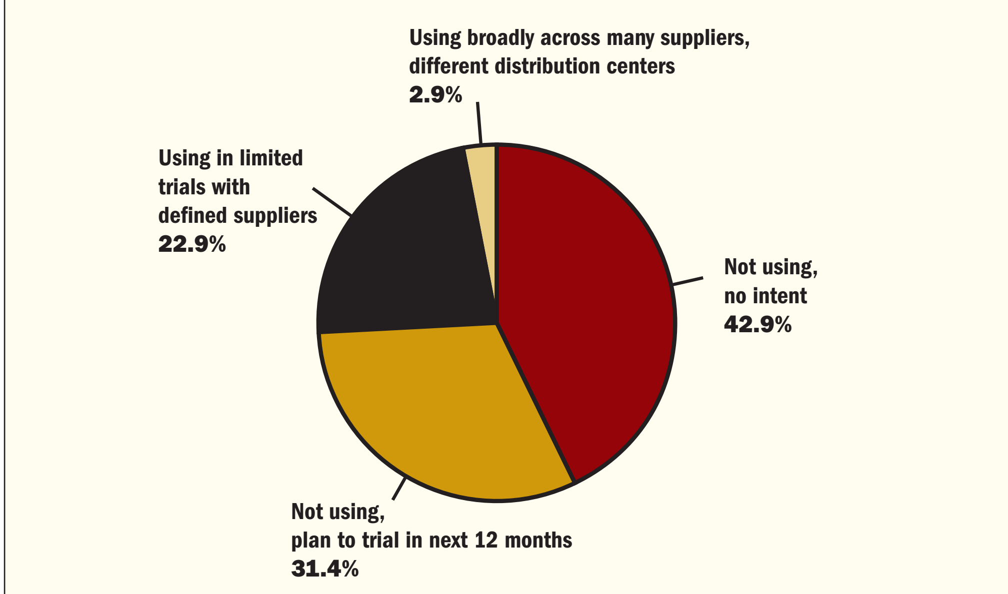
Source: Manufacturing Insights, 2008

RFID

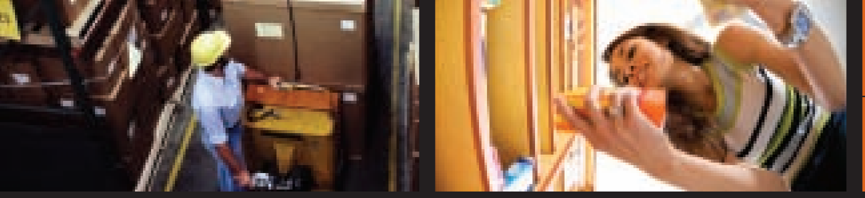
Multiple IDC surveys, including the question in Figure 1, continue to show resistance to RFID as a means of collaboration. Most retailers are unwilling to mandate case and pallet tagging, and few have even considered item-level tags. Despite these low results, we believe some of the basic hurdles are being overcome, including increasing maturity in the products and the standards. More companies are building business cases for uses such as shelf displays and signage; asset tracking in the supply chain, product freshness management using RFID with temperature, humidity and pressure sensors, combined EAS-RFID security tagging and promotional execution management. And we still have Wal-Mart's leading influence. Rather than concede failure with RFID, Wal-Mart refocused its energy on the more practical and benefit-rich exercise of tracking tagged pallets in Sam's Club stores.

For RFID collaboration to be successful, retailers and suppliers must agree on an equitable cost/benefit model that lowers the risks associated with investment and data sharing. We continue to maintain that mass RFID adoption can enable significant collaboration opportunities and transformative trading relationships. Projects that are likely to be funded will look like closed-loop initiatives — maybe one retailer with one or just a few suppliers, and they will in some way improve customer service. The massive RFID hype is behind us, and opportunity lies ahead. But there is a catch: Now is the time to develop a focused, RFID strategic plan to help minimize implementation costs and capture benefit.

