

Shifting from consumption to experience

Winning in the omnichannel retailing



EY

Building a better
working world

From e-commerce to omnichannel the new retail reality

Year 2014 marks the dawn of the omnichannel retailing age as well as a major turning point for the consumer market. Due to market saturation and other factors, times have changed and sales no longer involve simply producing and distributing products. In today's business environment advances in digital mobile technology are giving rise to dramatic changes, such as changing value chains and the synchronization of world consumer markets, which have the potential to impact the very foundation of a company's existence. As consumers increasingly demand experiential value or a back-to-basics, retail and consumer products companies must redefine their identity and reconsider the type of value they can offer consumers. Against the backdrop of these changes, this report examines key success factors and challenges facing companies.



Masayuki Aida

Japan Consumer Products
Consumer Products Co-Leader
EY Japan



Hitoshi Sasaki

Japan Consumer Products
Consumer Products Co-Leader
EY Japan



Synchronization of world consumer markets

The business-to-consumer electronic commerce market or the “e-commerce market,” is rapidly expanding. Global e-commerce market growth is forecast at an annual rate of 17% up to 2018, far exceeding the annual growth rate of 6% expected for the store-based retail market. The e-commerce market is expected to grow in Japan as well, at an annual rate of 9% as opposed to 0.3% for the store-based retail market. The share of e-commerce in the Japanese retail market is also forecast to increase from the current 3% to 6% by 2018.¹

Notably, the Asian market, which includes the Chinese and Japanese markets, is expected to overtake the North American market as the world's largest e-commerce market by 2016. Expanded e-commerce sales in sectors with traditionally low online sales, including food, beverage and consumer staples, is likely to fuel rapid growth of the e-commerce market. In Japan, the efforts of early entrants to the online supermarket business have ensured quality standards in the food sector and groundwork is being laid to expand the e-commerce market for perishable goods.

Advances in digital mobile technology have led to the synchronization of consumer markets around the world, which is a change of great importance for companies. This synchronization means that corporate competition will spread across countries and industries, which will provide huge business opportunities to some companies, but will pose a critical, life-or-death challenge to companies struggling or unable to cope with the shifting business environment.

For example, data analytics is one area in which significant technological progress has been made. Developments in this field include the launch of companies that provide real-time pricing data on retail stores around the world. The emergence of dynamic real-time pricing enables company headquarters to instantaneously change prices at all of its stores. Social networking services are also becoming powerful tools for word-of-mouth communication in open and closed networks, and networks are rapidly expanding beyond national borders as seen in the popularity of Japanese social networking services

both in Japan and overseas. With progress in display synchronization on multiple devices, such as TVs, PCs, tablets and mobile devices, as well as in the “internet of things,” where various objects including wearable devices are connected to networks, the number of touchpoints between businesses and consumers is on the rise and purchasing processes are becoming shorter. In addition, the shopping experience is being digitized through augmented reality technology that enables simulated product use. The emergence of various payment systems also makes it increasingly unnecessary to physically exchange money at the time of purchase. One leading payment system company has more than 130 million active users around the world and has grown to a level where the total value of transactions made through its system in 2013 exceeded US\$200 billion.² Some expect that the value of payment transactions made using smartphones and other mobile devices will increase from the current global value of approximately US\$230 billion.

Trends in technological progress

Diversification of payment methods

- ▶ Use of virtual currencies

Digitization of the shopping experience

- ▶ Possible simulated product use
- ▶ Augmented reality, 3D printing, etc.

Key technology trends

Data analytics

- ▶ Product development and promotion based on observations of consumer behavior
- ▶ Acquisition of worldwide pricing information

SNS

- ▶ Word-of-mouth in open and closed networks

Internet of things

- ▶ Increase in touchpoints and 24-hour shopping through synchronization of PCs, TVs, tablets and wearable devices
- ▶ Shortening of purchasing processes

¹ Euromonitor

² EY Study



New game rules and changing value chains

Against the backdrop of advances in mobile technology and resulting synchronization taking place around the world, competition in the consumer market is significantly changing. Particularly important changes include: (1) rewritten rules of the game, (2) changes in components that differentiate companies from one another and (3) changes in value chains.

