The new barbarians are attacking the core of the market: what should be done ?

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The success of the major global leaders in large scale distribution businesses, in FMCG, property, specialty chemicals and others, has often been founded on the development and roll out of competitive business models which allowed them to cover the core of the market effectively.

These models depended on an innovative high-end range borne out of high R&D investments, which strengthened the brand and helped them stay strong in the face of retailers, combined with a high volume mid-range, which drove strong margins. In turn, the mid-range financed the innovation and the marketing for the high-end.

This model has been brought into question in mature countries by the polarisation of buying behaviours and by the consequential emergence of new competitors, the “new barbarians”, which focus their attack on the most significant pockets of value.

Their capacity to grow and capture market value is multiplied by an attack on two levels: they challenge not only upstream players with a subsidiary (typically a brand), but they also short circuit the traditional downstream channels (typically the major retailers) with a direct selling or e-retail strategy.

The make-up brand Kiko is symbolic of this trend. This is a brand integrated into retail, which has established close links with several preferred suppliers, and focuses on a category (make-up) and a customer group (15-25 year olds), in order to offer products that are up to 60% less expensive than traditional brands. It has shaken the whole sector because it poses a strong challenge to “Entry level” ranges offered by the major make-up houses, as well as the “economics” of high quality cosmetics and beauty players.

Consequently, how might one spot the next areas to be attacked? And what is to be done to fight off the invasion of the new barbarians and continue to create value?

Where are the new barbarians attacking?

The new barbarians are focused on client segments, price positions or channels which have historically been poorly covered by traditional leaders. In mature countries they take advantage of the segmented and differentiated needs of the industry’s customer base, and from the technological maturity of methods to reach them (on the Internet or with direct selling), which lower the barriers to entry, allowing them to gain critical size with less investment, and to become highly profitable, more quickly (see Table 1).

When they invest significantly, and in a focussed manner in a coherent segment of the market which is large enough, they not only win in this segment, but they destabilise the traditional leaders completely, by taking their customers and the volumes that their business models depended on to remain competitive.

The logic of where they attack is according to four macro-economic trends:

Polarisation of customer buying behaviours

In mature markets, the mid-range is getting smaller, to the gain of the low cost and the luxury/premium ranges, through changes that are increasingly pronounced. Today, customers

- Table 1 -

The core market brands are attacked by the barbarians, who are more focused on segments of customers, and with more competitive business models

(example in the cosmetics industry)

Proximity and convenience (DollarShaveClub)

- *Focus on shaving products*
- *Attractive headline price*
- *Strong marketing over the internet*
- *Online distribution with primarily a subscriber model*

Low cost (Kiko)

- *Focus on make-up and notably nail varnish for young people (15-25 years old)*
- *Large range at low prices*
- *Small shops of 100m²* in highly frequented areas

Environment friendly (Stowaway)

- *Focus on daily cosmetics*
- *Small-sized products to reduce wastage*
- *Attractive headline price*
- *Online distribution*

Core market cosmetics
L'Oréal
P&G
Clairol
…

'Community' approach (Lush)

- *Focus on fresh and handmade products*
- *Development of the "Lushers" community spreading the manifesto "We believe"*
- *Bricks and mortar retail creates direct contact with the customer*

Service et advisory (eSalon)

- *Focus on hair colouring with personalised products according to the customer's hair type*
- *Price positioning between mass market and entry level hair salon*
- *Remote advice on the colourant and how to apply it*
- *E-Retail*

Natural (Bite Beauty) (The honest company)

- *Initial focus on cosmetics for infants and children*
- *Extension of the range to soap, shampoo, sun cream etc*
- *Customer engagement through the natural aspect of the container and the contents*

can buy low cost products in one category and invest in luxury/premium products in another category, and all this, whatever their level of wealth.

Positioning on the low cost market can create a cost advantage versus traditional players, whilst giving a qualitative value to the offer. The clothing retailer Primark has been able to develop in Europe through adapting its low cost and low price strategy, all the while following fashion trends and providing a pleasant buying environment.

In the same way, new luxury or premium concepts based on quality, brand, store location and innovation have seen strong and profitable growth. Apple (technology for the general public), Bose (audio systems), Hermès (personal and household goods), Jura (espresso machines) are examples of businesses that are growing strongly, who have often invested in retail or services for the consumer, in order to increase their value.

Communalism or specific customers coming together

A focussed approach on specific customer segments can allow for growth at a higher rate, provided the segment is large enough.

Lululemon has developed around Yoga and offers clothing and accessories that are part of this philosophy. This communalism is strengthened by communication tools and digital discussions.