FIGURE 1: Retailers' Current and Future Plans for Using RFID



Source: Global Retail Insights, 2008



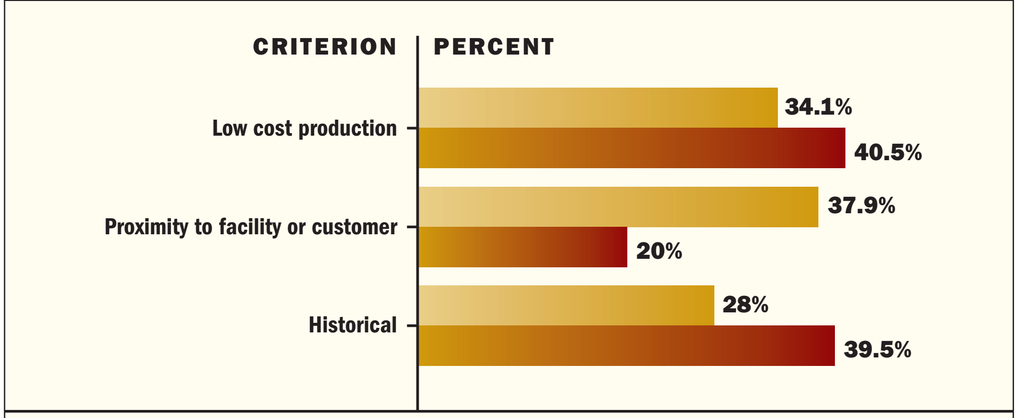
Supply Chain

Supply network strategies are changing, and low cost is no longer the dominant reason for selecting a supplier *(see Figure 1)*. Other criteria factor into the decision: how well suppliers are equipped to collaborate, required lead-time, proximity to customer demand and sustainability. In our research, we talk about this as Profitable Proximity Sourcing and how it is increasingly the way companies will look at their supply networks. Survey results show a strong indication that cost remains important, but more suppliers are selected due to either their proximity to customers or facilities *or* historical relationships. And, it is in those historical relationships where we often find collaboration.

Supply chain collaboration remains a top goal for manufacturers and retailers. In the case of manufacturers, collaboration involves many different types of suppliers (contract manufacturers producing finished goods, intermediary suppliers producing work-in-process components, raw and pack suppliers sourcing components and primary ingredients, and more). Add in globally distributed supply networks, often five to six supply levels deep, and you'll see a situation that can quickly dissolve into chaos.

Within this context, manufacturers are focusing on faster, better decision making, with increasing investment in collaborative tools and processes with suppliers. Relationships with suppliers usually follow the classic 80:20 economic rule, where a majority of collaborative value can be had from focusing on the suppliers (often just 20 percent of all suppliers) where they spend 80 percent of their dollars. That level of collaboration with top suppliers has improved over time and will continue improving *(see Figure 2)*.

FIGURE 1: Supplier Selection Criteria



Source: Manufacturing Insights, 2008

FIGURE 2: Collaboration Maturity with Top 20% of Suppliers over Time

	2006	2008	2010
Stage 4: **Strategic**			
			20% Retailers
Stage 3: **Process Harmonization**		25% CPG MFG	50% CPG MFG
			80% Retailers
Stage 2: **Electronic Data Sharing**	25% CPG MFG	12.5% CPG MFG	37.5% CPG MFG
		100% Retailers	
Stage 1: **Event-Based**	75% CPG MFG	62.5% CPG MFG	12.5% CPG MFG
	100% Retailers		

Source: Manufacturing Insights, 2008

> "For manufacturers, collaboration benefits tend to be more cost- and time-related, rather than revenue-related… Retailers prioritize quality and customer satisfaction above all other benefits…"

But manufacturers and retailers also reveal a significantly lower level of collaboration with second tier suppliers *(see Figure 3)*. However, this collaboration should also improve in the next two years. Perhaps manufacturers and retailers have made enough progress with the top 80 percent that it now makes sense to look at the remaining 20 percent, or perhaps the tools and techniques used up until now are more easily leveraged across the entire supplier base.

We are starting to see collaboration improvement in the second tier of suppliers as well. Not surprisingly, the reasons given for a lack of focus on the last 20 percent of the supply base are generally around economic realities (no pressing need to collaborate given size and influence) and/or technical capability *(see Figure 4)*. The improvements in technical sophistication among smaller business should make the economic cost of collaboration extremely low, given the potential cost benefits, and bring greater opportunities for collaboration across all suppliers.

For manufacturers specifically, the collaborative focus with the top 80 percent of the supply base is around economic rationalization (and reduction) of suppliers, an increase in quality audits and the implementation of key metrics through shared scorecards *(see Figure 5)*. This is a practical approach — fewer relationships makes for less complexity; scorecards and quality audits acknowledge that global supply networks can get out of control without proper governance. More strategic collaborative elements such as NPDI, sharing demand data and joint KPIs appear to remain the focus with just a few key suppliers, but there's an opportunity to expand this level of collaboration.

Retailers share many of the same priorities *(see Figure 5)*, but they are taking a more data-centric perspective regarding data connectivity and data quality, tying in with their interest in gathering information that will improve customer service and demand management.

For manufacturers, collaboration benefits tend to be more cost- and time-related, rather than revenue-related *(see Figure 6)*, which speaks loudly to the continuing perception of supply as a cost center rather than a revenue center. There is nothing wrong with that necessarily, but as we discussed in the context of supplier selection and profitable proximity, the next phase of supplier will look for collaboration and revenue opportunities, not just cost reduction.

Retailers prioritize quality and customer satisfaction above all other benefits, and if lead time is a way to improve customer service, then that is a good starting point for a discussion on how to improve collaboration.

