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A New Deal for Durables

The market for consumer durables—products intended to last more than a few years—is waking up. Except for the lively electronics sector, durables have been a relatively quiet, manufacturer-driven business in which innovation has proceeded at a leisurely pace and global competition has been minimal. Not anymore.

Increasingly, the whole sector—which also includes furniture, appliances, and some apparel—is beginning to mimic electronics: innovation cycles are accelerating, brands are under attack from private labels and imports, and sourcing from low-cost countries seems imperative.

With big-ticket items moving as quickly as packaged goods, and household appliances becoming status symbols, durables manufacturers and retailers have an opportunity to achieve unprecedented growth. That’s great news for the few companies that are fast and flexible. But it’s not so great for most durables companies, which are still operating the way they did 5—or even 20—years ago. They risk going the way of Westinghouse, in the United States, and Grundig, once a leading consumer-electronics company in Germany. To succeed in this new environment, durables companies must first recognize which of the many forces for change are likely to have the greatest impact on their own businesses.

We have identified a shortlist of the most significant challenges confronting the durables world: the growing power of retailers, the faster pace of innovation, the globalization of markets and proliferation of competitors, consumers’ preferences for trading up and trading down, the private-label threat, new technologies, and low-cost sourcing. If you are not already facing some or all of these challenges, you will be soon.

Retailers Are Gaining Power

In many durables categories, two or three retailers now control 50 to 70 percent of the U.S. market. (See Exhibit 1.) Some European markets—the United Kingdom, in particular, as well as France and Germany—are heading in the same direction. That may seem a boon to consumers looking for better prices, but profit margins will shrink as these retailers exert increasing pressure on durables manufacturers. Ultimately, consumers will suffer when profits aren’t strong enough to support innovation and variety.
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A few durables companies, however, are breaking with old patterns and embarking on “discoveries” with their largest customers. This effort to find ways in which manufacturers and retailers can both gain share by better understanding consumer needs is a far cry from traditional marketing dressed up in help-your-customer clothes. More than simply asking retailers what they want, manufacturers need to learn the strategic and economic factors driving retailers’ businesses and consumers’ lives, and to use that knowledge to provide products and services that benefit everyone.

Armed with fact-based analysis and rich insight into consumer behavior, the leading durables manufacturers are transforming purchasing-department contracts into broader, deeper relationships and helping suppliers and customers to create new value. Discovery is especially powerful in durables because of the sector’s low degree of vertical integration. Most retailers rely on manufacturers, wholesalers, and distributors for their products. Manufacturers need retailers for access to end users. Such value-chain interdependence increases opportunities for discovery partnerships, which in turn can lead to new sources of profits. Although retailer consolidation has left fewer retailers for manufacturers to work with, the fact that each one matters more makes discovery worth the effort.

Consider how one home-organization company cooperated with a national big-box customer. The retailer had set itself the goal of becoming more user-friendly for its shoppers, so the supplier worked with the retailer to develop a home organization department that would be easier to shop in and would showcase innovative products. As a result, the supplier’s balance of sales with that retailer increased from approximately 50 percent to more than 90 percent of the home organization category, and the retailer gained significant share. A victory for both parties. It is no longer sufficient to win “share of shelf.” Manufacturers should partner with retailers in merchandising their products, especially when retailers have considerable influence over consumer choice.

The Pace of Innovation Is Speeding Up

In the past, product development cycles for most durables companies took three to five years. But consumers and retailers are demanding more frequent updates, for at least three reasons:

- The electronics industry has taught consumers to expect something new every year—sometimes even more often.

- Household appliances are becoming aspirational purchases. Consumers are flocking to specialty stores, seeking new colors, styles, and technologies long before the models they own have stopped working. Dyson’s bagless vacuum cleaner, for example, has become a status symbol in many European households—a direct result of its innovative, fashionable design.

- A few companies that have products in both fast-paced and slow-paced innovation cycles are transferring capabilities from the former to the latter, thereby putting increasing pressure on slow innovators. LG and Samsung, for instance, have taken design principles from products in their electronics businesses and applied them to refrigerators and vacuum cleaners. Both companies seem able to innovate rapidly, with a high degree of global standardization. And there is a certain logic to it: mobile phones look alike around the world, so why shouldn’t refrigerators? And since LG is one of the largest manufacturers
of LCD TVs, why not put an LCD TV in the door of a refrigerator? But there is a fine line separating relevant consumer innovation from “gadgetry.” Not all durables manufacturers have figured out where to draw that line.

