ECR has achieved tremendous supply chain improvements. Now, is it time to take collaboration a crucial step further? Should retailers and manufacturers work together to jointly develop new products?

Rethinking strategies for new value creation

REPORT

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The first International ECR Research Symposium, organised by the ECR Europe Academic Partnership, was held to investigate both opportunities and barriers to retailer-manufacturer collaboration in new product development.

An exclusive group of senior practitioners and academics met on November 1 2001 at University of Cambridge's Judge Institute, to gain an insight into today's industry game of "new product development and introduction", and to explore opportunities by collaboration.

The new product challenge – and opportunity – facing both retailers and manufacturers is well known. Countless research reveals that up to 90 per cent of all launched products fail within one year. Considering all the costs involved in transforming an idea into a product available on the shelf, even a slight reduction in flop rates could help improve profits for retailers and manufacturers.

Yet, at the same time, most companies have already achieved high levels of efficiency in their internal innovation processes. So the biggest unexplored opportunities probably lie elsewhere – in the interface between the two sides.

But how can new product development and introduction processes be redesigned to meet the differing needs of both the retailer and the manufacturer? And how can these processes be improved to deliver a measurable benefit to both sides' bottom lines? These were the questions addressed at the symposium.

Boosting profits with new products

Prof Marcel Corstjens of INSEAD kicked the debate off by pointing out the differing competitive pressures faced by retailers and manufacturers. Over recent years, retailers have steadily gained power in relation to manufacturers (eg, as presented annually by *Progressive Grocer*), but they have not managed to use this increased

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When 90 per cent of new product launches fail, it should be easy to get better. But it isn't. The obstacles to improvement are deeply rooted

power to significantly improve their profitability.

Superior buying power has been turned into lower selling prices for consumers, not higher margins. Retailers' strategy of fierce price competition has forced them to pass on their savings directly to consumers.

Product innovations are ill supported by both retailers…

Consequently, they still rely on other additional revenue streams, some of which do not necessarily boost consumer value, eg, stocking fees, slotting fees, or promotion fees. They have also turned to private label to help boost their profitability. In particular, they have tried hard to differentiate their offers through high-quality, unique private label ranges.

However, even manufacturers supplying "unique" private labels report being kept at arms-length by retailers. So, there are many ways in which the retail environment could be more supportive of product innovation.

…and consumer goods manufacturers

The other side is hardly better. Manufacturers' competitive strategies often get in the way of their own product innovation. In many European countries, combat for shelf space by displacing competitor products is a key strategy applied by many FMCG manufacturers. Also, manufacturers seek to displace their rivals by introducing ever-more intensely advertised "new" with ever-shortening product life cycles.

But these new products are rarely innovative. Rather, they're aimed at getting more shelf space than the competition. Truly innovative product ideas often take time to reach critical mass because consumers are slower to become familiar with them. And in an environment where manufacturer's and retailer's priorities are the instant revenues delivered by new (ie, substitute) products, real innovation tends to suffer.

Both sides, in other words, can be so focused on "horizontal" competition (retailer versus retailer, brand owner versus brand owner) that they create competitive pressures which count against innovation.

Add in the history of exchangeable, arms-length relationships, and the chances of genuine collaboration to boost new product development seems remote. The question is whether, by changing some of their traditional practices, retailers and manufacturers can become more innovative, fulfil consumer wishes better, and thus grow faster together.

Loyalty as anchor point for joint profitability

According to Corstjens' research, there are some areas where such collaboration could be fruitful. They revolve around increased consumer loyalty.

Loyalty is crucial to both retailers and manufacturers. It delivers a double-win. First, loyal customers are more profitable.

Collaboration in NPD requires specified joint goals. One possible target: the 30 per cent of shoppers who typically represent 70 per cent of retail sales

Second, customer retention is cheaper than customer acquisition. Brands are a powerful tool to boost loyalty, so both retailers and manufacturers have been putting major efforts into building their brands.