FIGURE 3: Collaboration in the 2nd Tier: Today and In Two Years

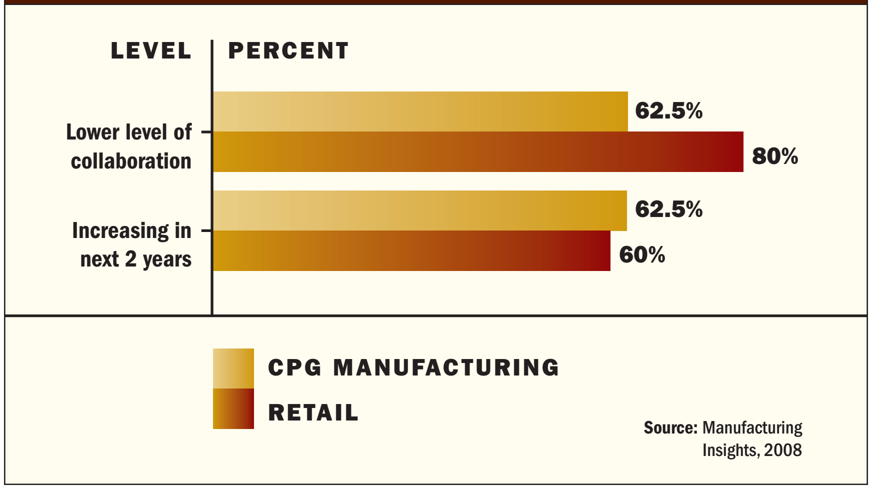


FIGURE 4: What's Holding Back 2nd-Tier Collaboration?