Generally speaking, retailers have traditionally competed to expand regional market share through brick-and-mortar stores. Meanwhile, internet technology companies and social network companies have established "economic zones" that they are expanding. The rules of the game are expected to be rewritten as the competition for consumers' time and disposable income spreads to these economic zones that extend beyond traditional retail channels. A main characteristic of these economic zones is that successful companies are often platform operators, rather than content creators themselves. These companies utilize advanced technology to provide a venue for the smooth exchange of

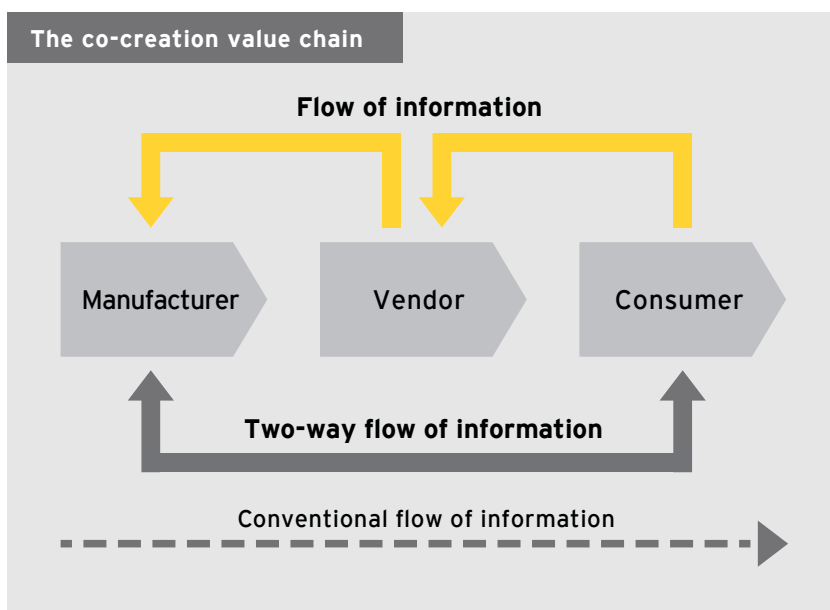
information, goods, services and funds between content creators and consumers.

As technology and competitors change, components that differentiate one company from another also change. Differences in the prices of a product are expected to continue shrinking. As price differences narrow, product distribution has become an important differentiating factor and retailers have begun emphasizing "click and collect" services. For example, according to a customer survey, 55% of customers prefer in-store pick-up to home delivery for grocery items. In response, one US retailer started a pilot program in which food products ordered online could be picked up.³ In addition, there is a growing trend of company e-commerce websites that allows visitors to limit their search to only products that can be picked up at stores and are expanding pick-up points beyond their stores to community locations, such as schools and sports clubs.

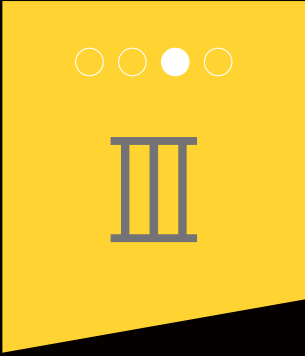
One major e-commerce company is well known for its relentless pursuit of

distribution efficiency. The company is actively taking measures with an eye toward the future, including enormous investment in distribution networks, installation of lockers used for picking up orders through "click and collect," patenting of "anticipatory shipping" system in which the company, based on big data analysis, ships products wanted by customers before they place an order and application to aviation authorities for approval of delivery by drones. In Japan, sales of the company continue to grow at an annual rate of close to 20% and the company now ranks 11th in terms of sales among retailers in Japan. The company's endless pursuit of distribution efficiency has become a threat to Japanese retailers.

Fundamental changes are also taking place in value chains. One of the important reasons for the aforementioned rise of platform operators is that their platforms facilitate two-way information flow. Information conventionally flowed in one direction where retailers would display in their stores the appealing features of products produced by manufacturers and consumers would make purchases. It is expected that the future will see a further spread of value chains based on co-creation in which value is generated through collaboration between companies and consumers, and among consumers. The emergence and improvement of various platforms, such as online shopping malls, content distribution services, social networking services, crowdsourcing systems and open innovation systems, is also expected. As this trend unfolds, middlemen will be sidelined, and retailers, which traditionally played the role of connecting manufacturers and consumers, will thus face the risk of being eliminated unless they adapt to the new age and provide added value.