Brand and store loyalty can support one another...

Based on extensive data analysis, Corstjens showed evidence that a major percentage of consumers actually tended to buy a preferred brand when they shopped in their preferred store. This suggests both retailers and manufacturers might profit from aligning their marketing strategies. This is a prerequisite for collaboration in a strategic field such as new product development and introduction.

...but it requires joint targets

Collaboration in new product development and introduction requires specified joint goals. In retail, on average, 30 per cent of shoppers represent 70 per cent of sales. By targeting these most valuable shoppers, retailers can achieve differentiation and thus higher profitability. However, joint goals require that the collaborating manufacturer targets the same consumers. In other words, both sides need to do joint market segmentation, and to be clear about the commonality of their individual goals.

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Selecting the right level of collaboration

But what about new product development itself. Where are the most fruitful areas for collaboration?

One of the most fruitful areas is knowledge sharing. Retailers know a lot about shopper buying behaviour – with their massive data on shoppers' past purchases – and can easily "test sell" new product ideas – especially to check a new product's attractiveness to shoppers.

Manufacturers are specialists in understanding a product's consumption, the category itself, and efficient, high-quality production. So potential synergies between retailers and manufacturers appear to be almost ideal, and where they are realised, significant benefits are unleashed.

Recently, for example, a major multinational consumer goods manufacturer implemented a new reporting format for new product development projects which required project managers to detail the value generated for consumers, shoppers, retailers, and the company itself.

It did so after realising that while many of its new product concepts significantly increased consumer value and were thus appealing to consumers, they still flopped because of a lack of understanding about shoppers' purchasing behaviour. Shoppers didn't like the way these new products were presented, how they were packaged and displayed, or even where they were located.

However, this example is an exception rather than the rule. Real sharing of shopper and consumer insight is still limited. It's an excellent idea – but only in theory, so far. Prof Luca Pellegrini of

Retailers' quest for exclusivity and manufacturers' quest for universality continually get in the way of collaboration. But joint goals are still possible

Bocconi University analysed some of the reasons why it is difficult to align retailers' and manufacturers' priorities in new product launches.

Today's incompatible targets for new products…

For example, while retailers are interested in cross-category themes, most manufacturers are focused on specific categories. Retailers look to new products to differentiate their product range. Manufacturers want to differentiate their portfolio with new products which add a new dimension to the category, that "de-banalise" the category, or prevent the entry of a new competitor.

…can be overcome

There are some signs of a shift in manufacturers' priorities. Having sold one of its key business units, a major multinational consumer goods manufacturer has redefined itself as food-health-company – a definition which is clearly cross-category. The symposium's delegates speculated that in the near future, manufacturers will focus on specific target consumers by delivering specific values. A similar focus on specific values might also be beneficial to retailers. In this way, retailers' and manufacturers' priorities might merge.

New approaches to sharing benefits

But there are other obstacles – a key one is the fact that retailers and manufactures are both focused on different benefits in NPD. Pellegrini pointed out that retailers want exclusive products to gain an edge on their rivals. Manufacturers on the other hand, are forced to sell the highest possible volumes as quickly as possible – via as many outlets as possible – to generate maximum returns until copies from competitors enter the market at much lower prices.

The contrasting needs for "exclusivity" v "universality" get in the way of collaboration.

A possible joint goal, however, is new product development activities which help both sides build their brands. Figure 1 gives a simple illustration of possible areas of collaboration as presented by Pellegrini.

Traditionally, retail brand-building and the search for exclusivity has led retailers to develop products that are sold exclusively under the retailer's private label. Likewise, manufacturers have developed products which are sold under the manufacturer's brand in most retail channels.

Consumers want products, *and* **service,** *and* **advice**

But it is possible to sell a manufacturer's brand exclusively in one retailer's channel – even though most manufacturers resist this as a waste of investment. And one retailer's private label products can be sold in another retailer's stores.

