Issue 16

Consumer Currents

Issues driving consumer organizations

KPMG
cutting through complexity

Reinventing retail

The profit behind data analytics

The issue that should be at the top of every boardroom agenda in the global consumer industry is generating the right kind of growth.

Amid the relentless press of world events, it is easy to feel inundated by the volume, variety and complexity of challenges facing every consumer-centric company, whether they are a retailer, manufacturer or supplier. With consumer confidence growing but fragile, many businesses will understandably remain cautious about departing from the formula that has served them well since 2008: stay lean, build a strong balance sheet and survive. Yet with the Organization of Economic Co-operation and Development predicting that the world's GDP will grow 3.6% in 2014, investors will expect the consumer industry to seize its opportunities, maintain its margins and grow through innovation, organic expansion and acquisition.

In this issue of *ConsumerCurrents*, we explore a number of the opportunities and challenges that face the consumer industry as it seeks to generate the kind of growth that adds enduring value to the business.

The drive to cut costs has revolutionized the consumer industry's manufacturing strategy in the last decade. Yet, as we investigate on p16, some brands feel the cost advantage has not been as significant as they had envisaged and now believe that manufacturing closer to home – or to their main markets – can make them more responsive to consumer demand or reassure customers about the quality of their goods. There is no 'one size fits all' answer to this but it's a question that many brands should consider.

Manufacturing is, at least, an issue that companies can manage with confidence. Yet from surveys, anecdotal evidence and my own conversations, it is clear that this is not the case with big data. Some retailers, brands and e-tailers have driven their business forward with intelligent analytics. Yet many companies admit they are not making the best use of data and don't quite know how to rectify that. Big data is a complex, time-intensive, expensive challenge but it can make a profound difference to a business's performance, so we investigate the issue on p10. The critical point here is proving cause and effect so that managers know if they are getting the right return on their data investment and can learn from their successes and mistakes.

One reason so many companies are investing in big data is that they believe it will enrich their understanding of their customers. The same desire has persuaded some businesses to open up their product development to consumers, as we highlight on p4. By embracing presumers (consumers who push, promote and influence products and services before they are realized) and custowners (customers who are so keen on a new idea that they help to fund it), companies can make their R&D more effective.

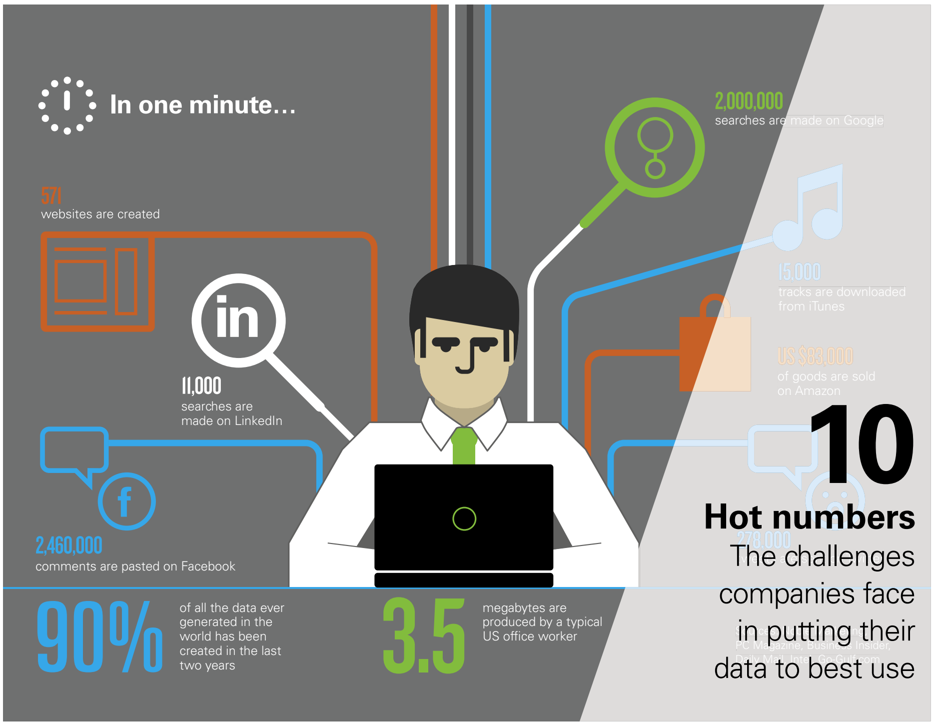
Sometimes looking inward can generate growth. On p20, Len Sauers, Vice-President of Global Sustainability at Procter & Gamble, reveals how people at every level of the FMCG giant's business changed their behavior, a drive that has paid off to the tune of US$1bn.

The need to focus on sustainable growth is at the heart of our interview with Matt Shay, the President and CEO of the National Retail Federation, on p6. He has 17 years of experience in the public policy world in Washington DC and, he says in the interview, one of his goals is to ensure that politicians understand the economic importance of retail – a point that will resonate with retailers, suppliers and brands across the world.

The political theorist Niccolò Machiavelli once wrote: "Whosoever desires constant success must change his conduct with the times." Though he made that observation 500 years ago, it has seldom sounded more apt.

Willy Kruh
Global Chair, Consumer Markets
KPMG International
@WillyKruh_KPMG

Contents



ConsumerCurrents is published by Haymarket Network, Teddington Studios, Broom Road, Teddington, Middlesex, TW11 9BE, UK on behalf of KPMG International. **Editor** Paul Simpson **Contributing Editor** Cathryn Newbery **Production Editor** Sarah Dyson **Art Editor** Paul Yelland **Designer** Amy Hanbidge **Contributors** Simon Creasey, Jeremy Hazelhurst, Lisa Palmer, Kath Stathers, Ian Whiteling, **Picture Editors** Dominique Campbell, Jenny Quiggin **Group Editor** Robert Jeffery **Senior Account Manager** Alison Nesbitt **Managing Director, Haymarket Network** Andrew Taplin
Cover image Xinhua/Wu Ching-teng/Photoshot.

Off the shelf

Lego understands the value of listening to what its customers want

Creative consumers

Some of the world's biggest brands are turning to customers to help drive their R&D as they seek to speed up product development and make it less risky

Even retailers and suppliers who strive to be customer-centric might balk at opening up product development to consumers, but some global brands feel it's a risk worth taking. This phenomenon started with crowd-funding websites such as Kickstarter and Quirky and helped create new types of engaged customers: 'presumers', who engage with products and services before they launch; and 'custowners', who invest in the brands they love and buy from.

Migros, Switzerland's biggest supermarket chain, decided to engage consumers on an online forum, Migipedia, through which shoppers can rate 13,000 of its own-brand products, suggest improvements and vote for new lines. Active members are rewarded with points and 'product godfather' status. Since its 2010 launch, Migipedia has amassed around 30,000 members who have submitted more than 15,000 product ideas and 130,000 pieces of feedback.

Lego invites fans to submit ideas for toy sets via its Cuusoo website, which attracts more than 500,000 unique visitors per month. Winning inventors receive 1% of royalties from their sets' sales. The advantage for Lego is that this approach enables it to launch products faster and be more confident there is a ready-made audience for its new products.

One set, based on the popular online game Minecraft, took six months to hit the shelves, rather than Lego's usual two-year product development period. Cuusoo draws in visitors with a variety of interests, from loyal fans to those more interested in themes, such as aficionados of *Back to the Future*, who wanted a model of the DeLorean time machine from the movie.

"We're very interested in ideas from fans that [are] weird, which wouldn't have survived the product development process," Lego New Business Group Senior Consultant Tim Courtney has said. "If our fans can tell us there's demand, why wouldn't we consider it? And if we turn it into a runaway success, that will show the value of listening to our consumers."

Matt Sevenoaks, UK Manager of KPMG Crowd Connection, says this strategy is "an evolution of the focus group, but you are getting deeper insight and more reach at a fraction of the cost".

"Brands are using open and closed online communities to de-risk product development and cut time to market. Customers that engage and collaborate in this way have stronger brand affinity and loyalty," he says.

"If you want people to really engage with your brand, you need to make a connection with your consumers and make the purchase an emotional experience. This way of working is picking up pace across all sectors. Brands that don't join the fray may not deliver services and products that meet customers' needs."

The longer-term challenge is whether presumers and custowners will help firms launch products that are radically different. The Sony Walkman, ATMs ("too impersonal", complained potential customers), and *Seinfeld*, America's most successful sitcom, were all nearly stifled before launch by hostile feedback from focus groups.

Nexttech

Switch on to t-commerce

Shopping gets easier every day. With smartTVs, customers can now buy products from home using their TV remotes, opening up a whole new sector – t-commerce – for retailers. With smartTV ownership predicted to hit 500 million by the end of 2015, this new sector is likely to grow rapidly.

Since July 2013, many of Samsung's smartTVs in the US have had the ShopTV app preinstalled, enabling viewers to buy products on-screen during shows. The app already covers more than 500 programs and hundreds of thousands of products. A May 2013 report by ShopTV creator Delivery Agent found that two-thirds of US shoppers were interested in shopping through TV, finding it convenient and enjoyable.

Chinese e-commerce giant Alibaba is investing in t-commerce, launching new smartTVs and set-top boxes in September 2013. The company's biggest online shopping channels, Taobao and Tmall, hit sales of RMB 1 trillion (US$159.5 billion) for January to November 2012. Alibaba's strategy looks sound as China has one of the highest market penetration rates for smartTVs at 44%, according to a 2012 GFK study.

"The increasing popularity of shopping on TV represents a sea change for retailers, advertisers and TV channels," says **Mark Larson**, Global Head of Retail at KPMG. "The challenge is to understand the opportunities and risks provided by this fast-developing sector."

The spending forecast

Misunderstanding the effect of weather on consumer behavior could be costing retailers billions of dollars

Changes in the weather influence what consumers buy, where they buy, when they buy and in what quantities they buy. These fluctuations might be the last untapped 'big data' frontier in retail. Analyzing the climate properly could help suppliers and retailers – who adjust their supply chains and product lines accordingly – gain a competitive edge.

"The weather affects the way people shop in every market," says Scott Bernhardt, President of Planalytics, a business weather intelligence firm. "A deviation from 'normal' weather will drive consumers to purchase or not, to 'cocoon' [stay home] and buy online, or visit local stores. It changes the pattern: for example, people tend to have a larger, more expensive breakfast when it's colder. Changes in the weather can break down economic barriers. I might decide not to spend money today; but if the weather makes me think differently, I will spend money."

The American Meteorological Society estimates 2.3% of US retail output is sensitive to the weather. Fluctuations in sales in particular product categories can be spectacular. During the summer of 2013, hotter than usual in the UK, retailer Argos sold more desk fans in a fortnight than in the whole of 2012. Luckily, managers had analyzed the climate so the company had enough stock to meet the demand.