³ EY Study



Recent consumer, manufacturer and retailer trends



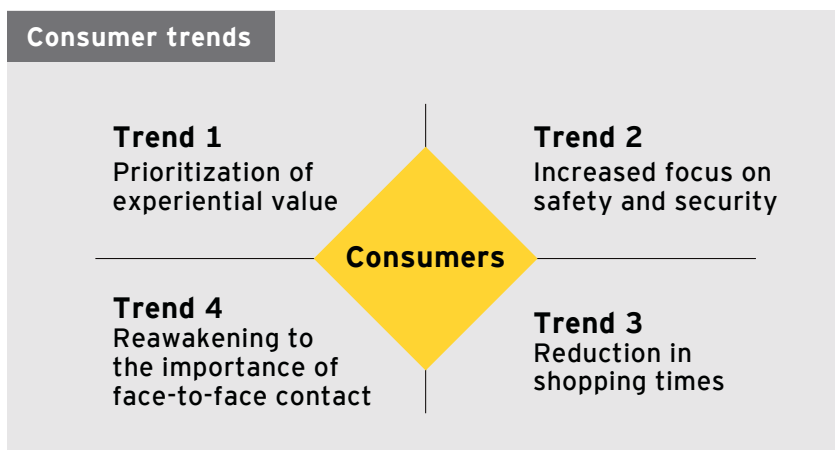
Consumer trends

Consumer values are becoming increasingly diverse as value chains based on collaborative value creation are emerging on a global scale, driven by consumer market synchronization around the world, the rise of platform businesses and bilateral information flow. In particular, the following four trends are important factors in the diversification of consumer values:

- (1) Prioritization of experiential value
- (2) Increased focus on safety and security
- (3) Reduction in shopping times
- (4) Realization to the importance of face-to-face contact

thinking), (4) act (invokes changes in our behavior and lifestyle) and (5) relate (draws upon our innate search for belonging and meaning). Providing experiential value associated with these five components is expected to become increasingly important. One of the characteristics of consumers emphasizing experiential value is that consumers are meticulous about not only the products and services themselves, but also their design and purchase process. As pointed out in EY's report titled *Five new consumer trends*,⁴ an important change in consumer attitudes is the trend toward the desire to be active co-creators instead of simply consumers. Another trend pointed out in the report is that consumers want to transform the design, provision, sales, and purchase of goods and services to their

Conscious consumers desire to go back-to-basics and are greatly interested in natural products, such as enzyme-rich foods and freeze-dried vegetables. As consumers' preference for back-to-basics becomes prevalent, companies urgently need to do the same. With regard to Japanese consumer products, there have recently been a series of problems involving unhygienic food, false food labeling and health scares. These problems are reflected in consumers' increasing demand for stricter accountability from retailers in regard to their environmentally-friendly and health-conscious products. In addition to traditional efforts to promote food hygiene and prevent the display of false food labeling, the Japanese Government has taken various measures, including entering into a treaty on equivalent arrangements for the certification of organic foods between the Ministry of Agriculture, Forestry and Fisheries and the United States Department of Agriculture in September 2013. With the treaty signed, organic food imports appear to be on the rise. A negative image of a company can spread rapidly and widely, partly due to the popularity of social network services. Therefore, companies should properly understand the importance of consumers' back-to-basics preferences and take appropriate measures.



Consumer trend 1

Prioritization of experiential value

It is expected that the range of choices for products and services will further expand and consumers will have a greater tendency to prioritize not only physical value and price, but also a broad variety of other factors. To understand these other factors, it is useful to consider the five strategic experiential modules defined by Bernd H. Schmitt. Experiential value refers to sensory value arising when people feel satisfied or moved through the experience of using a product or service, and its concept goes beyond the traditional sense of physical or monetary value. These five components are (1) sense (engages the five human senses of sight, sound, smell, taste and touch), (2) feel (creates positive emotional experiences), (3) think (appeals to our intellect and creative

preferences. These consumers value their own personal scenarios linked to products and want to be attracted to brand-name products without being constrained by the brands. What is necessary to provide value to such consumers is to encourage them to participate at various stages from design to purchase. Concrete examples include consumer participation in product development activities (user innovation), and sales activities related to used product markets and interpersonal transactions.

