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CONSUMER CURRENTS

"THE CONSUMER GOODS INDUSTRY HAS SELDOM CHANGED SO FAST OR IN SO MANY DIFFERENT WAYS AT ONCE"



WILLY KRUH
Global Chair, Consumer Markets
KPMG International

 @WillyKruh_KPMG

As Warren Buffett once said: "It takes 20 years to build a reputation and five minutes to ruin it." For companies in the consumer goods industry – whether they be brands or retailers – trust is the foundation of customer loyalty. And two distinct trends are making trust more critical than ever.

The first is demographic: the rise of the Millennial generation, an issue we explore in this edition of *ConsumerCurrents* on p14. People may disagree about the exact age range for this generation but everybody agrees that they are already having a profoundly disruptive impact on the consumer goods industry. The disruption is caused, in part, by their sheer spending power – one brand expert predicts that, by 2017, they will spend US\$200bn in the US alone – but also by the way they buy. A recent *Forbes* magazine study found that 1% of them are influenced by advertising, but a third consult a blog or peer review before making a purchase. There is conflicting evidence about how loyal Millennials are but the message that consistently comes through in research is that they want to relate to a brand – not just on social networks – and are curious about the story behind a brand. So, for example, the chocolate maker TCHO, who we profile on p20, has a story to tell about the way it uses science and technology to improve the quality of the cacao it buys from its farmers. On the flipside, Millennials can be volatile and are likely to shun brands with bad stories. It would only take a calamity in the supply chain, a bad review on social media or a cyber attack that leaks shoppers' credit card details and trust could be lost even faster than Buffett suggests.

The second trend is technological. In an age of e-commerce, contactless payments and the Internet of Things, brands and retailers need to think hard about how they protect the data customers share with them. According to Trustwave's 2014 Global Security Report, retailers were the target of 35% of the cyber attacks they monitored, while food and drink companies were victims of 18% of breaches.

The real damage caused by these incidents goes far beyond the investment needed to rebuild systems, the potential financial cost of compensation and the size of any fines levied by the authorities. What's really at stake comes down to one brutal question: can your customers – and, indeed, your potential customers – still trust you? Cyber crime cannot simply be dealt with by building the biggest, most sophisticated, state-of-the-art firewall. This is a risk to every part of your business and so, as we discuss on p10, every member of staff needs to understand how to protect the organization.

The world's consumer goods industry has seldom changed so fast or in so many different ways at once. And many aspects of that disruption are reflected in this edition. I hope you find this *ConsumerCurrents* insightful – and useful.

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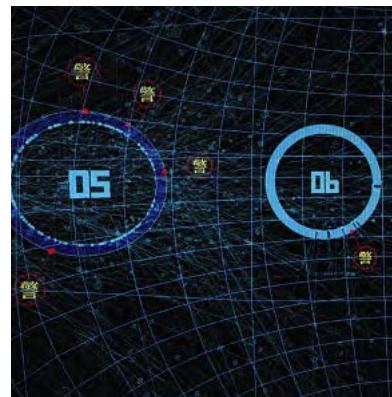
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INCUBATE TO INNOVATE

Manufacturers and retailers are founding their own labs and teaming up with start-ups as they seek to kick-start creativity



What can brands and retailers learn from the passion for innovation that made Jobs – and Apple – so successful?

As the late co-founder and CEO of Apple, Steve Jobs, once said: “Innovation distinguishes between a leader and a follower.”

The company proved his point by revolutionizing IT and the music industry.

To avoid getting left behind by the tech giants, many brands and retailers are investing in, acquiring or partnering with start-ups or creating innovation labs, many inspired by Jobs’ approach, which

biographer Brent Schlender described as “hiring talented people, having them work in small groups on specific projects and giving them a lot of latitude.”

Office supplies group Staples has opened three labs, with 170 staff, to ramp up its e-commerce drive and recently deployed a new app using Apple Pay. Labs have been founded by the likes of Amazon, Deckers Outdoor Corporation, Sears, Visa and Westfield Group.