Lush, in another market altogether, has developed fresh cosmetics, which are handmade from a base of organic fruits and vegetables. A community of "Lushers" has developed spreads the foundations of the brand which is captured in the manifesto: "we believe."

Proximity, speed and convenience

The Internet offers new possibilities and proposes new offerings, which enable customers to come across new experiences.

The American company eSalon offers personalised experience in hair salons, at an affordable price point and in a way, which is practical for the customer. The customer has access to a team of colourers via the Internet, who create a personalised hair colour. This team also provides remote support whilst the product is applied. At $25, the price point is between mass market Estee Lauder colouring products ($10) and entry level hair salons ($50). Almost the entirety of the customer base is full subscribers of a service which provides a product every 6 weeks (see Table 2).

In the same way, Dollar Shave Club (Boogies) offers an Internet-based subscription service for shaving products and has captured 15% of the disposable razor –head market in the United States. The concept "Shave time, shave money" is based on price competitiveness and ease of purchase.

Lastly, Stowaway is an Internet-based business for cosmetic products in small-sized containers, which gives the customer a more practical means to consumer it, as well as help reduce wasted product. This approach enables a reduction in the perceived cost and price, whilst allowing the customer to buy themselves a high quality product with the justification of a positive environmental impact.

Health and wellbeing

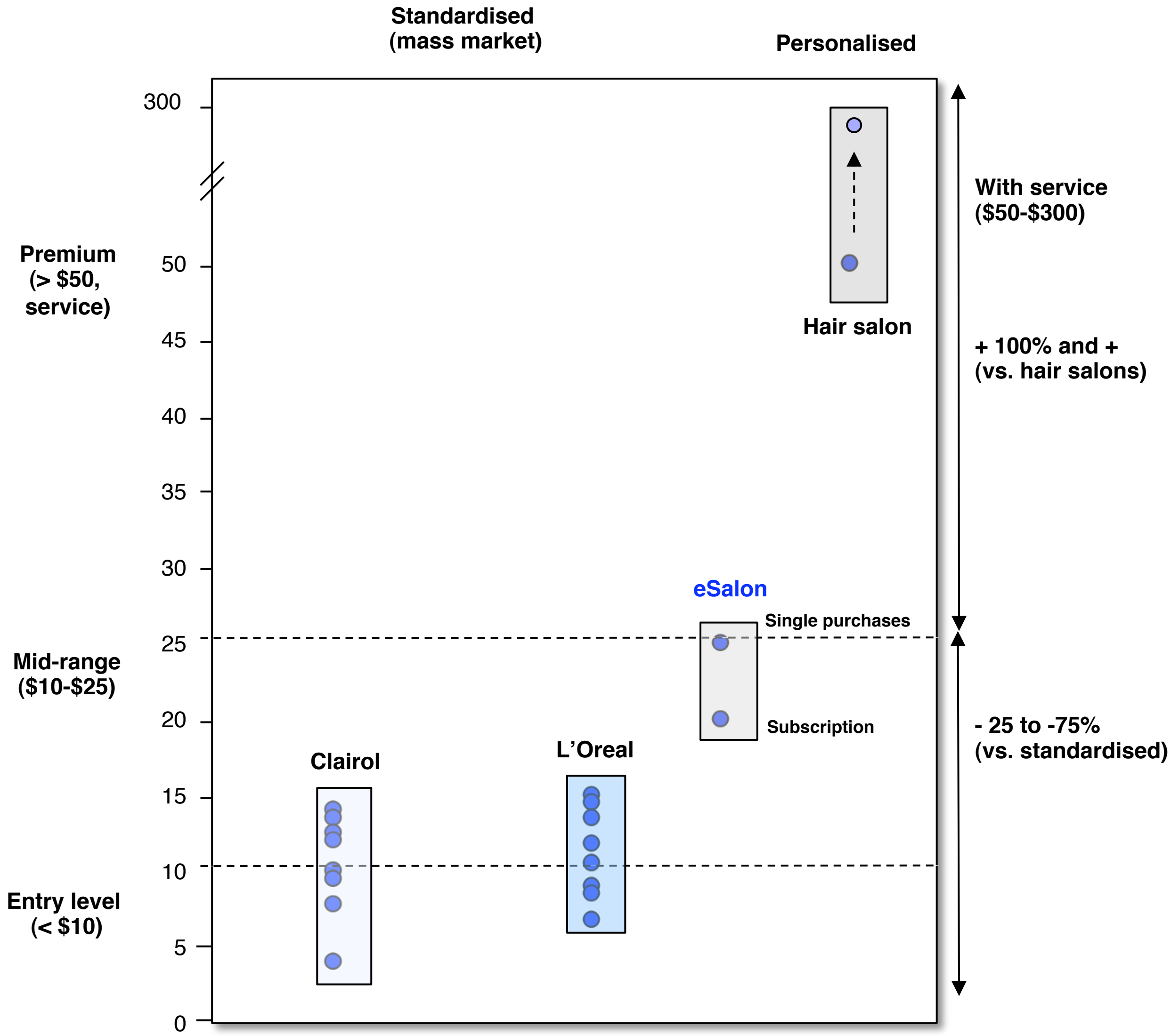
Many FMCG products are strongly invested in the trends towards health and wellbeing. In the United States, organic shops like Whole Foods and complementary shops like The Vitamin Shop are growing at strong rates.