Argos isn't the only retailer to realize it pays dividends to analyze climate. "You can't forecast the weather beyond 14 days," says Bernhardt. "But it doesn't matter if the forecast is correct. If the weather agency says it will be good for barbecue grills and it isn't, consumers act like it is." In April 2013, forecasts for 'barbecue weather' prompted a British supermarket to switch mince production to burgers. Weekend temperatures peaked at 59°F, but British supermarkets still sold twice as many burgers as usual.

36°F

average UK temperature in March 2013, blamed for 3.4% drop in fashion sales

David McCorquodale, Head of Retail at KPMG in the UK, says: "Online is a game changer when it comes to managing the impact of unseasonal weather. It enables consumers to buy off-season clothes which are no longer on the rails, and retailers can deploy targeted promotions and push a product line to suit a sudden change in temperature." Between March and May 2012, clothing retailer Bravissimo promoted its swimwear only on sunny days using a pay-per-click (PPC) weather-driven online marketing tool. PPC sales revenues for swimwear soared by nearly 600% compared to 2011, when it was advertised online in all weathers. Some clothes retailers and e-tailers now use geofilters to target their promotions: coats for shoppers logging on from a rainy city or sandals if their skies are blue.

Trend
Spotting

The rise of the ROBO shopper

With online research driving billions of in-store sales, companies need to capitalize on this consumer behavior, says **Alton Adams**, Principal at KPMG in the US

Why does London tailor Archer Adams have a branded black cab customers can book to take them to the store? Because the company wants to get customers who are browsing online through the doors of its shop. It's a smart move, because people who research online and buy offline (ROBO) spend three to five times more than when they shop through the website, according to research by IDC Retail Insights. When Macy's, a major US department-store chain, introduced its new e-commerce platform in 2010, the website generated a US$1 billion rise in online sales, and influenced more than US$5 billion on in-store sales improvements in its first year.

The percentage of consumers choosing to ROBO depends on the product, the consumer's age, and how urgently the item is required. GE Capital Retail Bank's 2013 survey of consumers who spent US$500 or more on a purchase discovered that 81% researched online before visiting a store – up 20% on 2012 – and spent an average of 79 days gathering data before buying.

"The realization that ROBO is here to stay has prompted some pure play e-tailers to open physical stores"

Regardless of location or age, consumers are becoming more pragmatic when buying, but this behavior is especially prevalent among the urban young, who are particularly comfortable with online and mobile technology.

Comparing products online is simpler and faster than in a mall. It empowers consumers to decide which stores they might buy from, and identify stores offering good deals. The easier it is for consumers to find your brand and products online, the more likely they are to buy. This sounds obvious, but some retailers are struggling to master e-commerce.

Simply being online isn't enough. Consumers expect certain functions – logical navigation, easy checkout, fast shipping and free returns – and will go elsewhere if they're not satisfied. As GE Capital's survey suggests that 88% of consumers who started researching purchases online via search engines went on to buy in store, this is a multi-billion dollar opportunity.

Collecting information from consumers online is relatively easy. The challenge is to understand the relationship between online research and offline purchases. If someone walks into your store and buys a product, they won't tell you they did an hour's research beforehand. Surveys, loyalty programs and promotions can all help brands and stores better understand omnichannel retail.

Retailers are already rewarding ROBO shoppers who visit their stores. Start-up app Shopkick has partnered with Visa and brands such as Target to offer customers points that can be exchanged for rewards. Many European retailers – selling goods as diverse as books, food and computer games – encourage customers to order online and collect from nearby stores.

Consumers will want to experience some products – such as clothing, footwear and furniture – first hand, so ROBO isn't going away. That's why some pure-play e-tailers have opened physical stores as marketing tools. Expect multi-channel retailers to recognize that bricks-and-mortar stores are far more than places to sell stock: they are the perfect places to launch products, raise brand awareness, and excite consumers about goods and services.

NRF president and CEO Shay aims to ensure the US retail sector's voice is heard and acted upon in Washington DC

"Retail is driving innovation"

Matt Shay, President and CEO of the US National Retail Federation, reveals how technology is transforming the way retailers do business

On a wintry morning in Washington, DC, in the headquarters of the National Retail Federation, Matt Shay was sporting a crisp white shirt with cufflinks that pictured Winston Churchill. "It's an American thing to have an affection for Churchill," explained Shay, the President and CEO of the NRF, the world's largest retail trade association.

Shay became the top advocate for America's powerful retail industry in May 2010, after performing a similar joint role for the International Franchise Association for six years. He had worked his way up the ranks at the IFA, having started there as chief general counsel. In his first job, at the Ohio Council of Retail Merchants, he crafted two laws that earned businesses multi-million-dollar tax breaks. Washington insiders were impressed enough to hire him and, having spent the last 20 years working in public policy in the capital, he is well placed to achieve one of his stated aims when taking office – to ensure that the retail sector's voice is heard effectively in Washington.

Right now, as the man who represents 3.6 million retail establishments that account for one in four American jobs, Shay is aiming to help his members by campaigning to ensure they suffer fewer restrictions from government red tape and rules.

ConsumerCurrents spoke with Shay about all things retail, such as what emerging technologies will change purchasing habits and how world events guide the way the industry does business.

Especially for our global readers, please provide a brief overview of the NRF.
We are a Washington DC-based corporate membership trade association, and our members are corporations. We represent companies, not individuals, of all shapes and sizes, from the very largest retailer in the world all the way down to the smallest single unit shopkeeper in a local neighborhood.

What key initiatives does the NRF offer its members?
Our primary objective is to create an environment in which retail businesses can operate without too many impediments from government regulations. In the past few years, that has primarily been about getting our economy going again.

Retailers are more successful in an environment where consumers feel more confident in the overall health of the economy and they've got jobs. They need to feel they are in a stable position to make investments, spend money and buy things for themselves and their families.

Also, we believe we ought to do more trade deals. We believe we should do more to reach the 95% of the world's consumers who live outside the United States.

Finally, we ought to get our immigration policy fixed, so that we can attract and retain the best and brightest talent from around the world, which is one of things that has made this country so competitive, innovative and diverse for so long.

The NRF's 'This Is Retail' campaign has highlighted the industry's role in driving innovation. Do you believe the sector is becoming more innovative? And does it get enough credit for that?
It is becoming more innovative, but we don't get enough credit for it. If you think about some of the innovations we take for granted today, like barcodes and RFID tags, those are retailer-led investments in innovation.

If you think about the way we do commerce today, with this [he points to his smartphone], customers try to find ways to innovate in their lives, to do things more efficiently, more quickly, to a higher level of satisfaction and confidence. Consumers have been driving this revolution in technology that has caused retailers to spend enormous amounts of money on innovations just to keep up with their customers.

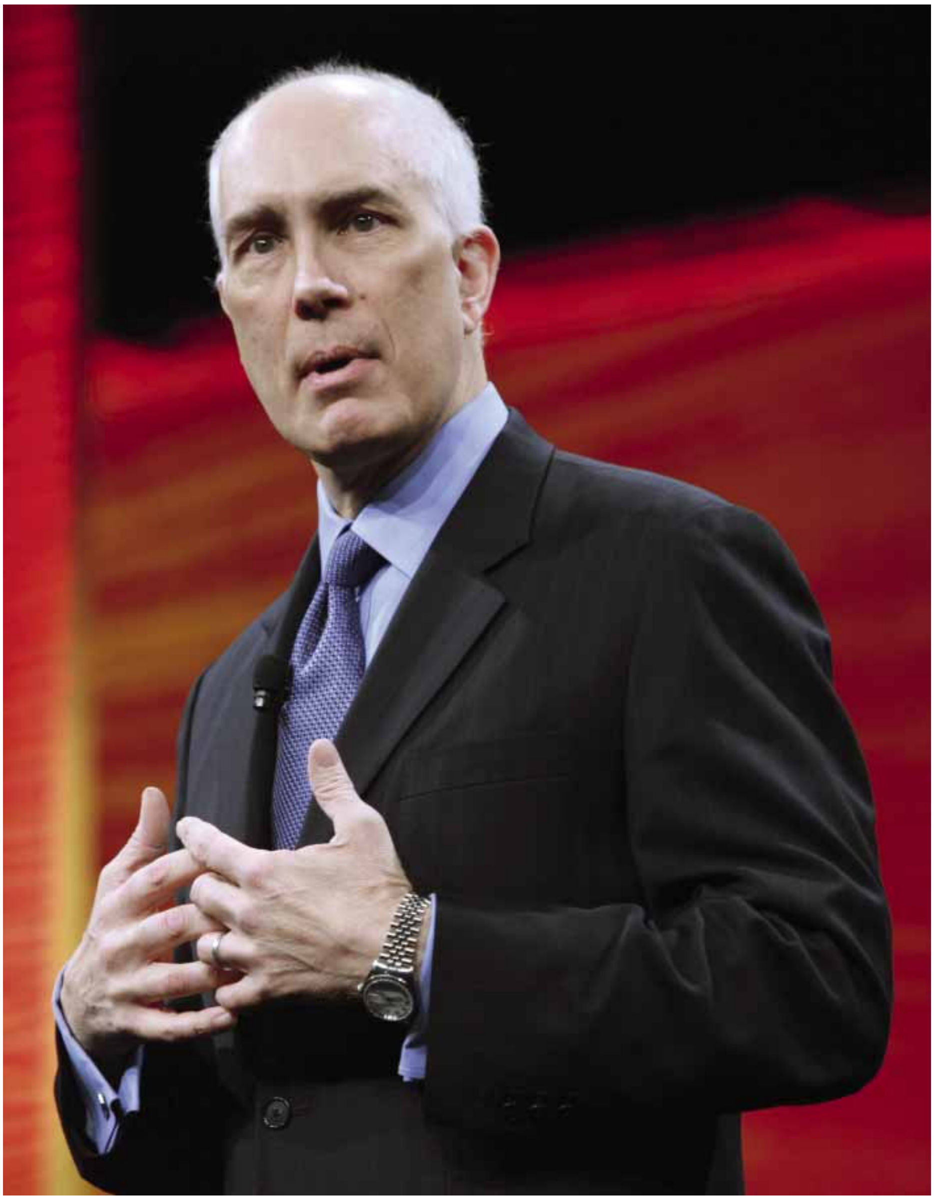
Customers are increasingly channel agnostic, and don't care about whether they go to a store to buy that sweater, or order it online from their computer in the office, or on their tablet in a coffee shop, or on their mobile phone on the subway.

Additionally, they often make different choices about where they want to pick that item up, whether it's at the store, or having it shipped home. It's all becoming conflated to the point that retailers now are simply looking at the bottom line and trying to create an experience where customers feel they are moving seamlessly from one platform to another. It has required an extraordinary amount of innovation from retailers to develop systems that can speak to one another, while maintaining brand fidelity across all platforms, to make sure consumers have an integrated experience wherever they get it.