Although some smaller companies are having difficulty keeping up with the rapid pace of innovation, others are rising to the challenge. They are introducing improvements without the major engineering changes that are normally added when a product is redesigned every five years. Doing so requires rethinking how the innovation cycle works in the organization, however. Adding more engineers is not the answer. As the pace of innovation accelerates and product cycles shrink, it can become harder to generate a return on new products. The trick is to ensure that important innovations make it to market faster and at lower cost than in the past.

Markets Have Become Global, and Competitors Are Proliferating

North America is facing an unprecedented array of new global competitors. Japanese, European, and, most recently, Korean and Chinese companies are all looking to gain market share. The United States is often one of their top priorities. The new competitors bring unique engineering and design skills, and the Asians in particular are equipped with advanced and low-cost manufacturing technologies. Many U.S.-based durables companies fail to appreciate the size—and ambition—of some of these companies. While seemingly small players on the U.S. import stage, they can also be leaders in their home markets and very significant on a global scale.

Indeed, companies like LG, Samsung, and Haier can be much larger—with many more product lines—than their North American rivals. Rather than take on the whole U.S. market, these companies often cherry pick positions in which they can make a good profit by focusing on a small selection of SKUs and channels. Some start by selling components to their U.S. rivals, then slowly move up the value chain. That helps them capture share at the high or low end of the market, thereby avoiding direct conflict in the mainstream until they are established.

What should incumbents do about these attacks? Fight the incursion. Never, never cede share to a rival in one of your core categories. There will be losers, but you don’t have to be one of them.

Consumers Are Trading Up and Trading Down

As more and more consumers trade up to affordable luxuries and trade down to products that offer low-cost functional benefits, many durables manufacturers and retailers find themselves caught in the middle—a segment that is shrinking as consumers seek the high and low ends of the market. (See Exhibit 2.) Consumers are abandoning products that provide neither a price advantage nor a functional or an emotional benefit. Companies that offer such products are in grave danger of “death in the middle.” They will be unable to match the price of value products or the emotional engagement of New Luxury goods, and as a result they will lose sales, profitability, market share, and consumer interest. To survive, they must revitalize and reposition their products or exit the market.
Private Label Is Growing as Brands Decline

Retailers have always recognized the power of destination brands, but many are finding that private labels can increasingly provide the quality once associated with manufacturers’ brands—and at a better price. (See Exhibit 3.) Furthermore, they’ve discovered that consumers shopping for durables often look for a retailer’s brand before searching out a manufacturer’s brand. In the home organization category, for instance, consumers tend to shop at just one store, and more than half are unaware of the brand of shelving system that they purchase. (See Exhibit 4.) It’s not surprising, then, that durables retailers are racing to develop their own brands. Although Sears’s Kenmore, Craftsman, and DieHard brands continue to...
lead the industry, other retailers are catching up fast, such as The Home Depot with its Ryobi and Ridgid brands and Wal-Mart with its GE Small Appliances.

Best-in-class durables retailers—such as Staples, Office Depot, Lowe’s, The Home Depot, and Best Buy—have recently announced improvements in gross margin from private-label sales. To compete with these private-label products, manufacturers must offer better innovation, design, and value. That entails assessing the threat customer by customer, investing in innovation, and developing skills in pricing and economic optimization. The trick is to know when to defend, when to attack, and how to change the dynamics to create an advantage. It means delivering new technical and emotional benefits for the consumer at a pace that leaves the competition behind.

Durables manufacturers could learn some valuable lessons about private-label economics from their packaged-goods counterparts. Consider how a packaged-goods private label develops: first in the most obvious categories, in which manufacturers may be underinvesting, then in the not-so-obvious ones, and finally from inside the category with products that offer both value and premium benefits. If you’re a branded manufacturer, your survival depends on knowing which categories are most likely to go private label and how to defend them.

Consider the Dell Computer model of distribution in consumer electronics, in which consumers order directly from the manufacturer. The trend hasn’t hit the rest of consumer durables yet, but there’s no reason why it won’t. It is efficient, and acceptance has been rapid. If consumers are willing to buy their plasma televisions over the Internet, why not their washing machines and other durables?

Given the inherent trade-partner conflicts, however, we expect this market to evolve with a new brand or to be controlled by an existing retailer, such as Sears.