In cosmetics, Big Beauty is focused solely on natural cosmetic products that can be eaten. These products are made with healthy and ecological substances, in terms of the content and the container.

Chobani's success in the ultra-fresh market in the United States is based on the perceived benefits of consumers in products with double the protein content, and a lower sugar content

- Table 2 -

eSalon offers an internet-based personalised colouring service, whose price is positioned between mass products and hair salons



Source : Estin & Co analyses

than traditional yoghurts. 10 years after its foundation in 2005, Chobani's revenue is over $1,5 Bn. It has captured 20% share of the yoghurt market (see Table 3).

What should traditional players do in the face of these new barbarians?

1 - Fight back on the core market

The models that engendered success on the core market should be adapted to maintain high margin levels.

This can be through cost optimisation at never-before seen level, or through acquisitions on the core of the market.

Cost and margin optimisation through tightening business models and fine tuning the offer and the operational expenditure deployed by the customer

It is necessary to better define and "tighten up" the entry level, mid-range and high-end models, in terms of products, services, marketing costs and added costs, in order to avoid cross subsidies and be forever less competitive than the low cost and the premium barbarian types.

This approach, which looks simple, should be done at a good speed and be wide-ranging in scope. It should not be done marginally, at the risk of being ineffective. It is an approach which will allow the competitor to break with the past, because it should be done on the basis that with models growing at 2%-4% per year at best, many costs linked to organisational complexity, quality and over-segmentation must be eliminated… that certain channels and customers should be abandoned and upstream capacities should be re-sized.

In the same way, the offer should be adapted at a detailed level in terms of the products, prices, logistics, merchandising and services. Each operating expense should be re-justified and the budgeted means differentiated more strongly.

Acquisitions aimed at consolidating the core of the market, which allow the competitor to maintain its value and begin creating value again

One of the classic consequences of the emergence of the new barbarians and their capacity to short circuit the traditional channels, is that they have to be focused to remove capacity and realise efficiency gains. The corollary of this is that their suppliers may be incentivised to merge with each other due to the significant pressure they are under, and in a bid to take back some of the market power in the value chain.

2 - Become a "barbarian"

However, major leaders on the core of the market cannot be sustained by defensive optimisation strategies. These strategies are based on logics of optimisation. They cannot create groups which are able to stand up to markets whose value escapes them, and whose value increasingly escapes their retailers. They need to develop new approaches to capture new sources of growth.

They must also become new barbarians.