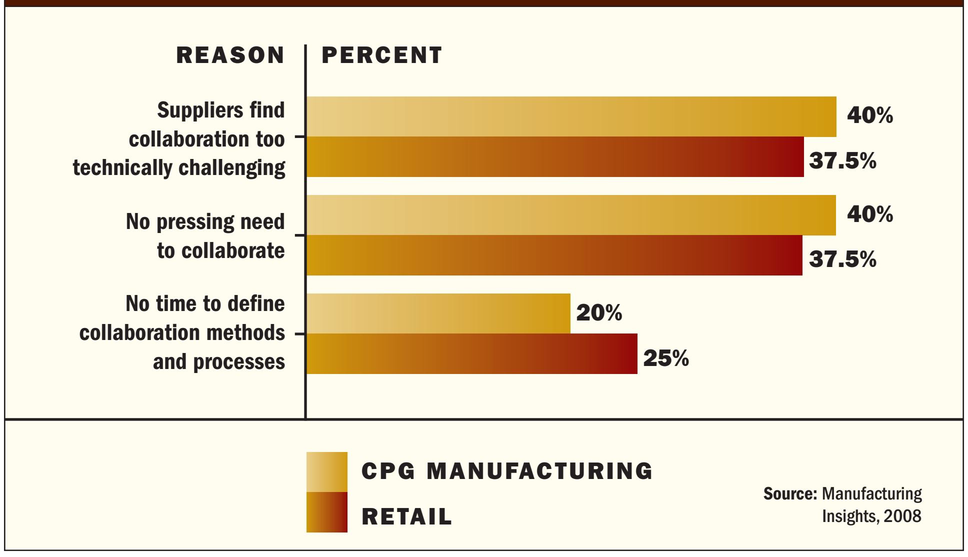


FIGURE 5: Collaboration Elements: CPG Manufacturing vs. Retail

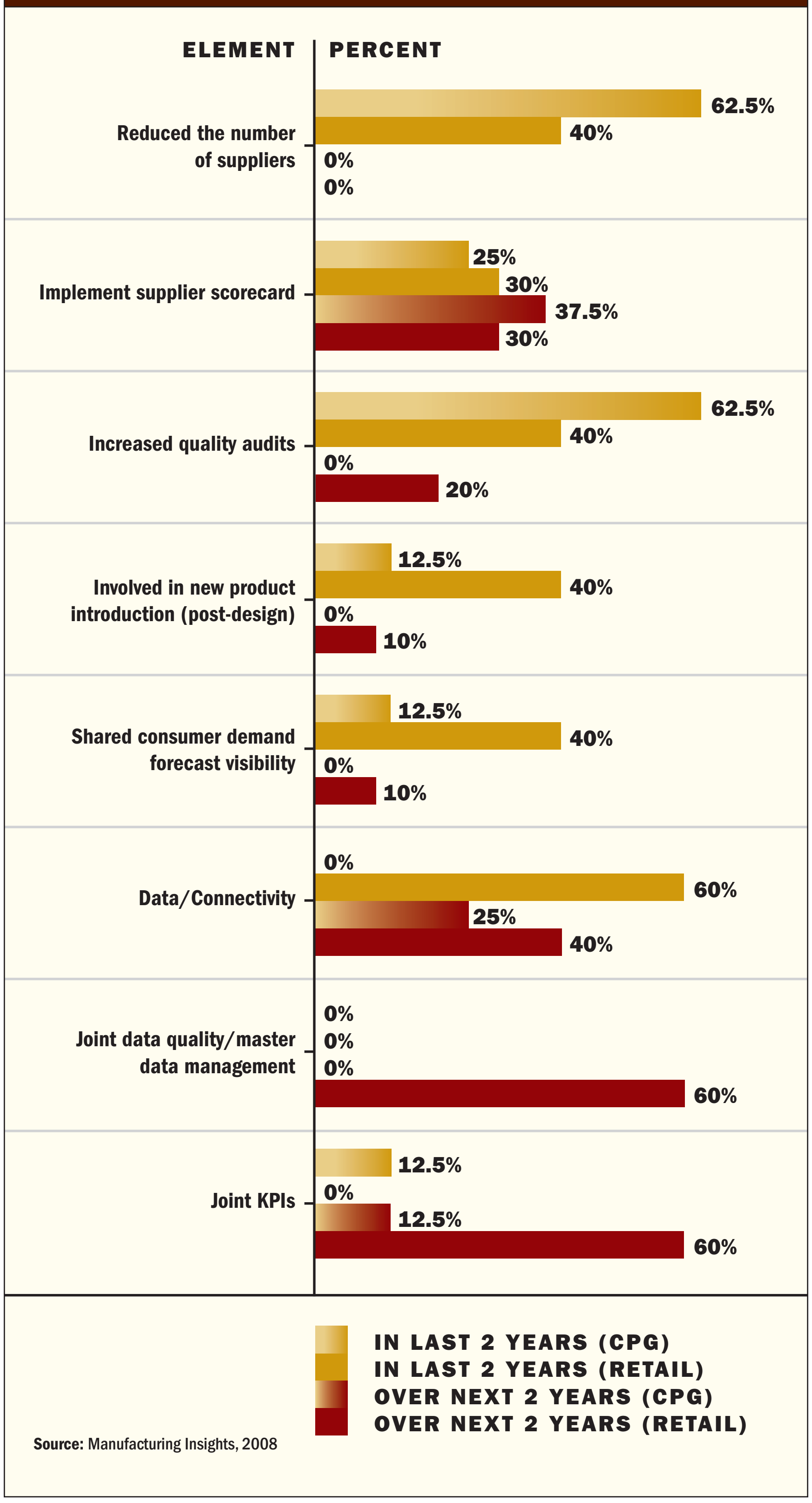
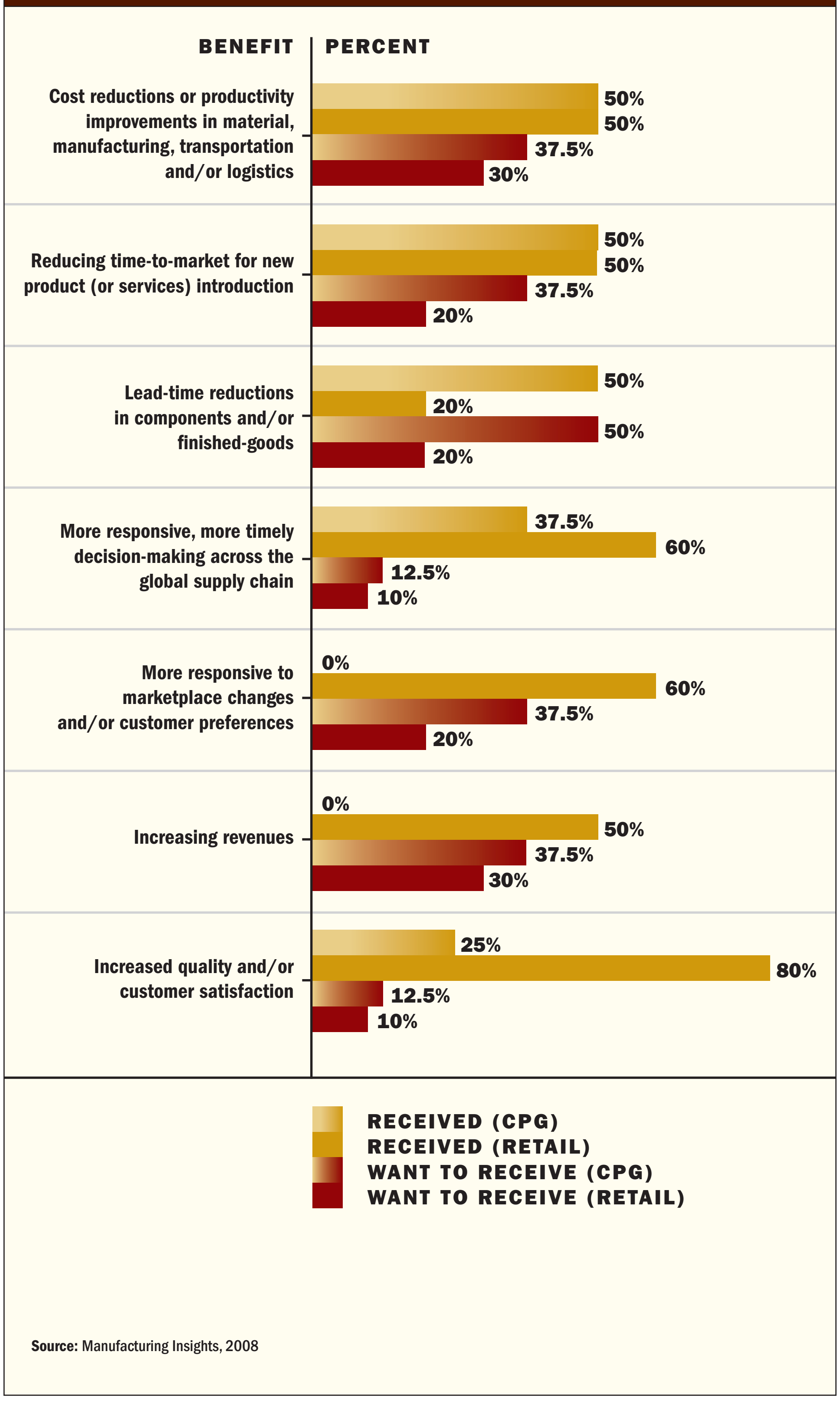
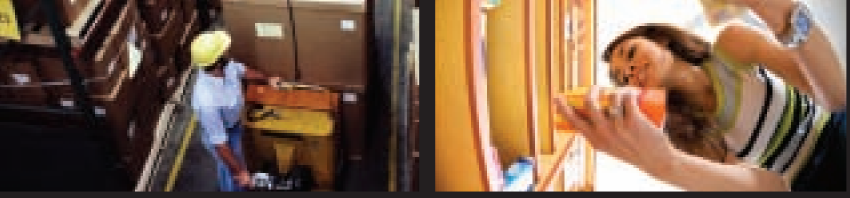