Consumer trend 2

Increased focus on safety and security

In recent years, consumers, led by experts, have become increasingly aware of health and environmental issues in recent years, and accordingly are becoming increasingly sophisticated.

Consumer trend 3

Reduction in shopping times

With changes occurring in technology and lifestyle, consumers' attitude toward time has significantly changed. A survey on consumer trends found that 50% of the world's consumers want time-saving products and services.⁵ A survey on food products found that 68% of Chinese consumers desire time-saving products. In short, consumers seek tools and services for optimizing the use of their time or minimizing the time required for a given task. Today's consumers have strong needs for immediate satisfaction. These trends are expected to spread around the world as technology evolves and becomes more readily available, and as emerging countries grow

⁴ *This time it's personal: from consumer to co-creator*, EY, 2012.

⁵ *Consumer and Innovation Trends in Ready Meals*, Datamonitor, 2012.

economically. Companies are faced with the challenge of competing for consumers' time and disposable income, rather than participating in the traditional game of capturing sales and larger market shares. How companies can provide value to consumers in this environment is expected to become increasingly important.

Consumer trend 4

Reawakening to the importance of face-to-face contact

As digital mobile technology advances, consumers are rediscovering the importance of human connections and have begun emphasizing customer service experiences at brick-and-mortar stores and e-commerce websites. In Japan, particularly since the Great East Japan Earthquake, people are rediscovering the importance of human connections. A survey found that in the United Kingdom, the United States, Australia, and Canada, as well, consumers' expectations from stores has shifted from low prices to human connections.⁶

Companies have begun to respond to this trend. For example, one transport company in Japan provides services for seniors as part of its independent-living support business, which involves such things as providing errand services and checking the safety of customers. With respect to e-commerce markets, an e-commerce consumer-to-consumer shopping website in China has a chat function designed in such a way that if stores do not instantaneously answer questions from consumers, stores cannot make sales to consumers. There are now companies that support the improvement of customer service at e-commerce websites. In the US, there is a company that sells software to help stores answer questions and provide explanations to website users on how to use the store's website through its real-time chat platform or by telephone. The software has already been adopted by more than 8,000 companies.⁷

Role of manufactures

Now is the time for manufacturers to

rediscover their roles in response to changes in technology and consumers. The source of value added by companies is expected to shift from manufacturing to the creation of intangibles. And the so-called service-dominant logic, which emphasizes experiential value (generated from, for example, non-product services, purchasing processes and user experience), is expected to become the mainstream in marketing. Manufacturers need to prepare for a new environment in which they must take charge of contact with customers, which has been entrusted to wholesalers and retailers in the past.

There are companies that have anticipated changes in the business climate and have already begun adjusting to the new era. For example, a US consumer products company set up mobile stores in train stations and bus stops, in cooperation with e-commerce operators, which allow consumers to shop online with their mobile devices. The stores have been successful in the Czech Republic and Canada. In Japan, there are examples of consumer products companies, in collaboration with a major e-commerce company, developing products that are only sold through e-commerce. In addition, a number of companies have incorporated user innovation, which takes advantage of ideas from consumers regarding product development or improvement.

Role of retailers

Consumers are increasingly gaining power, and, at the same time, manufacturers are increasing their contact with consumers. Under these circumstances, retailers have come to a critical turning point. The role of retailers is expected to change as the e-commerce market expands, and how companies manage this change is the most important issue affecting their survival. Today, having an omnichannel retailing strategy is a must — the time to discuss its necessity is over.

Retailing trend 1

Stores are places for experiences and for covering the "last mile"

The movement to redefine retail stores

as places for experiences instead of places for shopping is spreading around the world. At the National Retail Association meeting held at the beginning of 2014, one real estate company CEO stated that retailers should remind themselves of the desire to build and maintain relationships with others — an intrinsic part of human nature. Offering a place for experiences is not a new role, but reflects a back-to-basics approach for retailers.