There has been a positive benefit for retailers. They can operate their businesses more effectively and more efficiently. Previously, they had non-integrated inventories. Inventories were located in distribution centers that fulfilled online orders. Stores fulfilled the needs of customers who walked in off the streets. Now retailers use technology and create platforms that can look at everything in every store and every distribution center, and decide if they can ship it from a store or a distribution center. Businesses make thoughtful decisions about whether it is more cost effective to ship items from the store close to the customer's location, or whether it's best to pull it from a distribution center five hours away.

In addition to technology, what other forces are inspiring new approaches?
It's the consumer experience. With something like mobile payments, we are comfortable putting credit card information into a laptop and sending it to the internet world. Rather than have to lug around a computer, maybe it is stored in a chip in your phone or in a direct link to the bank. Mobile payments and the evolving electronic wallet is one development retailers feel excited about. Retailers are clearly leading on mobile payments in ways no other industry is.

Also, we will see point-of-sale changes. The old method where the sale occurs at the cash register is not as common now. Now a sales associate walks around with an electronic tablet to make the transaction, like in the Apple store. On the experience side, it is much easier to have the sales associate walking around and interacting with the customers rather than them sittings behind a counter. It gives customers more human interaction, because the associate is with you and you're doing something together.



Shay is rallying for policies to drive economic growth of 4-6% and give customers enough confidence to buy

What recent innovations in the retail industry do you feel have been particularly successful?
The use of mobile devices is the one that jumps out most quickly. Think of the ability to use technology to drive messages to mobile devices using geolocation systems while customers are in stores. This is a significant area that is going to be what retailers focus on and invest in, because it's the way consumers want to shop.

How well do you think retailers are adopting new technologies and opportunities from using digital and mobile channels?
Retailers are at a high level of awareness and at a significant level of adoption. We are at the beginning of this development, not the end. More capital investment needs to take place. Retailers on the cusp of investment decisions now have to decide whether to build more stores or distribution centers, or adopt technology and invest in innovation? It's a constant balancing act. The store experience is not going away any time soon. With certain items we need and want, we can only get them in a store. On the other hand, the investment in online and mobile will continue.

How is the interplay between online, mobile, and bricks and mortar shaping the retail industry?
Do you mean bricks and clicks? The CEO of Macy's recently made the observation, almost as if he were surprised to hear this, that the supermarket chain is the tenth-largest internet retailer. So the big players on the internet are going to be the big retailers. They are not there yet. Part of that has to do with their investments in stores. But retailers don't distinguish as to where they make the sale. Like consumers, retailers are increasingly channel agnostic. It all goes to the same bottom line.

With consumer confidence quietly returning, would it be true to say that generating the right kind of growth is the top priority for the US retail industry in 2014?
Yes. Consumer confidence has been up and down. Looking at the past five years, people shop differently today to the way they did before the recession. People at all income levels are more thoughtful in the way they spend. The affluent are not back to spending the way they did before. Everyone has adjusted to some degree.

Do you believe the credit crunch and the economic crisis have permanently changed customer behavior?
If you think of the recession as a credit recession. Yes, people are not confident about what growth is going to be and, therefore, they are not as willing to take big risks to extend themselves. That's because they don't know if the economy will grow. Am I going to get a raise? Can I make that investment? Home purchases were good this year, auto sales came back, and home improvements are doing well, but they came at the expense of other kinds of spending. Consumers could either spend money on discretionary purchases or make investments in durable goods, but they couldn't do both. But we need an economy that can do both simultaneously.

What are the biggest challenges American retailers face?
Consumer confidence, job creation, and economic growth. If customers aren't confident about the health of the economy, they are not going to shop. We can't resign ourselves to 2% GDP growth. We take the view that we should be doing things to get the economy growing at 4, 5 or 6%.

What important developments in world events and economics are guiding the way retailers do business?
Trade. We need to reach consumers outside of this country. We need to be facilitating commerce across borders and encouraging a new generation of leaders, thinkers and innovators to come to this country.

Think of the phrase that the US sneezes and the world catches a cold. What we import creates opportunities for manufacturers in China, Brazil, Germany and around the world, because it helps markets in other places. The US needs to be a growing, consuming economy.
In terms of immigration, I tell people that if they think we should be protectionist and isolationist, then we are going to be a second-class economy.

Is there a particular management theory, thinker, writer or book that has inspired you or you feel would be important for retailers to read?
Having been a lawyer my whole career, I went back to Georgetown University a few years ago to get my MBA once I started working as a CEO. At graduation, one of our professors who taught strategy gave an address on the importance of strategy. Right after him, the keynote speaker, who was the CEO of a company, got up and came to the podium and said, "Professor, I just want you to know that culture will eat strategy every day of the week!"

In an organization, which comes first, the strategy or culture? I think culture comes first. If you don't create the right tone or environment, then strategy won't make a difference, because you will never be able to execute it.

"Like consumers, retailers are increasingly channel agnostic. It all goes to the same bottom line"

US RETAIL BY THE NUMBERS

US$2.5trn in retail contributes to America's GDP.

42 million Americans work in retail.

2-3% annual sales growth in-store takes place in US retail.

12-15% annual sales growth online takes place in US retail.

95% of US retailers work in one location.

95.2 million Americans shopped on Black Friday, 29 November 2013, the first Friday after Thanksgiving Day.

77% of US holiday shoppers did some of their shopping online.

1911 was the year the National Retail Federation was founded.

FROM PROMISE TO PROFIT

The mountain of information retailers are accumulating is about to pay big dividends. But to harness the true power of big data, crunching the numbers is less significant than strategic vision

With the amount of stored information growing four times as fast as the world economy – and the processing power of computers nine times faster – the most striking aspect of big data is its sheer scale. Yet for consumer brands, suppliers and retailers, the quest to realize the immense promise of data analytics doesn't begin with zettabytes, software packages or organograms depicting real – or imagined – flows of information, it starts with a spot of self-analysis.

Eddie Short, Partner and Lead for Data and Analytics at KPMG in the UK and EMA, says: "It's not all about the numbers behind the strategy, it's about the strategy behind the numbers. You need to understand the key drivers of value in your business, make sure you have a clear line of sight between data and your strategic priorities and make sure you have the processes you need to convert data into actionable insight."

Big data is an urgent challenge but the temptation to act now and discuss later should be resisted. Understanding your priorities is crucial if you are to achieve the requisite return on investment. George Svinos, Head of Retail for KPMG in the Asia Pacific region, says: "What some companies are struggling with is proving there is a cause and effect in any measureable way. If you invest in new data – or new analytics capabilities – to launch a discounted promotion to a particular customer segment, how do you know that you wouldn't have sold to those same customers anyway?"

In the retail industry, which has invested billions in customer relationship management systems and powerful data warehouses, complacent executives may assume they have data covered. Not so, Short cautions: "Companies like Google, Facebook and Amazon already know more about most companies' customers than they do themselves. The only thing you can be certain of is that doing nothing is not an option. You have to up the ante to win market share."

In the retail sector, big data is often reductively seen as relating to the kind of consumer metrics luxury goods brand Burberry has developed. Programs such as Customer 360 – a data-driven shopping experience that invites customers to digitally share their buying history, shopping preferences, Twitter posts and fashion phobias – harness powerful data platforms to analyze and deliver that information to sales staff via their tablet computers. Such schemes have already proved their value, but Short says there's far more to big data than getting to know your customer.

KPMG's research has identified three types of analytics that companies focus on, and in each area, big data could make a crucial difference:

Core analytics

Amazon has relied on analytics that support the organization's core purpose – and its culture of metrics – to achieve its growth targets. "Successful companies in this area," Short says, "recognize that analytics is not just about driving profits but helping monitor trends internally and externally, which helps them stay ahead of customers, suppliers and their competitors. So, for example, if you're doing sentiment analysis on social media, you might identify a trend six months before your rivals and steal a march on them."

Ancillary analytics

Some activities are not core to the business, but still need to be monitored – and can be improved. Here the focus is not on being the best but on having adequate capability. Even so, data can still yield dividends. By sharpening its understanding of ancillary analytics, Heineken has been able to reduce the number of vendors it uses by a factor of 10. Better insight into its vendors has also translated into major improvements in its contractual arrangements with them.

Remedial analytics

Big data isn't always driven by the need to seize an opportunity. When the worst happens, companies need to quickly and accurately understand what went wrong and how to rectify it. Short says: "Our research indicates organizations that take a disciplined approach to the key areas of analytics are likely to bounce back much more rapidly from disaster."

All these kinds of analytics are critical to long-term success yet they will affect each organization differently. The questions may be similar – Where would big data be a game-changer for the business? What

GUM

1974

A packet of Wrigley's chewing gum is the first item scanned using Universal Product Code in a Marsh supermarket in Troy, Ohio

50%

of Chinese consumers shop on their mobile phones, compared to 16% of US consumers

17 attributes are rated on every item purchased using a Tesco Clubcard to build up a profile of the shopper

38,718

TOMATO SOUP

items carried by the typical US supermarket

10%

The rise in in-store sales US retail giant Macy's attributes to its investment in data processing

2,650,000,000

loyalty program memberships are held by US customers in 2012

65,000,000,000

location-based payments are made every year in the US

30,000,000,000

RFID tags were in circulation by the end of 2011.