FIGURE 6: Collaboration Benefits: CPG Manufacturing vs. Retail





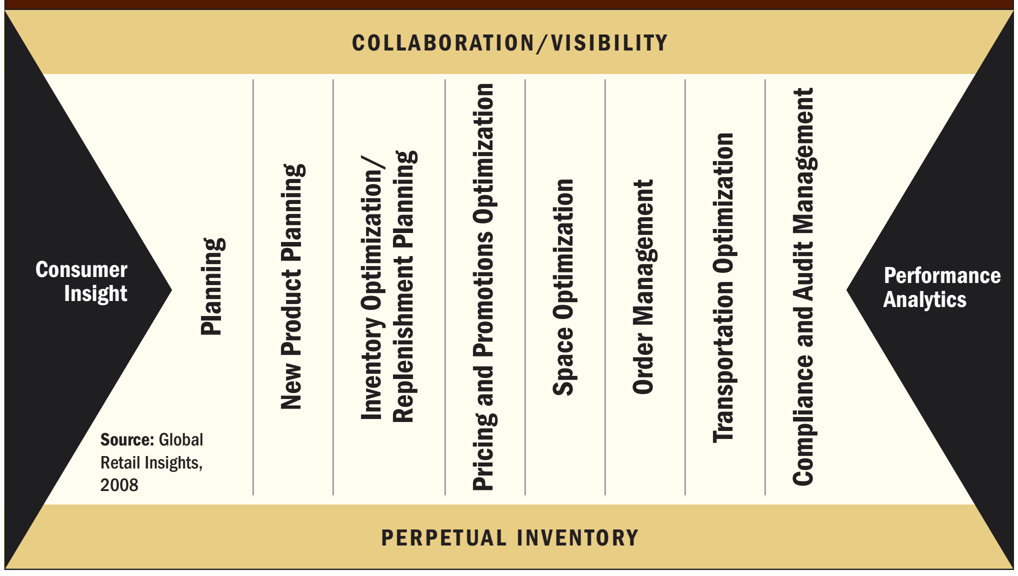
Demand Intelligence

Rising inventory levels and out of stocks are a clear indication that demand intelligence needs to improve. Just having a good understanding of consumer demand does not fill shelves. What it does require is an end-to-end understanding of the demand inputs from retailer and supplier, as well as how that demand will be fulfilled at the shelf — including sensible SKU management.

Organizations must move beyond thinking that demand intelligence alone will solve out of stocks at retail. Retailers and suppliers will realize greater efficiencies when they refresh their demand intelligence initiatives with a full end-to-end systems view.