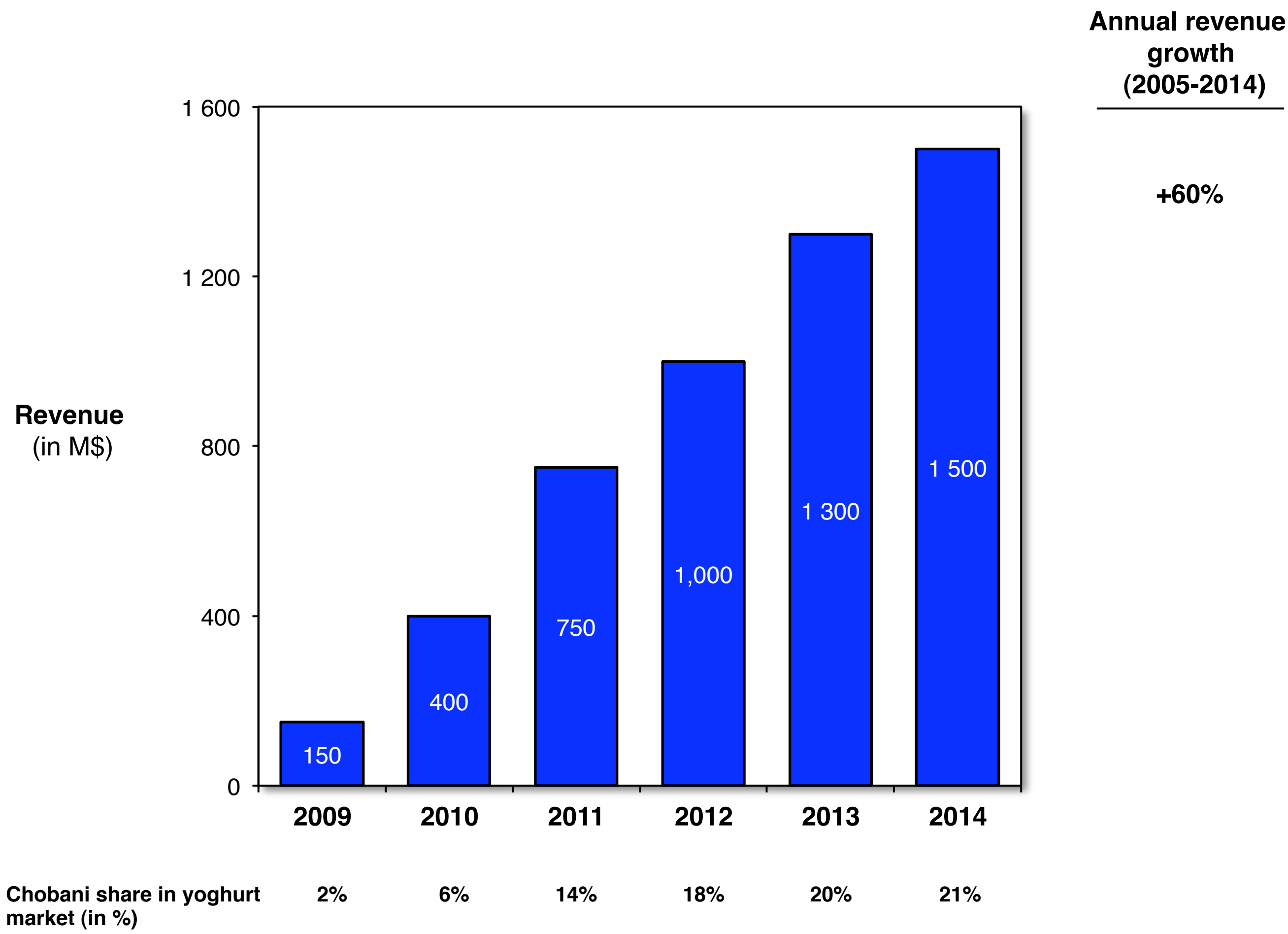
This happens through:

- The development of segmented offers which are aimed at specific groups of consumers,
- New commercial approaches, and new channels: e-commerce, direct selling, doorstep selling, alternative sales networks…

The issue is to define the largest pockets of growth and profitability, and the most relevant models in order to effectively respond to the major rollout steps.

- Table 3 -

Founded in 2005, Chobani has taken 20% of the ultra fresh market in the United States, based on the perceived benefit of healthy products with twice the protein and a reduced level of sugar, compared to traditional yoghurts



Source : Estin & Co analyses

The challenge is to spell out:

- *The 5-year target vision of the barbarian "pure player", putting aside the old operating model*. It is key to define what the desired ambition is for the business in 5 years with its new market offer: which segments are the most attractive in terms of growth and profitability? Which angles could the business exploit to be competitive on these segments? With what means?
- *The critical path and the speed of rollout.* The key challenge is to find the right rollout speed between a rapid rollout which enables the business to gain strong market positions and a slower rollout which allows this business to better test the new set of offers and carefully manage the maintenance of its position in its historic channels. It is especially critical to avoid the pitfall of not fully committing to the move, only to stop short, in the face of the first sets of results, which will necessarily be limited in terms of success, or internal resistance, or reprisals from the retail networks. It is necessary to accept that the model is being deployed with high risks of cannibalisation and strong reprisals, whilst these can be limited if the service levels and brands are sufficiently differentiated from new models and from old models, that direct price comparisons and direct competition will be reduced.
- *The financial investments required to commit to the development of new models,* and the contribution that historic businesses should make, with changes in incentives step and changes in objectives.
- *The organisational links between traditional and new operating models*, with initial priority given to the speed of rollout and therefore autonomy to take 'barbarian' decisions internally, with synergies being of a lesser priority.

What conclusions can we draw?

In mature countries, the new barbarians will increase the pressure on the operating models designed for the core of the market. Optimisation and market consolidation will not be enough to contain the invasion. It is necessary to develop new and wide-ranging approaches, rolled out at high speed. All of this pre-supposes that the most attractive segments have been identified, that the move has been made to focus on these development axes, to roll out the most relevant business model, and to manage the conflict with the existing model. In brief, it is necessary to "get out of the box", especially as the box gets smaller: it is time to put in place a strategy to break with the past.

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