16%

of US federal IT budgets expected to be spent on big data within five years, an investment of US$13bn

Byte size

1,000
Kilo = one low-res photo

1,000,000
Mega = data on a small floppy disk

1,000,000,000
Giga = a movie shown in TV quality

1,000,000,000,000
Tera = one tenth of the data stored in the US Library of Congress

1,000,000,000,000,000
Peta = half the information stored in America's academic libraries

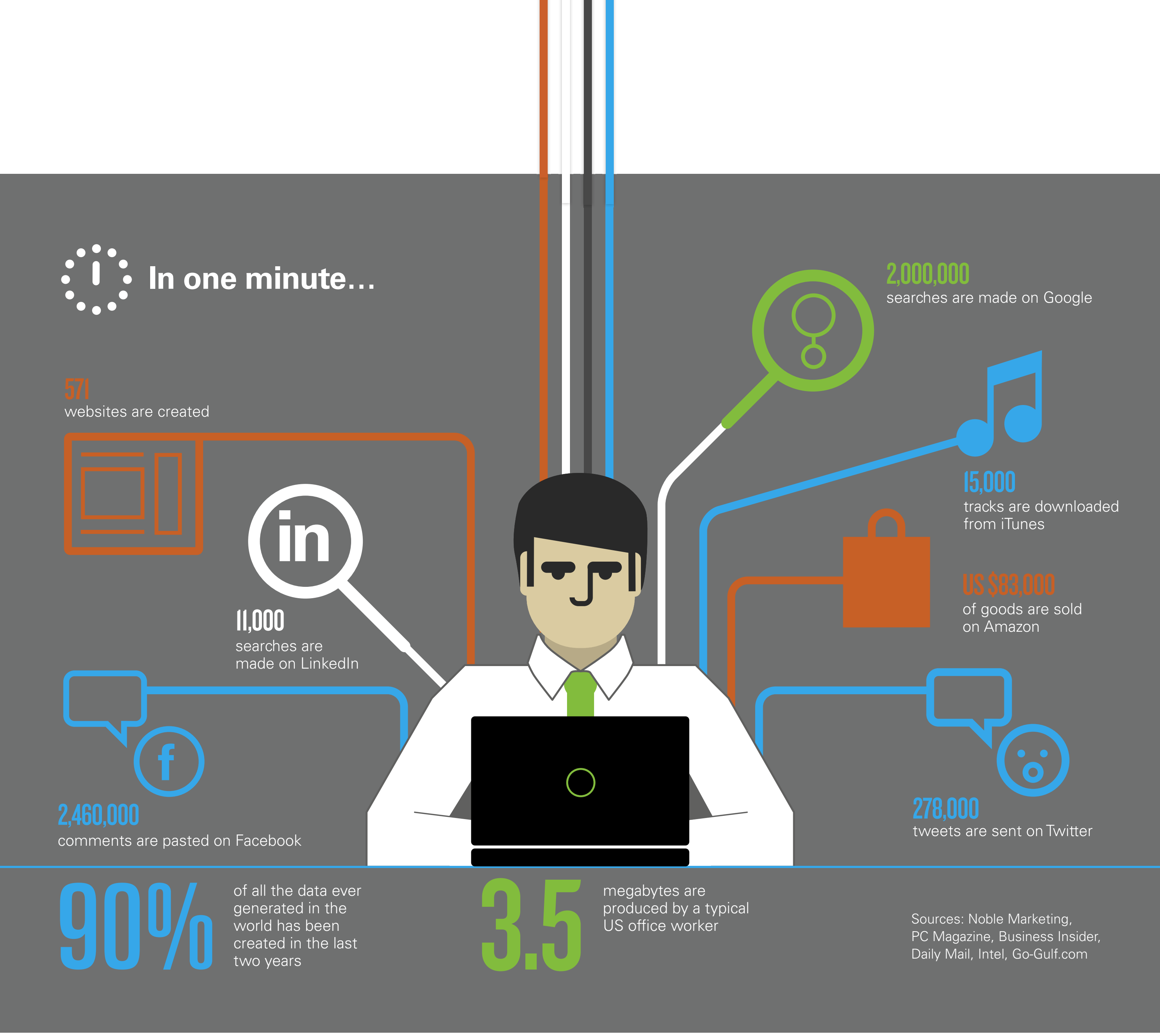
1,000,000,000,000,000,000
Exa = a fifth of all the words spoken by human beings

1,000,000,000,000,000,000,000
Zetta = 55% of the data stored in 2011.

20 BILLION

internet-connected devices will exist in the world by 2020, 2.6 per head of population

Sources: IDC, Radicati Group, TR Research, Pow Internet, LoyaltyOne, IBM, Food Marketing Institute, Havas Worldwide, Deltek, Macy's, MeriTalk



supportive process, policies and structures will be needed? What expertise will add the most value when aligned to your business objectives? – but the answers certainly won't be.

For some, the immediate value may reside in reducing churn in a critical sector of the workforce. For others, it may be about analyzing why the ratio of floor traffic to sales varies so much between stores. One upscale US retailer has used big data to analyze key data points (sell-through rates, out-of-stocks, price promotions) at the product or stock-keeping unit level at a particular time and location, developing thousands of scenarios to assess the probability of selling a product – so it can optimize assortments by location, time and probability. A US retail bank monitors social media activities to identify at-risk customers. One large consumer products company, analyzing related-party payments by contractors and third parties, identified over US$30m of erroneous checks and payments over an 18-month period.

"Until recently, advances in our capacity to collect data has exceeded our ability to use it profitably. This is starting to change"

There is a lot of hype around big data. Technology critic Evgeny Morozov recently quipped: "If you have a trove of unpublishable papers, just add the words 'Big data' and see them go viral." Yet Short says: "Big data will be one of the essential management tools of the 21st century." Indeed, various studies into the potential impact of big data have concluded that analytics could improve retailers' margins by anywhere from 40-60%, far from insignificant in an industry where margins are constantly under pressure.

Big data describes vast quantities of raw, digital data that test the ability of existing software and management tools to manage and analyze, data so massive it is hard to know what it can tell you and what it can't – and what value it might bring to the business. Svinos says: "Until recently, advances in digital technology have meant that our capacity to collect data has exceeded our ability to use it profitably. That is starting to change."

Many companies are already realizing the latent competitive advantage in mining the data they already own (or can access). One major US retailer, which moved from spreadsheets to big data in three years, credits its investment in analytics for a 10% increase in store sales. Other retailers believe that in a world where consumers are tracked in-store as closely as on websites, and consumer personalization is becoming exponentially more sophisticated, big data could help them solve the enduring conundrum that is the omnichannel. This conviction may explain why US retailers spent US$2bn on business intelligence and US$9.4bn on infrastructure in 2013.

To succeed, business leaders need to realize that putting analytics at the heart of their business is not the same as becoming a slave to data. Svinos says: "Not everything that succeeds in business is based on what you have done before. A successful product will not necessarily predict the next successful product. But this kind of analytics is an essential component of sound decision-making." Take away the hype, the software and the technology, and you could argue that big data is just evidence-based management elevated to the nth degree.

Eddie Short
eddie.short@kpmg.co.uk

Eddie is a Partner and Lead for Data and Analytics at KPMG in the UK and EMA. He has more than 20 years' experience helping multinational organizations leverage their data to create bottom-line business value

Managerial mindsets

Although some analysts argue that big data's algorithms can replace managers as decision-makers, Short says: "Management insight remains a vital part. The deeper your insight into your business, the less you will have to rely on the kind of mathematical muscle Google brings to big data. Often, even when the data scientists have interpreted the information, it may not present you with one solution. It may suggest there is an opportunity – or problem – to be faced and your experience, insight or instinct could guide your response."

In their book Big Data, Viktor Mayer-Schönberger and Kenneth Cukier suggest the key is not replacing management with data-crunching software but developing a corporate mindset where managers can analyze data, understand how to tap into it and unlock new forms of value.

To do this, companies need expertise. Hal Varian, Google's chief economist, says: "Data is so widely available and strategically important that the scarce thing is the knowledge to extract wisdom from it."

Burberry delivers detailed customer data direct to the tablets of its sales staff

The interaction between managers and data scientists is critical. Historically, companies ask a question and collect data to answer it. With big data, it's the other way around. The data is being collected and it's up to you – and your data scientists – to know what to ask. The challenge for data scientists is how they present their findings and make their assumptions clear. The challenge for managers is to intelligently interrogate the findings and not fixate on the precision of the data or suggest that the best solution is to ask for some more data.

"Being able to ask why, rather than spending more time demanding to know more, is likely to deliver genuine insights that can be acted upon," says Short. There is, he admits, a risk that "C-level execs scream for more data, seeing it as a panacea. Showing them that not all data is business-critical – some is utterly useless – can be difficult."

Yet when the relevant data has been defined, managers and experts must feel free to mine it for value. Svinos says: "Often the real value comes when you combine different data sets. Let's say, for example, that you are a supermarket that is branching out into insurance. If you found a data set that told you an applicant regularly filled their car up at 3am at a downtown gas station, that would affect how you handle their application. The key is developing an understanding as to which relationships between data and data sets are important."

Hiring data scientists and investing in software do not, by themselves, create an information-led organization. You also need a new attitude towards IT. Many managers at retailers perceive IT as a back-office function – in other words, a large cost center – whereas with big data, it needs to become the engine of business growth.

Trial, error and strategy

Successful companies make analytics an enterprise-wide, strategic priority; identify whether they have the appropriate governance, operating, competency and process models to make the best use of the investment; and act to ensure they have the mechanisms to deliver the right information to the right managers. Time is of the essence – front line managers tend to want it all and want it now – but so is simplicity. Complex legacy systems should not prevent retailers or brands from delivering a single customer view across all products and markets.

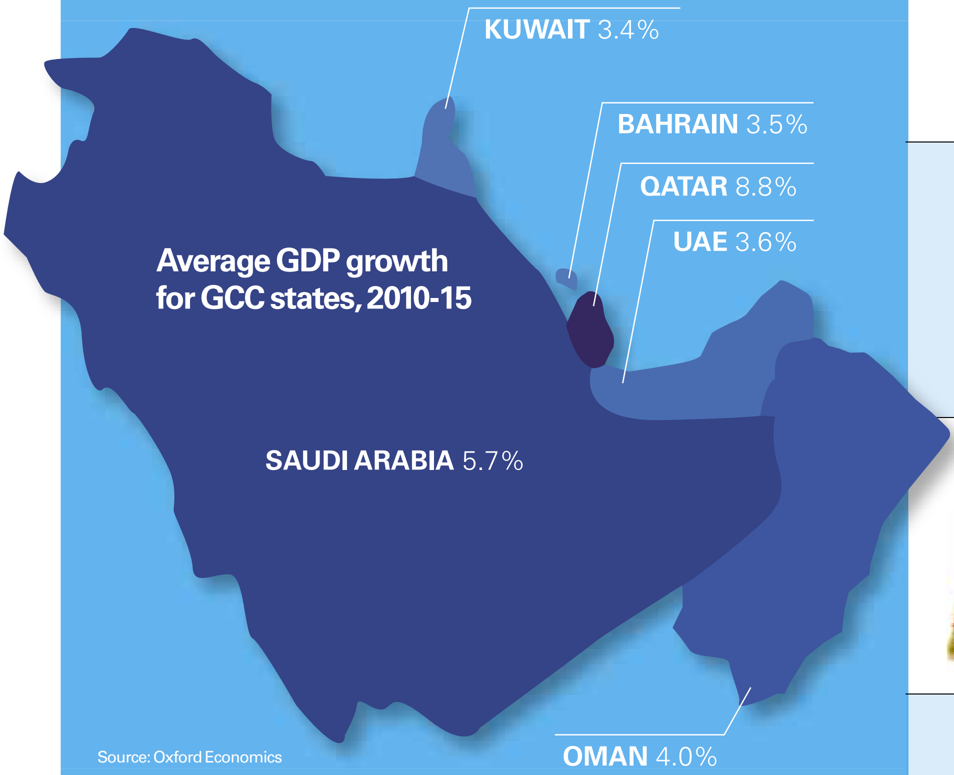
Given such complexities, Svinos's advice to companies about to invest in big data is: "Remember it's a case of trial and error. Don't bet everything on one approach. Accept your defeats, learn from them, and think hard about the kind of information you are collecting and how it can deliver the most enduring value for your business. And always remember the question you should start out with: what am I trying to achieve?"