Figure 1 highlights areas in which retailers and suppliers can achieve better visibility and efficiency. While each of these areas must be clearly monitored and measured, this shouldn't happen in the organizational silos that have hindered demand intelligence in the past. Trading partners need to optimize collaboration opportunities to ensure demand can be satisfied. Effective collaborative supplier and retailer input will result in real consumer demand insight, augmented with practical retail experience, real-time performance analytics and feedback into consumer insight databases.

FIGURE 1: Rethinking Demand Intelligence



Source: Global Retail Insights, 2008

Advanced Category Management

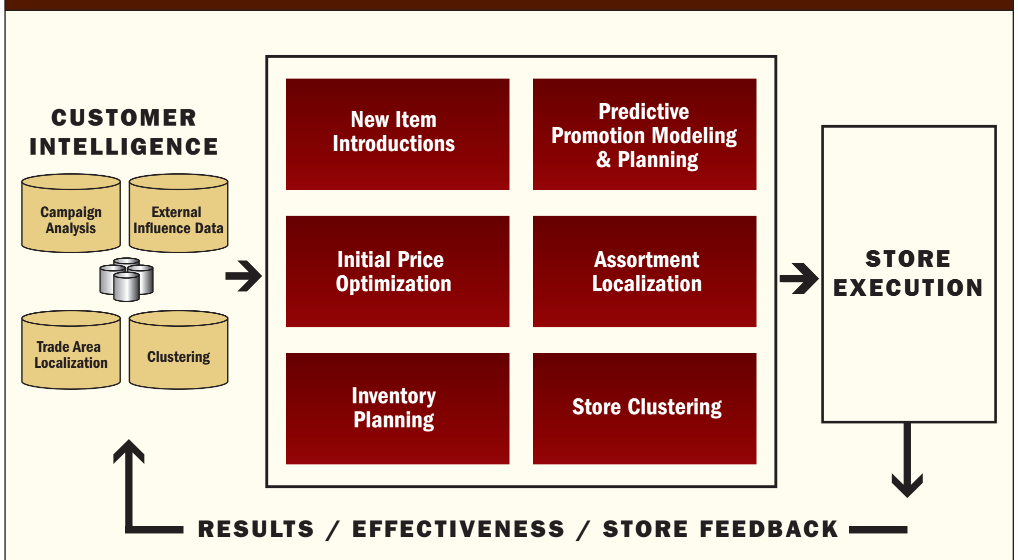
Advanced category management succeeds because it's collaborative and consumer-driven, not just cost-driven *(see Figure 2)*. It leverages consumer insight to get plans right, sometimes at the expense of trade funds. Buy-in from store operations is essential to for alignment of goals and priorities — store execution can then be evaluated and results factored into future plans.

Key components of an advanced category management systems include intuitive workflows that be shared between retailer and supplier, embedded performance analytics and optimization, and common multi-lever demand forecasts.

Properly executed, advanced category management can reduce inefficiencies and tactical emergencies, improve response to demand shifts, enhance speed to market, and enable flexible store/localized plan-o-grams and promotions. Retailers and suppliers can then collaborate on localization requirements and consumer specific offers. This results in a shared vision and focus with increased accuracy and adaptability — supported by science. Internal and external demand drivers can be incorporated across organizations and organizational silos.

Retailers must collaborate with suppliers using advanced category management to drive exceptional store execution that incorporates store-based demand and localization strategies.

FIGURE 2: Advanced Category Management



Source: Global Retail Insights, 2008

CASE STUDY ADVERTORIAL

Brown-Forman Corporation

AN SAP BUSINESS TRANSFORMATION STUDY

A History of Continuous Growth

Whether by local law or long-held tradition, the alcoholic beverage industry leans toward exclusive distribution, which can lock unlucky companies out of key markets. In 1923, Brown-Forman Corporation secured one of only 10 U.S. licenses to bottle medicinal whisky during prohibition and, therefore, was able to acquire whisky maker Early Times, which had not. Brown-Forman continued its domestic acquisitions, such as Jack Daniel's Tennessee Whisky, and secured U.S. distribution rights for international products such as Korbel Champagne. Although it was becoming one of the largest American-owned spirits and wine companies, its domestic growth did little to ensure access to international markets.

Global Expansion and Synchronization with Regional Operations

To gain an international foothold, Brown-Forman formed a joint venture with Altia Corporation in 2000 for global distribution of Finlandia Vodka, and by 2004 they acquired full ownership of the brand. Brown-Forman put a global sales and operations planning process in place by leveraging the SAP Advanced Planning & Optimization (SAP APO) component of the SAP Supply Chain Management (SAP SCM) application and cut forecast error by over a third by 2005. Brown-Forman also purchased French firm Chambord Liqueur in 2006 and Mexican tequila producer Casa Herradura in 2007. Because Casa Herradura was running SAP software, Brown-Forman could exchange master data with it quite literally overnight.