Back-to-basics is becoming popular in Japan as well. For example, convenience stores have increased their usefulness as places for shopping by stocking items such as prepared food and consumer staples and have therefore succeeded in expanding their customer base from their existing main customers (men in their 30s) to include more women, such as homemakers. Meanwhile, convenience stores are being increasingly used by seniors as places for human interaction. An increasing number of companies use IT to improve their quality as places for experiences. For example, a leading US retailer has installed a system to enable customers to try on make-up without opening the packages. Another retailer has introduced micro - location marketing based on a near - field communication system, which improves the customer experience at its stores by sending coupons or product recommendations at a suitable time for appropriate products.

In other cases, retailers successfully operate websites. In 2012, a major UK retailer invested £100 million (approximately ¥12.6 billion) to build an online platform. The company's CIO notes the company's policy to emphasize its website, saying that economies of scale cannot be obtained through outsourcing. The company utilizes both online and retail sales channels, and more than 54% of online orders are either placed or picked up at stores.⁸

As the e-commerce market develops, the value of being able to receive orders anywhere at any time is gaining importance. One high-end supermarket chain in the United Kingdom, stepped up its e-commerce online development with the introduction of services, including the installation of lockers in its store's parking lots capable of storing products

⁶ *A New Era of Pause and Purchase*, American Express, 2010

⁷ *EY Study*

⁸ *EY Study*

that should be kept frozen or refrigerated. As a result, its online sales for 2012 increased by 49% from the previous year. Considering that the industry's growth rate was 19%, the company's efforts can be said to have produced a substantial effect.⁹

The above trends indicate a shift in the role of retail stores from places for shopping to places for covering the "last mile," and we are heading into an era in which retailers that cannot exhibit originality through their product lines will be unable to survive. It is expected that traditional stores whose strength has been attributed to their vast shopping space will face a battle for survival, and regional store chains that lag behind others in e-commerce and do not have distinctive products or services will have to close more stores.

In contrast, retailers capable of showing their originality have more and more opportunities. For example, regional retail stores with a limited selection of products could sell products with distinctive local characteristics as a primary sales strategy while reducing inventories, or saving on logistics investment associated with national-brand products or low-turnover products, by cooperating with e-commerce operators with a nationwide distribution network. Also, by setting up a store on a social commerce website, Japanese department stores are trying to attract overseas customers, taking advantage of their distinctive local features.

analysis from outside sources and to achieve innovation in order to rebuild relationships with customers. For example, a leading US retailer is working to procure highly-skilled engineers by purchasing startup companies in order to promote its strategy for social mobile e-commerce. Another retailer combines data from its online store and data from a social networking website, to enable searches for products that are frequently reviewed. In addition, a Specify started crowdsourcing for new product development in cooperation with a US online social networking company.

What all these efforts have in common is an attempt to improve analytical techniques for gaining customer insight and therefore rebuild relationships with customers in order to increase customer engagement. These companies have actively strengthened their cooperation with startup companies to take advantage of rapidly advancing technology.

As the e-commerce market expands, how should retailers compete with companies specialized solely in e-commerce and coexist with them? What is most important is providing differentiated value. The key components of differentiated value will be not only the aforementioned experiential value provided in stores, but also the value of guaranteeing product quality and reliability. As Japanese companies have leading technology in biometric authentication, Japanese retailers have the potential to

become pioneers in this field.

Advantages that can be gained by both retailers and e-commerce businesses through collaboration include entering into contracts for product distribution. As mentioned earlier, Specify invests an enormous amount in its distribution networks. If retailers consign e-commerce businesses with such extensive infrastructure to distribute products, retailers can concentrate their efforts on differentiating the products and value that they provide. Cooperation in product development is also an important factor. By collaborating with manufacturers as well as e-commerce businesses, retailers can promote product development and user innovation based on the analysis of data on customers' shopping experiences. This enables retailers to improve their ability to provide value to customers and is thus an important factor in differentiating their products.