BIG DATA: THE BIG CHALLENGES

- Turning left-over data into valuable data-driven processes
- Identifying which data is valuable and which data only complicates analysis
- Embedding analytics into the corporate culture
- Confirming the accuracy of externally sourced data
- Ensuring IT data investments deliver value
- Increasing the flow of value-added data and analysis
- Identifying and maintaining the right expertise and capabilities
- Understanding how big data could affect your IT infrastructure
- Using big data to improve financial planning, business performance management and financial consolidation

Inside the Gulf states

With a combined GDP of US$1.37trn, this region is one of the few emerging markets where the retail sector is forecast to grow significantly and consistently over the next three years. Here is our guide to the Gulf Cooperation Council bloc



Source: Oxford Economics

Annual GDP growth for GCC, 2010-15

5.45%

Annual GDP growth for world, 2010-15

2.96%

BAHRAIN

STATE OF THE MARKET

Recent political unrest has failed to affect the country's economic outlook. GDP rose by 2.5% in the first quarter of 2013, fueled largely by rising oil output. Although oil accounts for around a quarter of its economy, Bahrain is considered to have the most diversified economic mix in the region.

STRENGTHS

The retail market is tough to gauge due to recent political unrest, but reports suggest consumer confidence has rebounded with spending set to rise. Bahrain's major malls enjoy high occupancy levels and strong rental growth.

WEAKNESSES

Social unrest, which erupted in 2011 and caused the Grand Prix to be canceled, hurt tourism and the large finance sector. CBRE reports that occupancy rates have fallen in some smaller malls.

CONSUMER STARS

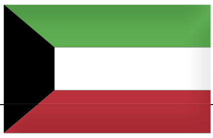
Originally launched in 1913 from a small shop in a souk, today Ashrafs WLL is now one of Bahrain's leading retailers. The company sells major international fashion brands and household goods, as well as consumer electronic brands such as Kenwood, Nikon and Sony.

FOREIGN INVESTORS

Waitrose now has four stores in Bahrain. Géant Hypermarket, a partnership between Fu-Com International and Groupe Casino of France, is the largest retailer in Bahrain. LuLu is opening three hypermarkets this year as part of a long-term US$334m investment program.

THE VERDICT

"Bahrain was the only GCC country badly hit during the Arab Spring. Tourism was severely affected, and consequently retail. But now things are relatively stable and the economy is responding well, with investor confidence returning."
Anurag Bajpai, Partner,
KPMG in the UAE



KUWAIT

Launched in 2010, Kuwait's five-year plan to strengthen its private sector, most notably with major infrastructural investment, seems to be working: GDP is growing by around 6%. Strong retail sales are being fueled by urbanization and a big influx of foreign workers from Iraq.

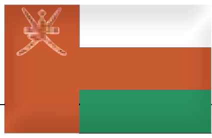
Retail sales are forecast to grow by US$4bn from 2011 to 2015. GDP per capita in Kuwait is circa US$40,000. Global brands are popular, particularly fashion, and young people are splashing out on electronics. Two new malls will add 2.4 million sqft of retail space.

Kuwait's censorship laws have deterred certain retailers of books, films, records and clothing. Virgin Megastore and Dubai-based record distributor Music Master withdrew in 2012. Of greater concern is a political crisis which has led to parliament being dissolved six times since 2006.

Long-established Kuwaiti Al Ostoura fashion boutique has more than 40 stores occupying over 107,600 sqft of retail space under its Al Ostoura or Limelight fascia. The chain also runs stores under the names of fashion designers whose clothing it stocks.

Kuwait hosts many Western brands, including IKEA, Victoria's Secret, Prada, Mothercare and American Eagle Outfitters. EMKE Group has opened hypermarkets in the country.

"Despite little economic diversification and a big reliance on oil, Kuwait has a mature retail sector and high penetration of multi-brand and fashion stores, including many Kuwaiti retailers. But low tourism means less growth potential than other states."
Neeraj Dassani, Partner,
KPMG in the UAE



OMAN

With a relatively small population of just over three million, Oman has a lower GDP per capita (US$26,000) than some neighbors, but a large number of high net worth individuals. The concentration of wealth has particularly attracted luxury brands.

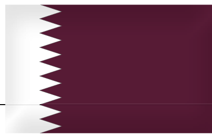
The capital, Muscat, is driving change in Oman's retail sector. New projects, such as the Muscat Grand Mall and Mustafa Sultan complex, should attract global retailers. Consumer spending power should increase, driven by more tourists and expats.

Oman is seen as a stable rather than spectacular opportunity for retailers. The economy keeps growing and consumer confidence is stable, but malls and supermarkets aren't expanding as fast as elsewhere in the Gulf – possibly because the economy is small and GDP per capita relatively low.

Established in 1870, Khimji Ramdas runs more than 50 Khimji's Mart supermarkets across Oman and manages a chain of Welfare Markets for the police.

LuLu, which is part of the EMKE Group, has a strong hypermarket network across Oman. Major retailers LVMH, Marks & Spencer and L'Occitane have all had a presence in the Gulf state since 2007.

"There have been some major moves in terms of retail penetration, with more modern and well-established retail brands increasing their presence in Oman, as are supermarkets. As a result, the economy is becoming far less fragmented."
Anurag Bajpai, Partner,
KPMG in the UAE



QATAR

With the highest GDP per capita in the world – US$102,000 in 2012 – Qatar's global profile keeps rising as it prepares to host the 2022 FIFA World Cup Finals. Current GDP growth of 6.5% is set to continue as some experts predict the state's population could double to 4 million by 2020.

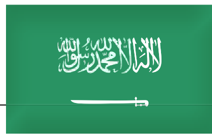
Growing affluence, expat numbers and tourism are driving growth, as will Qatar's new airport. The healthy 3,200 sqft of retail space per 1,000 people is set to rise in the run up to the World Cup.

Projected high infrastructure, housing and retail-space growth in Qatar means its population and economy need to grow by over 5% a year, say financial experts. The economy needs to become less dependent on energy. There's a fear the retail property market could overheat if not carefully managed.

Qatar-based supermarket and hypermarket chain Al Meera runs 33 stores and six more are in the pipeline. It is also developing a network of stores with French retailer Casino under the Géant fascia.

Tex-Mex brand California Tortilla opened a store in Qatar's capital Doha this year. Marks and Spencer has two shops there. Al Meera runs three WHSmith outlets – eight are planned for the new Doha airport. Fashion brand By Malene Birger has recently opened stores in the capital.

"Qatar has seen rapid development of many shopping malls featuring high-end retailers, along with the penetration of a lot of established supermarket brands due to the big potential spending power of the rapidly growing population."
Neeraj Dassani, Partner,
KPMG in the UAE



SAUDI ARABIA

Despite a fall in oil production this year, the National Commercial Bank expects GDP to rise in Saudi Arabia by 4% in real terms in 2013. The burgeoning middle class is expected to drive growth. The Oxford Business Report estimates that the retail sector accounts for 17% of GDP.

One of the Gulf's fastest growing retail markets, Saudi Arabia will benefit from the arrival of around 1.7 million new consumers over the next five years. Retail floor space has grown rapidly, increasing by 80% in Jeddah alone since 2005.

Youth unemployment in Saudi Arabia is around 30%, one of the highest in the world. There are lingering concerns over the country's supply chain infrastructure, which government plans to invest US$110bn in the next five years may help to address.

Fawaz A Alhokair & Co (known locally as Alhokair Fashion Retail) trades off its strong local market knowledge to forge franchise partnerships with global fashion brands such as Gap, Banana Republic and Zara.

Toys R Us operates 11 stores in Saudi Arabia under a licensing agreement, and plans to open two more this year. In August, the retailer unveiled plans for a new 377,000 sqft distribution center that will be the hub for its five-year regional growth plan.

"GDP per capita is lower than its neighbours, reflected in Saudi Arabia's retail brands, while the market is fragmented, focused on the main cities. But with entry for foreign brands easing and 60% of the population under 30, the country has strong growth potential."
Neeraj Dassani, Partner,
KPMG in the UAE

UAE

The GDP of the world's eighth-largest oil producer grew 4.2% in 2012. Non-oil GDP growth is 3.1%, as tourism booms. Dubai is second only to London in real estate consultancy CBRE's rankings of global retailer presence. Dubai Mall attracts 35 million visitors a year.

The UAE's free-market economy makes it one of the easiest Gulf states to do business in – it's often used as a test bed for retailers new to the region. Clothing sales in the UAE and Saudi Arabia are strong, expected to exceed US$14bn this year.

A dearth of retail space in Dubai has led to high rents. This will be eased by new retail projects, such as Nakheel Mall on the Palm, which will provide an extra 1 million sqft of space by 2016. High-street stores face a threat from online sales, tipped to rise from US$280m today to US$1bn by 2020.

Founded in 1974, Jumbo Electronics is one of the UAE's leading consumer electronics firms, with 27 stores and nine service centers, selling such brands as Apple, Dyson, Lenovo and Sony.

Fashion brands Crazy 8, George and Calzedonia launched in Dubai this year, Abercrombie & Fitch will follow suit in 2014 while LVMH is investing in a new mega fashion mall. Fashion retailer M&Co plans to have 12 stores in the UAE by 2018.

"Seen as a safe haven, the UAE's retail sector is being boosted by tourism and investment from Saudi Arabia and Qatar. The next evolution is likely to be homegrown UAE retail brands expanding across the GCC and beyond."
Anurag Bajpai, Partner,
KPMG in the UAE

Production's coming home

Reshoring is more than a buzzword. There is a strong case for consumer goods companies to rethink their manufacturing strategy – as long as they drill down to the detail

Kenai Sports creates 100% sustainable clothing. Like so many others in the labor-intensive fashion industry, this American company started off manufacturing abroad. "Hats that cost 45 cents to make and T-shirts that came in at under $1/piece were a siren's song for an upstart apparel company," says Kenai founder Charlie Bogoian.

With cheap oil, low labor costs in many developing countries and new technologies making it easier to manage these relationships, offshoring has been the strategy of choice for many businesses for more than a decade, especially since China joined the World Trade Organization in 2001. Yet in the past two years, moving manufacturing back home (reshoring), or to other low-cost regions closer to key markets (near-shoring), have become fashionable.

Bogoian's experience helps explain why. "With issues like unreliable communication and extended lead times, customer satisfaction was quickly waning," he says. "Avoidable mistakes prevented us from realizing the cost advantages we anticipated. Those problems were coupled with an overall lack of accountability that showed little sign of changing." Kenai's leadership decided the best way to fix those problems was to return production to the US.