Brown-Forman also looked to distribution partnerships where growth can be faster, but where visibility into inventory levels and demand is critical. With SAP SCM, Brown-Forman increased the number of combined item/locations offered in some regions while maintaining 12 inventory turns per year and 99+ percent service levels. And again, for a distributor already running SAP software, the on-boarding process was a "nonevent" because the two companies "spoke the same language." Brown-Forman met their long-term inventory targets within a few months of start-up.

On the domestic front, SAP SCM helped Brown-Forman align production, material and storage constraints with projected demand. This alignment resulted in a reduction of over 40 percent of finished goods inventory over a two-year period. Out-of-stocks were cut as were materials obsolescence costs.

Global distribution — for items such as Finlandia Vodka — required a planning process that synchronized global sales with regional production. Information sharing based on SAP SCM supported this process, and now, instead of expensive, carefully coordinated business trips to Finland, Kentucky-based supply chain executives can hold meetings with resources in Finland readily via teleconferences.

A Return on People

A four-person team at Brown-Forman used to collect, aggregate and distribute demand data among the sales and marketing staff and supply planning stakeholders. With SAP APO, reports are produced automatically with the SAP NetWeaver Business Intelligence component and published throughout the organization with the SAP NetWeaver Portal component. Thus freed up, the team now focuses on value-added services, such as increasing forecast accuracy through process improvements.

Brown-Forman continues to expand its product line and global market distribution, while reducing inventories and maintaining excellent customer service. Like its Jack Daniel's whisky, Brown-Forman's investment in SAP SCM improves with age.

AT A GLANCE

Industry: Consumer products – beverage

Revenue: $2.4 billion (2006 gross)

Employees: 3,750

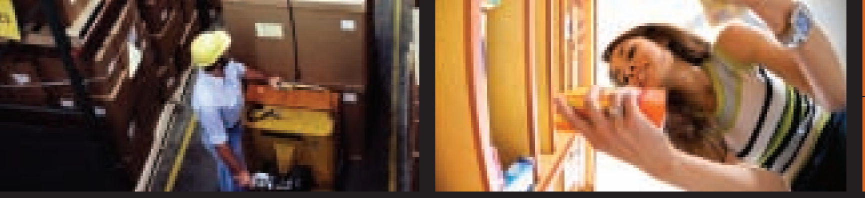
Location: Louisville, Kentucky

Web Site: www.brown-forman.com

SAP Solution & Services: SAP Supply Chain Management application

Implementation Partner: Accenture

> "What SAP Supply Chain Management has enabled us to do is expand our products and distribution network while meeting the Sarbanes-Oxley requirements without taking on additional staff."
>
> - JIM HUTCHINSON, SENIOR VICE PRESIDENT OF SUPPLY CHAIN MANAGEMENT, BROWN-FORMAN CORPORATION



Private Label

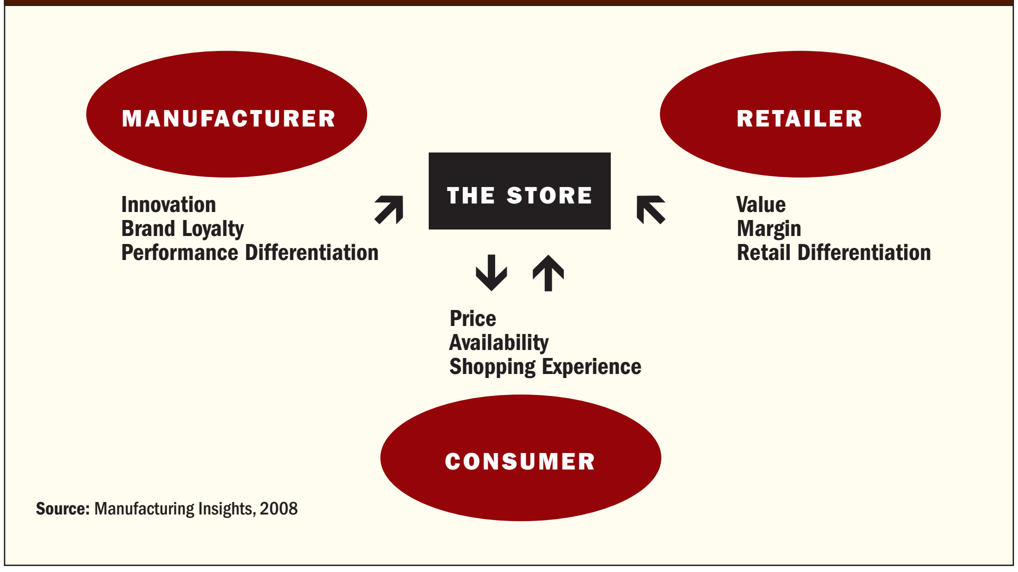
Private label (and increasingly private brand) has been a staple of U.S. retail for decades, yet we are seeing renewed interest as a way to stem retail margin erosion.