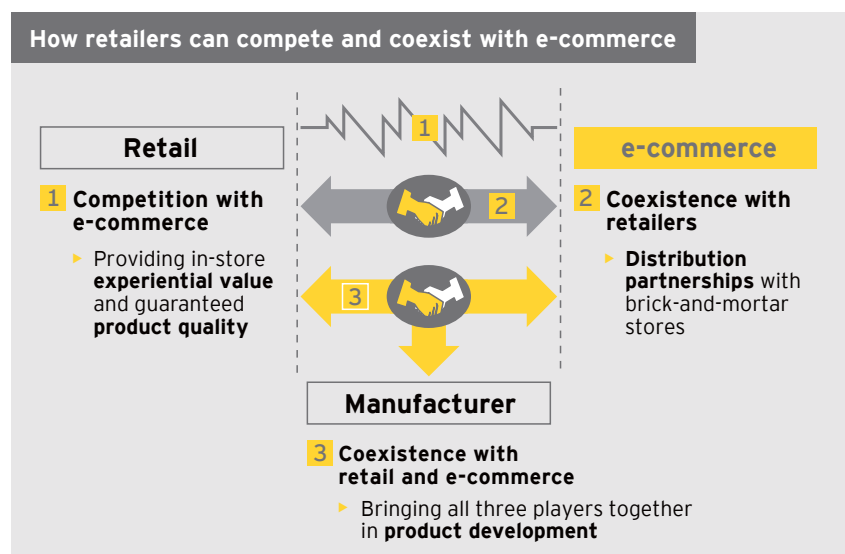
Retailing has become an information-based industry. One negative side effect of this trend is risk associated with information security. In the United States, seven retailers suffered cyber-attacks carried out using malware during the Christmas shopping season in 2013, and one of the company's sales revenue for the fourth quarter of 2013 was affected by the security breach and fell by 5.3% (approximately ¥117 billion) from the previous year. Strengthening information security systems has now become one of the highest priority issues for retailers and consumer products companies around the world.

Retailing trend 2

Transformation from vendors to "information providers"

The ability to analyze and disseminate information has already been an important factor for retailers, and its importance is expected to continue to grow. As retailers become experience providers, they are expected to increasingly emphasize the use of digital mobile technology for providing information on products and services in order to deliver value to customers.

European and American retailers have already begun efforts to absorb technology for consumer behavior



⁹ EY Study



IV

Challenges for Japanese consumer products companies and retailers

How should consumer products manufacturers and retailers adapt at this turning point in the consumer market? In light of the changes in the consumer market discussed above, we consider the following three factors to be the key sources of future competitive advantage: (1) providing safe and secure products and services, (2) giving customers experiential value and (3) integrating IT and marketing.

Providing safe and secure products and services can be achieved through measures such as collecting substantial amounts of product reviews and evaluations, strengthening brand appeal of the company or product, and securing consumers' trust in the company and its products through collaboration with major chain-store operators or utilization of e-commerce. In addition,

to ensure safe and secure consumer use of e-commerce, mechanisms e-commerce such as escrow services for person-to-person transactions or personal authentication systems (e.g., fingerprinting and other biometric authentication systems) need to be strengthened.

The key to giving experiential value to customers is how companies can conduct branding, marketing and product development activities that appeal to consumers' desire for experiential value, a sense of belonging and participation. Another important issue to consider is the provision of value arising from personal interaction at brick-and-mortar stores or through social networking services.

With regard to the integration of IT and

marketing, companies need to acquire predictive data analysis capabilities in order to rebuild relationships with customers (or increase customer engagement based on observations of consumer behavior). Another important managerial challenge is to achieve optimal allocation of IT investment (e.g., investment allocation between traditional and e-commerce retailing channels) based on partnerships between CIOs and CMOs. Furthermore, in terms of supply chain management, it is necessary to construct networks that connect manufacturers' warehouses, distribution centers, stores and customers, and build cross-channel, low-cost and shorter supply chains by encouraging partners in different sectors to share inventory information and create mechanisms that cover the "last mile."