In a survey published last year, the Massachusetts Institute of Technology found that 33.6% of the 340 respondents were considering bringing manufacturing back to the US, with 15.3% definitely planning to reshore. Some American businesses have led the charge. Tailors Brooks Brothers, for example, moved 70% of its suit production to a plant in Haverhill, Massachusetts, rather than offshoring production to Thailand. Easybike Group, which makes electric bicycles, is moving production from China to Saint-Lô in Normandy at the start of 2014 to benefit from government subsidies and tax breaks, and to build on the Solex brand's French heritage.

Many companies 'coming home' are reaping the rewards not just operationally, but also in the marketplace. Homegrown

The rationale for making goods in China is more about access than cost

products project such desirable values as quality and sustainability because of a shorter distribution network, while tapping into consumers' patriotic sentiment. Recent research suggests that 76% of US shoppers notice 'made in the USA' labels. Last year, Karen Kane dresses, blouses, and jackets promoted with 'Made in the USA' posters at Dillard's department store posted 15% higher sales than similar non-promoted clothing.

When Jack Welsh was chief executive of General Electric, he said the ideal strategy for a global company would be to put every factory it owned on a barge and float it around the world, taking advantage of short-term changes in economies and exchange rates. Reshoring, offshoring and nearshoring, or the most efficient combination of the above, are a more realistic way of maximizing growth opportunities. Yet Boards need to consider the big questions: What are the strategic goals? Does a shift in manufacturing support the strategy? Have we truly considered all costs?

"Many businesses failed to assess the costs associated with offshoring correctly, with error margins of around 20% in some cases," says Andrew Underwood, Head of Supply Chain at KPMG in the UK. "When considering reshoring, the mistakes should not be repeated."

With Underwood's advice in mind, here are five factors that every company should consider before they recalibrate their manufacturing strategies:

The **rules** of reshoring

Seven points to ponder when considering relocation

1. Don't just follow the herd

"Organizations may notice their competitors reshoring production and increasing their market shares," says Andrew Underwood, Head of Supply Chain at KPMG in the UK. "But this does not mean it is right for their businesses. Any move must be supported by an assessment of all factors associated with reshoring."

2. Challenge your assumptions

Reshoring can help companies to exert more control over their suppliers, and to rejuvenate their supplier network. But reinventing supply chains can be traumatic, disruptive and prove more of a drain on resources than forecast. Companies need to be robust about challenging the case for moving manufacturing. Do your figures still make sense if your assumptions about quality control or reliability turn out to be 5% worse than forecast?

3. Weigh every cost

Less apparent or hidden expenses – such as exchange rates, taxation, real estate, and organizational overheads, which can have a big impact on profit – must be considered.

4. Consider your key markets

One of the strongest arguments against reshoring is market access. Many offshoring hubs are fast-emerging economies with a burgeoning middle class. "You've got to think about the markets where you are likely to see growth – where you might regret pulling back," says Underwood. "If you follow the herd for short-term cost benefits, you may later find these are exactly the places you want to be." Swedish white goods giant Electrolux, for example, is still manufacturing in China and Thailand while closing plants in Australia, Europe and North America, partly because it believes that many of its future customers will be in Asia's emerging markets.

5. It's not just about the manufacturing

With recent research suggesting that by 2025 developing economies will account for nearly 70% of global demand for manufactured goods, some multinationals are taking a broader long-term view, seeking a deeper local presence in countries they previously regarded as sources of cheap labor. One Swiss corporate giant has moved on from what it described as a 'cost arbitrage' strategy for countries such as China to an 'in country for country' approach that encompasses not just manufacturing but the location of product management and R&D functions. This thinking can persuade organizations it is better to stay close to rapidly developing new markets.

6. Don't ignore sustainability

Failing to consider social responsibility can seriously damage your brand. "Awareness of sustainability means you might prefer not to ship products long distances," says Professor Ann Vereecke of Belgium's Vlerick Business School. Manufacturing close to your markets makes environmental sense. This will become increasingly important as carbon taxes rise. It will be interesting to see how Australia's expansion of the carbon tax to encompass the transportation sector impacts on supply chain costs when it comes into force in 2014.

7. Is it wise to bet everything on one country?

Reshoring may look like a viable option, but do you have to manufacture all your goods in a single market? Manufacturing in different countries might reduce the risk of being caught out by fluctuations in consumer demand, political instability, natural disasters and exchange rates. Offshoring and reshoring are not mutually exclusive.

Close for comfort? Speed to market is vital for fast-moving consumer goods retailers such as Zara

Cost analysis

The catalyst for most companies' decisions to offshore their manufacturing was cost, driven by cheap labor. Yet in many emerging economies, labor is more expensive than it used to be. Better educated workers are increasingly aware of their bargaining rights, and low-skilled labor is becoming harder to find. Wages in China, for example, have risen by 15 to 20% per year over the past four years. In comparison, US salaries have fallen by 2.2% since 2005.

The relentless automation of the manufacturing process – the International Federation of Robotics predicts global robot sales will rise by 2% to 162,000 units in 2013 – has also meant that labor accounts for a diminishing proportion of total cost. These factors have prompted several manufacturers to mull over reshoring.

But before taking the plunge and bringing production home, it's important to assess how such a move would influence costs across the business, from exchange rates and taxation to energy charges, organizational overheads and distribution. After careful consideration you may find that taking only a proportion of your manufacturing home makes the best financial sense.

Rather than pulling manufacturing out of China altogether, for example, some companies – especially textile producers – are adding another production base in a lower-cost Asian country, such as Bangladesh, Cambodia, Indonesia, Malaysia, the Philippines, Thailand or Vietnam.

To make the right decision, it's crucial to have an in-depth understanding of the exact cost to serve across each line of product and channel in your business. Much of the necessary information tends to be available within organizations' enterprise resource planning (ERP) systems, yet too many companies struggle to use this data to run effective programs and projects.

> **"The question that every company considering moving production should ask is: where are our customers?"**

Customer centric

The question every company considering reshoring should ask is: where are our customers? This was a key factor in Karen Kane moving most of its manufacturing back to the US and Mexico.

If products are mainly exported – especially to markets close to existing production facilities – reshoring could lengthen the supply chain, ramp up distribution costs and lengthen the time taken to reach the market. Do you really want to cease or cut production in a market like China where, by 2022, 630 million middle-class consumers could provide a huge potential audience for your products? As Professor Ann Vereecke of Belgium's Vlerick Business School says: "If you want to sell in China, you had better be in China. To compete you must use the same weapons as those already in that market."

"You've got to think about the markets where you are likely to see growth – where you might regret pulling back," says Underwood. "If you follow the herd for short-term cost benefits, you may find later that these are exactly the places you want to be."

Another option is to nearshore: to locate facilities in a country close to the company's base and/or key markets. Swedish furniture manufacturer IKEA is planning to start production in the US to cut delivery costs, while some British manufacturers are choosing to nearshore in Poland and the Czech Republic. For American firms, Latin America (especially Mexico) is proving particularly appealing. Siemens is focusing on Indonesia and Thailand as it seeks to expand in these emerging markets.

Speed to market is vital for producers of fast-moving consumer goods (FMCG). Spanish retailer Zara's fashion-forward reputation rests on how quickly it gets designs from the drawing board to stores: just two weeks for the 60% of products it manufactures in Europe. The remaining 'basics' – items such as plain T-shirts whose demand is less influenced by shifting trends – are made in Asian and African countries where the benefits of cheaper labor outweigh shorter lead times.

There is some evidence that consumers' spending habits have become more stop-start and less predictable since the global financial crisis, prompting companies to seek shorter, more flexible supply chains. Technology has also driven this behavior as customers test out new channels, some of which make demand more volatile, such as the rise in returns stemming from customers over-ordering online to 'try out' products.

Hazard warning

"Organizations are waking up to the challenges of offshore manufacturing in distant parts of the world – and the risks," says Underwood. Many CFOs believe that reshoring helps them manage these risks more effectively. Relying on one region can be dangerous. The 2011 tsunami in Japan disrupted the supply chains of many of the world's electronics manufacturers, while 2013 floods in Thailand shut an area that makes almost half the world's disk drives.

Yet reshoring production has its own hazards. The changeover period will cause instability in the supply chain and could disrupt orders. A manufacturer's tier-one, -two and -three suppliers may not decide to follow, meaning the component supply chain lengthens and becomes more exposed to risk. The other option is to source new suppliers, which can be very time-consuming and has pitfalls of its own, such as no shared history, contracts that may be misunderstood and differing expectations of service.

Nor should companies assume a plentiful supply of skilled labor in home markets. A 2012 survey by recruitment firm Manpower found that 81% of Japanese companies had struggled to recruit qualified technicians and engineers to fill vacancies. A shortage of appropriate labor could harm product quality.

Reputation management

Manufacturing thousands of miles away can have a profound influence on your reputation, especially if something goes wrong. It's not just the plant at the end of your supply chain: your brand is out there, too.

KPMG research has found that many global manufacturers had little confidence in their supplier risk audits, while many have looked to localize/regionalize supply chains to manage their risks better. Such concern was brought into tragic focus when a textile factory in Bangladesh collapsed in April 2013 killing more than 1,100 workers. One major UK clothing retailer, which used the plant, featured in news headlines for all the wrong reasons when protesters waved placards outside its flagship store in London. Another European brand that denied using the factory had to change its statement after its labels were photographed in the rubble.

All the firms implicated in the Dhaka incident have vowed to get a clearer view of their supply chains, but Underwood says this is "remedial and reactive. A good chunk of people are not doing enough due diligence."

The importance of R&D

Companies should not underestimate the synergy between manufacturing and R&D. The quality of products, your ability to innovate before your rivals, and how quickly you can bring goods to market are all at stake. "There is an appetite to bring manufacturing and R&D closer together," says Underwood, "but this doesn't mean all production facilities will necessarily be reshored. PZ Cussons, a London-listed healthcare and consumer goods manufacturer, produces soap bars in Eastern Europe, but reshored liquid soap to Salford, near Manchester, because it has greater value added and demands more R&D."

You also need to gauge how straightforward your manufacturing process is. The simpler it is, the easier you might find it to manufacture some distance from your R&D. If the process is complex, it may be safer and more efficient to keep it near R&D. The US is home to a third of the world's high-tech researchers, which is why so many firms whose revenue is driven by R&D are based there.