Retailers are very motivated to increase their private-label activity. Respondents say that 46 percent of grocery retailers have plans to increase their private-label mix by 3 percent to 8 percent, and 73 percent of respondents said they are increasing their private-label products this year.

This creates significant tension between manufacturers and retailers, precisely when we advocate a more open and collaborative relationship. There must be a balance in CPG where, generally, manufacturers build consumer brand loyalty through innovation and performance differentiation, and retail brands deliver margin, value and differentiation. Finding that balance continues to be a challenge.

CPG executives believe it is critical to have a premium-to-value spread across product categories to build customer satisfaction, making the role of both the manufacturer and retailer brands essential. This should drive more strategic levels of collaboration around brand positioning and value.

FIGURE 1: Private Label: Finding the Right Balance



Source: Manufacturing Insights, 2008

Innovation

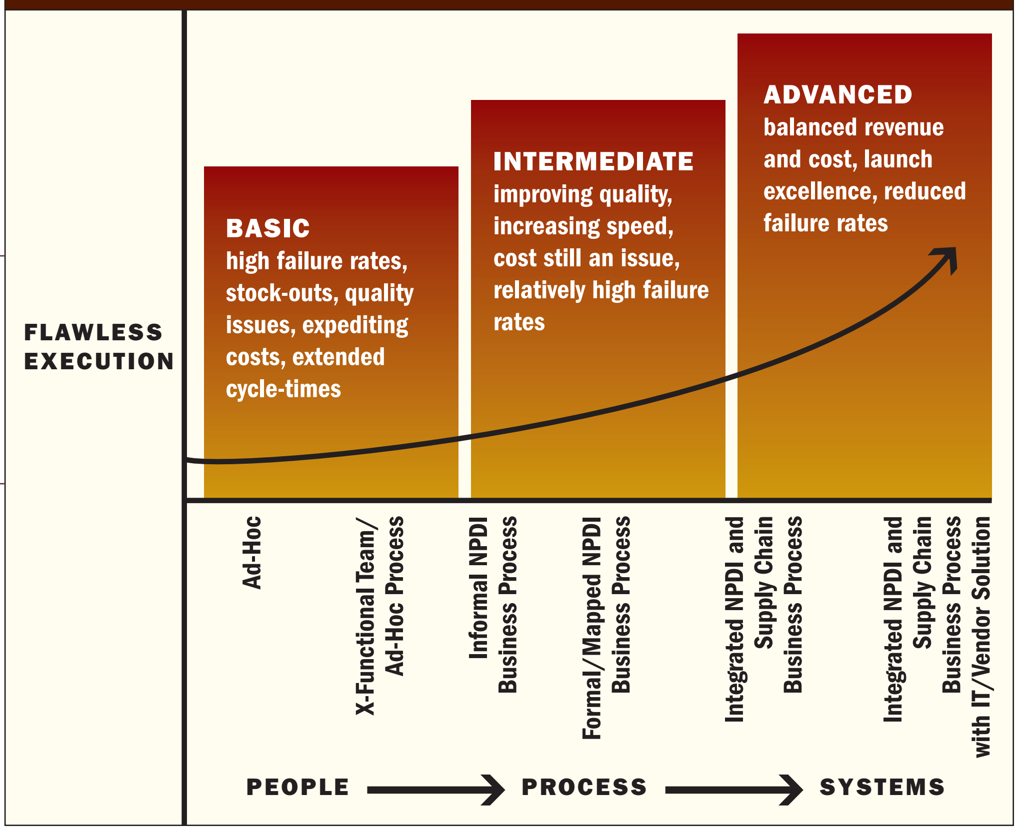
Despite extensive consumer polling and focus groups, more than 80 percent of new CPG products fail, wasting precious time and resources. The reasons for new product failure are varied, usually failure-to-deliver against consumer expectations, but often because of poor brand differentiation and lousy launch execution. Our data shows that retailers are increasingly looking to collaborate to achieve improvements in these areas, with emphasis on the product introduction side given the perceived risks associated with design collaboration.

> "Retailers are increasingly looking to collaborate to achieve improvements... with emphasis on the product introduction side..."

Figure 2 represents significant benefits from intra-manufacturer collaboration in the NPDI process. When there is high process synchronization, businesses reported lower innovation cost, flawless execution and lower failure rates. One challenge is determining who is responsible for directing the NPDI collaboration and how to manage the inherent risk in this type of collaboration.

Although somewhat anecdotal, similar stories result from bringing the retailer into the innovation process. Most retailers express interest in this kind of participation, and we encourage manufacturers to get at least their key retail partners involved.

FIGURE 2: The Benefits of Collaborative Innovation



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