Critical success factors for consumer products companies and retailers



Taking these factors into account, we believe that the following six measures are important and should be taken — particularly by Japanese companies. First of all, from an organizational or operational standpoint, it is important to adapt to the new omnichannel age by (1) appointing a CMO who is enthusiastic about the digital mobile world as well as (2) establishing cross-sectoral organizations that go beyond traditional and e-commerce channels, optimizing supply chains and implementing performance evaluation systems. It is also important to develop and secure human resources so that companies can differentiate themselves from competitors by (3) training employees to improve customer service and (4) developing or appointing data analysts. Lastly, as a foundation to support these measures, it is necessary to prioritize efforts to ensure information security by (5) establishing industry standards for protecting personal information and (6) responding to cyber-security risks. It should be noted that many of these measures center on technology. To adapt quickly to advances in mobile technology and win over consumers whose behavior and attitudes are rapidly changing, it is essential for manufacturers and retailers to incorporate evolving technology and provide new types of value.

Key challenges for Japanese companies in the omnichannel retailing

Organization and business

1. Appoint a CMO enthusiastic about digital mobile world
2. Establish cross-sectoral organizations that go beyond traditional and ecommerce channels, optimize supply chains and implement performance evaluation systems

People

3. Train employees to improve customer service
4. Develop or appoint data analysts

Information security

5. Ensure personal information protection meets industry standard level
6. Respond to cyber-security risks

Meeting our people

Japan Consumer Products Center Leaders



Hitoshi Sasaki (certified public accountant)

Ernst & Young ShinNihon LLC
Consumer Products Co-Leader
sasaki-htsh@shinnihon.or.jp

Hitoshi provides advisory services, mainly in accounting, auditing and IFRS compliance, to global companies in the consumer products industry. He also serves as liaison with the EY Global Consumer Products Center.



Masayuki Aida (certified public accountant)

Ernst & Young ShinNihon LLC
Consumer Products Co-Leader,
aida-msyk@shinnihon.or.jp

Masayuki has over 20 years of auditing experience. He provides auditing services, accounting services, advisory services, support for building internal control systems and support for introducing IFRS mainly to major general food manufacturers.



Takeshi Hitomi

Ernst & Young ShinNihon LLC
Consumer Products Strategy Leader
hitomi-tksh@shinnihon.or.jp

Takeshi has been engaged in projects related to M&As, post-merger integration (PMI), business strategy, overseas business management, corporate finance and business improvement for about 15 years, mainly in the retail and consumer products sectors.



Mariko Asao

Ernst & Young ShinNihon LLC
Consumer Products Analyst
asao-mrk@shinnihon.or.jp

Mariko analyzes business trends and company strategies in the consumer products sector in cooperation with the global analyst team.



Hiroyuki Nishida (certified tax accountant)

Ernst & Young Tax Co.
Consumer Product Tax Services leader
hiroyuki.nishida@jp.ey.com

Hiroyuki provides services to companies and investment funds regarding tax structuring in cross-border M&As as well as tax due diligence of target companies for investment.



Tsukasa Yoshimoto

EY Advisory Services (EYA)
Consumer Products Advisory Services Leader
Tsukasa.Yoshimoto@jp.ey.com

Tsukasa provides support for proposing domestic and overseas marketing strategies, and reforming SCM, retailing channels, sales operations and contact centers. He also supports the introduction of relevant systems.



Tatsuya Hiramoto

Ernst & Young Transaction Advisory Services Co., Ltd. (EYTAS)
Consumer Products Transaction Advisory Services Leader
tatsuya.hiramoto@jp.ey.com

Tatsuya provides financial advisory services related to proposing and implementing strategies for domestic and overseas M&As.

Please visit the following website for the most up-to-date information on consumer products and retail business:

ejyapan.jp/industries/consumer-products/

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

How EY's Global Consumer Products Center can help your business

Consumer products companies are operating in a brand new order, a challenging environment of spiraling complexity and unprecedented change. Demand is shifting to rapid-growth markets, costs are rising, consumer behavior and expectations are evolving, and stakeholders are becoming more demanding. To succeed, companies now need to be leaner and more agile, with a relentless focus on execution. Our Global Consumer Products Center enables our worldwide network of more than 16,000 sector-focused assurance, tax, transaction and advisory professionals to share powerful insights and deep sector knowledge with businesses like yours. This intelligence, combined with our technical experience, can assist you in making more informed strategic choices and help you execute better and faster.

© 2014 EYGM Limited.
All Rights Reserved.

EYG no. EN0592
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.