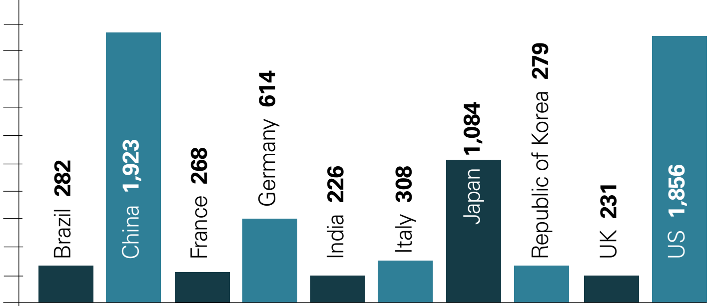
No tipping point – yet

Reshoring is in vogue but Underwood says we have "yet to reach a tipping point". Market instability means many companies are reluctant to move production at all; 97% of respondents to Area Development's 2012 Annual Corporate Survey did not expect to move a foreign facility back to the US, while 98% didn't expect to relocate a domestic production plant off shore.

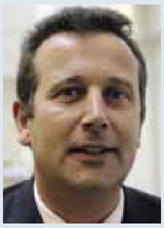
"You've got to think about likely growth markets," says Underwood. "Making a quick, trend-led decision purely on cost is very dangerous. You must carry out a full, detailed assessment of all associated costs and factors before making any changes.

"Some of the desired benefits of near-shoring – increased agility, shorter lead times and improved information flow – can be achieved in an existing company structure by a renewed focus on operational and distribution efficiency."

International comparisons of manufacturing output 2010 (US$ billion)



Source: UN National Accounts Main Aggregates Database



Andrew Underwood
Partner, Management Consulting, Supply Chain Management, KPMG in the UK
andrew.underwood@kpmg.co.uk

The key questions

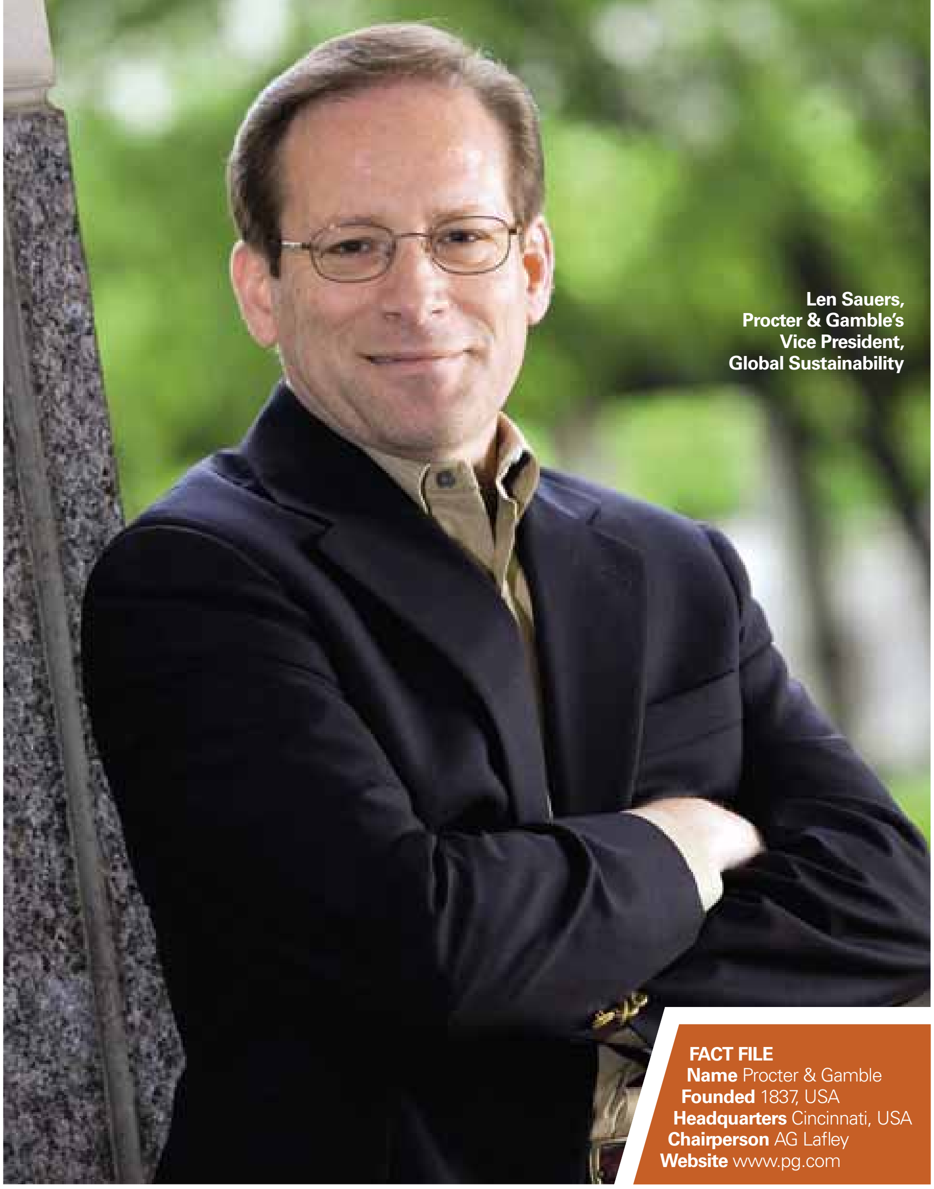
Will moving production cost or save you money?
This is the first question every Board asks but they don't always come up with the right answer. You can't just calculate wages and shipping costs. The aspects that are too often ignored – or not investigated properly – are inventory carrying costs, quality, speed of communication, government policy, impact on innovation, and travel costs. If these aren't considered, you can't get a true picture.

Will the move enhance or damage your brand?
Making products at home may help you market the quality of your products – but you have to deliver. Similarly, unless you keep close control of your supply chain, if you let cost override every other factor in your manufacturing strategy, you run the risk of a Bangladesh-style disaster.

How much confidence do you have in your supply chain?
The horsemeat scandal in the UK led some supermarkets to source their products from close to home. Horsemeat was an especially emotive issue but the wider point remains: if you have a very complex global supply chain, you run the risk of similar quality issues. The other concern for companies is resilience: some supply chains are becoming so interdependent that it is hard to isolate them from the impact of events such as the earthquake in Japan.

How significant are your logistics costs?
Cheap oil was the magic ingredient that made many long supply chains work a decade ago. That era is over, although some manufacturers have been attracted to the US by headlines suggesting the shale gas boom will slash industrial energy costs. Some sectors look set to gain more than others but, in general, it is important that companies should not exaggerate the competitive benefit to be derived from lower energy prices.

Wherever you manufacture, how easy is it to do business there?
This is one factor that is too often overlooked, even though the World Bank runs an authoritative global competitiveness index. Torsten Slok, Chief International Economist at Deutsche Bank Securities, says: "If you ask how many days does it take to open a business, to get electricity, things like that, you realize there are a lot of reasons why the business environment is much better in the US than in places where labor happens to be really cheap."



Len Sauers,
Procter & Gamble's
Vice President,
Global Sustainability

FACT FILE
Name Procter & Gamble
Founded 1837, USA
Headquarters Cincinnati, USA
Chairperson AG Lafley
Website www.pg.com

Sustainable strategy

Procter & Gamble's rigorous goals to minimize its carbon footprint are good for the planet – and for the FMCG giant's bottom line

Len Sauers, the Vice President for Global Sustainability at Procter & Gamble, has a job on his hands. He leads an organization that has to find ways to: power its manufacturing plants with 100% renewable energy; use 100% renewable materials in its products; ensure no consumer waste goes to landfill; and deliver products that have a smaller carbon footprint.

Procter & Gamble is a US$84 billion business with 140 factories worldwide. It has 25 brands that generate over a billion dollars in annual sales. And it tasks its workforce with innovating and acting to make every day better for people and the planet.

Sustainability is a priority for Procter & Gamble, even in uncertain economic times. Its sustainability program has brought US$1 billion to the bottom line over the past 10 years through smart use of manufacturing waste materials. For example, the company has sold diaper manufacturing waste for use in cement products. Currently, 50 of the multinational's manufacturing sites send no waste to landfill, while 96% of the raw materials leave in its products. The rest is either recycled (3%) or reused. The roof tiles at some of its sites are made from paper refuse.

Sauers, who has a PhD in toxicology, began his Procter & Gamble career 26 years ago as a toxicologist. He has since taken on roles of increasing responsibility in the areas of biotechnology, human and environmental toxicology, and regulatory affairs. "P&G has always seen value in having someone with a technical background lead our sustainability work," he says, "so when the job opened up, I had the right skill set to step in."

> **"At P&G there is a directive that sustainability be a part of everyone's job"**

Companies that prioritize sustainability understand the challenges and the business benefits. Business leaders like Sauers are accountable for outcomes, whether meeting greenhouse gas reduction targets or managing waste water. "Focusing on sustainability can drive business success because it can inspire companies to devise new solutions," he says. For instance, reducing its blades and razors packaging saves Proctor & Gamble over US$1 million annually, while making the products easier to open.

Sustainability issues can still be a hard sell at board level, but they are increasingly becoming a core component of doing business. "Sustainability investments must deliver the same return as other business units," Sauers says. Companies leading the way on sustainability issues seem to have one trait in common: they integrate the financial, social and environmental risks and opportunities around sustainability as they would any other aspect of their business – that is, without special treatment.

Only four years ago, Procter & Gamble faced rising commodity prices and slow growth in some developed markets. Yet sustainability was still seen as a way to build profitability. The company had begun to put a price on waste and greenhouse gas emissions attributable to products, from production to use by consumers. Its environmental vision added value and boosted the bottom line. These goals were incorporated into Procter & Gamble's annual US$2 billion R&D budget, driving environmental innovation.

What is Procter & Gamble's secret?

"All company leaders are involved in sustainability decisions," says Sauers, "and there is a directive that sustainability be a part of everyone's job."

He doesn't get a free pass on his ideas. When he sought to replace foam-based packaging with a renewable material, such as haircare brand Pantene's bio-resin bottle, he met with finance to explain why it made sense to switch to something that cost 20 cents more per pound. The time frame for return on investments is a stumbling block sustainability officers must overcome. "You have to go in with a business case," he says. "I want us to move from a petroleum product to renewables because they use fewer greenhouse gas emissions in their production."

As laudable as that goal sounds, it isn't enough to swing the board. Sauers also has to put numbers on business risk and brand value, something finance people understand. "Renewable materials can give you more flexibility in materials supply," he says. "It can be this factor that a consumer is responsive to and that drives a purchase decision."

Procter & Gamble's sustainability strategy is ambitious. Sometimes fulfilling it is a matter of detail. When managers studied the use of laundry detergent, they found that the environmental impacts differed between the developed and developing economies.

"If I think of the developed world and I look at the laundry sector, energy is the main sustainability theme. Hot water washing of clothes accounts for 4% of the total energy use in the United States," says Sauers. "If we look at the developing world, under laundry, water drives the footprint."

This analysis has driven the development of products such as Downy Single Rinse, in which one rinse provides the same performance as the traditional three-stage process. In regions where household water can be several hours' walk away, the product also saves time and effort.