**New Technologies Are Everywhere**

Whether you are building electronics into new products or using new materials and manufacturing methods, technology is changing the way consumers use durables. Composite materials in golf clubs and tennis rackets have changed the nature of those games, and stainless steel has contributed to a huge increase in kitchen appliance sales. Digital electronics offers much better performance at lower costs, with more flexibility for both the manufacturer and the consumer. Home-appliance sales departments abound with new colors, finishes, electronic controls, and embedded LCD TVs. With increasingly fickle consumers, it is critical to invest in technology that fulfills their real needs and stays clear of unnecessary gadgetry. Leaders in this space will establish a more innovative (and fashionable) image, resulting in higher price realization and greater market share.

**Low-Cost Sourcing Seems Imperative**

Thanks to global telecommunications and free trade, low-cost sourcing is revolutionizing the industry. To appreciate the power of this phenomenon, consider the fact that it took ten years for VCR prices to drop 50 percent. In contrast, with low-cost assembly in China and digital designs, it took only two to three years for the price of DVD players to fall from $300 to $29. Some durables companies have been caught unprepared for this trend. The major U.S. players in floor care, Hoover and Eureka, are rapidly losing market share (and profits) to
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Asian entrants that have figured out the basic technologies and can make the products less expensively.

Many companies today are also outsourcing engineering, design, accounting support, and customer service. Managed wisely, this can be a powerful weapon, as long as the goal isn’t only to reduce costs. Instead of cutting engineering costs in half by outsourcing to India, for example, a company could outsource only one-quarter of its work there and increase the number of engineers on staff to improve overall engineering capacity. But not all products—and not all portions of a product’s supply chain—should be outsourced. Lasting competitive advantage requires a nuanced approach. You must consider internal costs and organizational processes in the tradeoffs you make when deciding what to outsource, where to send it, and how to operate. Even when outsourcing is the right answer, most companies face a steep learning curve.

Because outsourcing in low-cost countries (LCCs) is often fraught with uncertainty, getting operations right can be particularly challenging. Lead-time, delivery performance, and product quality can vary widely. One U.S. company outsourcing in China, for example, received quotes for some parts that differed by as much as 80 percent—compared with variations of 2 to 5 percent for similar parts in the United States. Companies need to institute stringent procurement practices, such as early audits of supplier operations and costs. In Europe, many companies have come to realize that some Eastern European countries offer attractive alternatives to low-cost sourcing in Asia. When you take into consideration total sourcing costs, including overhead and transportation, those Eastern European countries can compare very well with Asia, despite higher labor costs.

Fortunately, most companies can prepare themselves for these challenges by taking a number of steps:

• Setting aggressive targets and giving the internal organization a chance to meet them
• Leading from the top to avoid cross-departmental conflicts
• Putting one person in charge of LCC operations companywide
• Defining appropriate structural linkages and incentives
• Ensuring that global efforts are not underresourced
• Communicating early and often

Capturing the Opportunity

This is an exciting time for durables companies. The opportunity to grow and gain share over weaker rivals—global or domestic—has never been greater. The path to competitive advantage will depend on how quickly a company can move in four key areas of its business:

• Understanding the consumer. How well do you understand what consumers want and are willing to pay for? Knowing this will enable you to deliver the right products to market at the right time and preempt your competitors.
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- **Becoming “partners” with the trade.** To avoid being treated as just another supplier, you need to develop a win-win relationship with your largest and fastest-growing trade partners. Understanding each other through “discoveries” will produce new sources of growth for both of you and give you an advantage over your competition.

- **Leveraging product innovation.** No matter how loyal consumers of your products are, they will go elsewhere for a better product. Innovation in durables can be expensive and time consuming, but it doesn’t have to be. Flexible product architectures can permit rapid but relatively low-cost innovation that will keep consumers interested and loyal. Never cede the innovation edge to new entrants.

- **Maintaining an efficient operating model.** It might seem logical to move all of your manufacturing operations to LCCs. But does that always make sense? Have you lengthened your supply chain to such an extent that you are unable to respond quickly to customer demand? Will political uncertainty, fuel costs, or transportation issues make you less efficient overall? Moving or outsourcing your engineering or customer service to an LCC could be a step backward if not done correctly. It is critical to look at the total system cost of any one of these moves to determine the most competitive operating model.

You can do well in the tougher, more competitive world of durables. But it will require a structured plan and ruthless execution. The important thing is to get started before it is too late.

**John Bogert**

**Joe Manget**

**Stefan Rasch**

**John Bogert and Joe Manget are vice presidents and directors in the Toronto office of The Boston Consulting Group. Stefan Rasch is a vice president and director in the firm’s Munich office.**

You may contact the authors by e-mail at:

bogert.john@bcg.com

manget.joe@bcg.com

rasch.stefan@bcg.com

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