President's Choice in Canada is the classic example, though recently the UK's Marks & Spencer has started selling some of its products in other retailers' outlets – such as M&S sandwiches in WH Smith. Differentiation by chain is the main obstacle to the spread of this strategy. It is also possible to co-brand manufacturer

Three potential areas of NPD collaboration

1. Manufacturers developing exclusive variants of existing brands for particular retailers
2. One retailer selling its private label goods through another retailer's outlets
3. Retailers and manufacturers co-branding new products

and retailer brands. There have been some successful experiments in France, but only a few. And they might hit some snags in competition law.

Assessing these different pressures, Pellegrini identified three potential areas of collaboration.

1. Manufacturers could develop new variants of existing brands, using minor innovations to provide retailers with exclusivity. This could help reduce price comparison across chains.

2. More private labelled new products could be sold via other retailers.

3. Co-branding of new products could provide sustainable ground for co-operation and innovation. However, the risk of tensions with other retailers might rise if they feel they are being treated less favourably with new product ideas.

These three fields require different activities, aim for different goals, and call for distinct degrees in partnership quality.

Assessing the benefits

So far, only a few cases of new product collaboration between retailers and manufacturers have been made public. We need more openness about the experience we do have, and additional case studies to better understand the mechanisms needed for this very complex process.

A research project conducted by the authors with several hundred suppliers of a major UK retailer illustrates these potential complexities. In general, improved collaboration resulted in higher numbers of new product introductions, lower failure rates and quicker time-to-market. But there were significant differences, depending on industry sector (eg, ambient v perishable goods) and in size of supplier.

Collaboration with ambient goods suppliers resulted in higher numbers of new product introductions – but there was no evidence found for any increase in efficiency (in terms of failure rates or speed to market).

On the other hand, collaboration helped perishable goods suppliers increase efficiency, which in turn helped them invest in the introduction of more new products.

For bigger companies, collaboration focused mainly on process definition – properly defining the sequence of and interface between process steps. This led to an increased number of new introductions. Senior practitioners reasoned that this might be because retailers felt more committed to listing products they had been involved with during development. There was, however, not enough evidence to prove the benefits – or otherwise – of exchanging shopper and consumer knowledge.

Big boys introduced more new products...

Smaller manufacturers realised more

Research suggests that improved collaboration leads to more new product introductions, a lower failure rate, and faster time to market. So why wait?

...while smaller companies also boosted development efficiency

benefits, by both introducing higher numbers of new products and by increased efficiency. Here, sharing of shopper and consumer knowledge was an important part of the joint collaborative business process. This might be because in smaller companies the marketing function, which is responsible for consumer and shopper understanding, and R&D, responsible for conducting the product development, work closer together. Also, smaller companies might be more flexible, allowing them to better adjust to the retailer's processes.

Two building blocks of collaboration are key. Trust is essential if consumer and shopper knowledge is to be shared by the two partners. Neither retailers nor suppliers would provide one another with their unique understanding of customer behaviour if they were not certain this information remained confidential.

Suppliers considered a top-level in the retailer's know-how and competencies (we call this retailer capabilities) to be antecedent to both the sharing of consumer and shopper knowledge and to the implementation of a joint process of new product development and introduction.

The suppliers evaluate the major incentive of collaboration to be the complementarity of capabilities, thus requiring the retailer to bring good capabilities into the partnership.

Summing up

The changing business environment challenges both manufacturers and retailers to identify and implement new practices to achieve sustainable competitive advantage.

New product development and introduction is not only a core activity for a company's long-term success, but also is a major lever in strategic category management. Attractive, distinct and efficient assortments are the mandatory foundation for retailers' and manufacturers' success. Neither retailers nor manufacturers can get there alone, making successful collaboration in new product development and introduction ever more important.

The opportunities are obvious, yet the most suitable forms of collaboration remain to be researched. Some companies have already realised first benefits and established partnerships.

Keep these developments on your radar screen if you don't want to lose contact with those who are revolutionising the consumer goods business.