5 key steps to a greener Procter & Gamble*

$52 billion	sales of sustainable innovation products (US$2 billion over target)
68%	reduction in absolute waste in last five years
14%	drop in water use
8%	fall in energy consumption
11%	cut in carbon dioxide emissions per unit of production

*Achieved from 2007 to 2012

As Sauers works on attaining Procter & Gamble's 12 new 2020 goals, he says he has come to realise that long-term partnerships are integral to success. In 2013, the company joined forces with companies including Heinz and Nike in the Plant PET Technology Collaborative to develop plant-based plastics. The aim of the group is to replace conventional plastic made from fossil fuels with plant-based versions, which would significantly reduce the environmental impact of plastics manufacture.

Although businesses such as Alcoa, Google and Procter & Gamble have embraced sustainability through investments and decision-making, many companies in the Standard & Poor's 500 lag behind on such efforts. Luckily, more firms are moving in the right direction by creating alliances and making sustainability part of everyone's job. The investments Procter & Gamble has made, on Sauers' watch, prove that being good for the planet can pay dividends. That's one win-win CFOs would be foolish to ignore.

One of Procter & Gamble's key sustainable goals is reducing the environmental impact of its products

Vincent Neate, Head of climate change and sustainability at KPMG in the UK

Make a business case for sustainability
How easy it is to do this depends on the sector and the sustainability issue. For Procter & Gamble, making a business case for saving energy and water wasn't too difficult, because efficiency measures save resources and money.

There are more complex issues, such as providing healthcare in developing countries. Convincing someone that teaching about cleanliness and health activities is a good investment is a life-changing thing to do.

Sustainability can improve a firm's image
Companies and brands that have fallen foul of sustainability issues have had their reputations badly damaged. Undertaking a sustainability program is, therefore, about getting things consistently right, and ensuring your business activities won't harm your brand's reputation.

Believe in sustainability and your strategy will succeed
Any sustainability program must be driven by your company's desire to actually do good, not just appear to be doing so. If you believe in sustainability, make it integral to everything you do. Then there's no risk of you sacrificing sustainability principles when things get tough.

Measure the difference you are making
Although it's easy for companies to measure inputs, activities and outputs, it's significantly harder to measure what the impact of a sustainability program is on the local community. That really is the Holy Grail of sustainability programs: to measure and understand the positive impact your activities are having.

Moby: musician, producer and open-source pioneer

BOTTOM LINE

1 Be strategically vigilant
The internet creates new products and services, kills existing ones and accelerates the pace of change. In IT, it's a case of survival of the fastest – that may soon be true for music and retail. CEOs must look ahead, be strategically nimble, and ready to innovate with new business models.

2 Weigh risk and reward
When transformational change beckons, it can be easier to quantify likely losses than potential revenue from completely new products and services. The winning companies will be those whose goals are not impeded by a legacy mindset.

3 Put the customer first
Are you providing the service your customers need – or one that is convenient for you to offer? The labels' past focus on traditional formats and outlets let new entrants flourish. Many retailers are struggling to create a multi-channel strategy that lets consumers buy what they want, when, where and how they choose.

Remaking music

With the internet poised to transform retail, the record labels' experience of the digital revolution could well prove instructive

The most intriguing aspect of Moby's new album *Innocents* isn't the music, it's the fact that the musician – credited with helping bring electronica to the musical mainstream – has open-sourced the drum, guitar and keyboard parts so fans can remix his songs. So far, Moby's bundle of music has been downloaded two million times from BitTorrent and 21,000 fans have remixed his music to suit their personal taste.

Innocents is the culmination of a revolution that started in 1979 when Sony launched the Walkman portable cassette player. The success of this device – and the CD version launched in 1984 – proved that consumers were willing to pay to play music where and when they wanted to, integrating their favorite songs into their everyday lives.

Yet this revolution had limits. Even with the Walkman, music still had to take a physical form (cassette or CD), be bought from a store – principally in a format (the album) that was profitable for the labels – and the CD player, though portable, was still hefty.

The internet changed all that. With digital files, physical products were a choice, not a necessity. Artists could circumvent record labels by distributing music from their websites as Radiohead did, selling 1.25 million copies of their album, *In Rainbows*, this way.

The major labels, having invested millions in the 1980s in digitizing their music for CDs, initially saw the internet as a threat, rather than an opportunity. Their business model had been built on revenues generated by the album format. Millions of consumers still liked albums, yet many others preferred to download, share or rent music – and were happier paying 99 cents for a song than $20 for an album with a few fillers.

Anxious not to cannibalize their existing business, the labels allowed 'outsiders' such as Napster and Apple to drive this digital revolution. Then in 2000, global recorded music revenues began to decline – and kept declining until 2012 when they grew, by 0.3%, to US$16.5bn.

To be fair to the labels, the disruptive power of the internet was not obvious. The major known unknowns included: how severely it would hurt traditional music retailers, what kind of consolidation it might trigger among the labels, and how artists would view this revolution. And despite repeated predictions of the CD's demise, CDs still accounted for 57% of the industry's global revenue in 2012, compared to 35% for digital, the fastest-growing sector.

Like many large companies forced to reinvent their business in a hurry, music labels initially found change easier to articulate than to execute. Defining a new strategy was tough. Aligning leaders and divisions behind that strategy, measuring – and reacting to – success or failure and changing behavior was even harder.

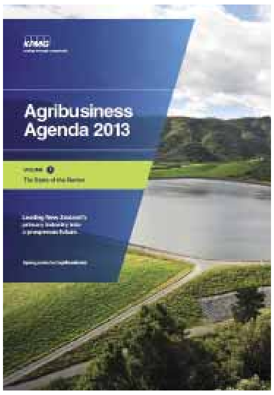
Music is now everywhere – and the labels are profiting from new revenue streams. Some have invested in Spotify, a service with six million who subscribe to stream music rather than purchase it. Sony and Universal Music partly own Vevo, the biggest music video outlet on YouTube, on which Miley Cyrus's latest video generated a record 19.3 million views within 24 hours. Some have also negotiated deals to take a cut of their artists' total income, including revenue from merchandizingand live performances.

Moby's fans can remix his album for free, but if his innovation succeeds, artists, companies like BitTorrent and labels could charge consumers to personalize the music they love. Rock and roll is an unlikely open sourcing pioneer but such initiatives suggest the industry is rediscovering its mojo.

Insights

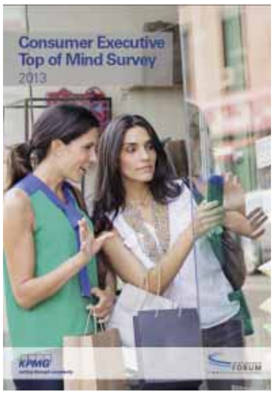
KPMG member firms provide a wide range of studies, analyses and insights for the Retail and Food, Drink and Consumer Goods (FDCG) industries. For more information, please visit **www.kpmg.com/retail** or **www.kpmg.com/FDCG**.

Other publications



Agribusiness Agenda 2013
The series tackles the big issues facing agribusiness in the areas of biosecurity, markets, community, water, regulation, people, the meat sector and sustainability.

Intellectual Property Rights Study
This report examines current consumer attitudes in Hong Kong and Macau towards the purchasing of counterfeit goods.



Consumer Executive Top of Mind Survey 2013
This survey identifies the top priorities for consumer executives in the areas of growth, operations, responsibility and regulation.

Focus on Consumer Goods
This UK multimedia magazine looks at some of the greatest threats to the Consumer Goods sector, including the impact of harmonization on innovation and tactics for beating cyber crime.

kpmg.com/app

Download on the App Store

kpmg.com

Contacts

Global contacts

Willy Kruh
Global Chair, Consumer Markets
+1 416 777 8710
wkruh@kpmg.ca
KPMG International

Dan Coonan
Global Executive, Consumer Markets
+44 20 7694 1781
daniel.coonan@kpmg.co.uk
KPMG International

Mark Larson
Global Head of Retail
+1 502 562 5680
mlarson@kpmg.com
KPMG International

Elaine Pratt
Global Marketing, Consumer Markets
+1 416 777 8195
epratt@kpmg.ca
KPMG International

Regional contacts

Patrick W. Dolan
Americas
+1 312 665 2311
patrickdolan@kpmg.com
KPMG in the US

Nick Debnam
Asia Pacific – Consumer Markets
+852 2978 8283
nick.debnam@kpmg.com.hk
KPMG in China

John Morris
Europe, Middle East and Africa
+44 20 7311 8522
john.morris@kpmg.co.uk
KPMG in the UK

George Svinos
Asia Pacific – Retail
+61 (3) 9288 6128
gsvinos@kpmg.com.au
KPMG in Australia

Country contacts

Julie Fahey
+61 (3) 9288 5791
juliefahey@kpmg.com.au
KPMG in Australia

Ramesh Srinivas
+91 80 3065 4300
rameshs@kpmg.com
KPMG in India

Daryll Jackson
+27 (11) 647 6895
daryll.jackson@kpmg.co.za
KPMG in South Africa

Carlos Pires
+55 11 2183 3148
capires@kpmg.com.br
KPMG in Brazil

Wah Meng Gan
+02 6763 2445
wgan@kpmg.it
KPMG in Italy

Carlos Peregrina Garcia
+34 91 456 3516
cperegrina@kpmg.es
KPMG in Spain

Jessie Qian
+862 1 2212 2580
jessie.qian@kpmg.com
KPMG in China

Akihiro Ohtani
+81 3 3548 5804
akihiro.ohtani@jp.kpmg.com
KPMG in Japan

Stephane Gard
+41 21 345 03 35
sgard@kpmg.com
KPMG in Switzerland

Eric Ropert
+33 1 5568 7190
eropert@kpmg.fr
KPMG in France

Jasper de Grauw
+31 206 568568
degrauw.jasper@kpmg.nl
KPMG in The Netherlands

Liz Claydon
+44 20 7694 3483
liz.claydon@kpmg.co.uk
KPMG in the UK

Mark Sievers
+49 (40) 32015 5840
marksievers@kpmg.com
KPMG in Germany

George Pataraya
+7 (495) 937 4446
gpataraya@kpmg.ru
KPMG in Russia

Missed an issue of *Consumer Currents*?

Back issues are available to download from:
www.kpmg.com/consumercurrents

kpmg.com/socialmedia

Photography and illustration: Procter & Gamble, Lego, Bloomberg/Getty Images, Peter Kramer/NBC/Getty Images, Thinkstock, Ian Dutnall, Bukajlo Frederic/SIPA/Rex Features, Apple, iStock, Shutterstock, LFI/Photoshot, Carl Daniel Cox, Vectorportal

Publication name *ConsumerCurrents*
Published by Haymarket Network Ltd
Publication no 130870
Publication date January 2014
Pre-press by Haymarket Pre-press
Printed by RR Donnelley