DATA DRIVEN

Number-crunching innovation

40,000ft²

Area Westfield Labs devotes to high-tech retail experiments

US\$1m

Amount Patagonia has invested in Swiss firm BST

13.2%

Percentage of revenue Google invests in R&D

US\$9.1bn

Amount Amazon is said to have spent on R&D last year

Sources:
Adweek, Patagonia,
Fortune, Amazon

High-end department store Nordstrom has bucked the trend. It set up a lab four years ago, but now retains only a core team, preferring to foster innovation throughout the company.

For some, open innovation is the answer. Food and drinks giant Strauss has been chosen by the Israeli government to set up an ‘incubator’ for promising food technology start-ups, which will share its knowledge of consumer needs and support R&D.

In similar vein, high-end outdoor clothing company Patagonia partnered with Yulex, a latex-free rubber supplier, to create an eco-conscious wetsuit that is 60% bio-rubber and retails at US\$500. The clothing firm is also investing in Swiss company Beyond Surface Technologies (BST) to reduce textile chemicals’ environmental impact.

Such alliances can help solve one issue: the war for talent. Persuading the best engineers and developers to work in the consumer industry, rather than for tech giants in Silicon Valley, can be tough. Visa recently opened an innovation center in San Francisco, to help hiring and immerse itself in high-tech culture.

“Innovation is partly about listening to the market, sensing the changes and taking the appropriate action,” says **Mark Larson**, KPMG’s Global Head of Retail. “Manufacturers and retailers need to make sure they have the structures – or relationships – in place to do that.”

It can be hard to define the return on investment for such projects but many brands and retailers are convinced that innovation is the key to their prosperity.

Nexttech Nanotechnology

Prevents staining, repels odors and kills bacteria: this may sound like a commercial for laundry detergent, but nanotechnology is gaining attention from clothing manufacturers and could soon revolutionize the industry.

Changing the definition of “wearable technology,” nanoparticles can be woven into

or sprayed onto fabrics, enhancing their characteristics. Silver nanoparticles release positively charged ions that kill bacteria and combat odors, while silica nanoparticles create a waterproof surface and prevent stains. Called the ‘lotus effect’ – because the leaves of a lotus plant repel water – liquid forms into beads that roll off fabric rather than soaking into it.

Titanium dioxide and zinc oxide nanoparticles – already used in sunscreens – protect the skin from damage by blocking ultraviolet rays.

“The commercialization of nanomaterials and nanoparticles is a radical concept for the retail industry,” says **Edge Zarella**, KPMG in China. “Yet, compared to wearable devices such as smart watches and Google Glass, it has

been largely ignored by the media.” Nanofibers will also create ‘intelligent fabrics’ that will respond to the body and its environment, warming or cooling it down.

There are safety concerns – further research is needed into the effects of silver nanoparticles in the environment – but nano-enhanced clothing looks set to become part of our everyday lives.



THREE SECONDS TO FIND THE SWEET SPOT

With shoppers deciding what confectionery to buy in an instant, how do brands ensure they break through the in-store clutter?

Consumers are exposed to more than 3,000 in-store marketing messages, yet the average shopper spends just three seconds deciding whether they will buy a confectionery brand. As many as 82% of purchase decisions are made at the shelf, according to research by shopper marketing agency Saatchi & Saatchi X.

In 2014, the global retail value of confectionery sales reached a record US\$198bn, up US\$4bn from 2013. Sales are growing, yet so is competition. With 30,000 new confectionery SKUs launched each year, how can brands maximize every second to catch a shopper's eye?

Standing out from the competition is key for all brands. Merchandising is the first step. Innovative, eye-catching and brightly colored packaging will enhance the shopper's sensory experience.

As confectionery is a top impulse buy, outlandish promotions can help capture attention. Print Cates, Vice-President of Development at US candy supplier J. Sosnick & Son, said: "Merchandising doesn't start at the ground floor, it starts at the ceiling and drips." Some brands have gone further, with Cadbury creating a Willy Wonka-style factory in a mall.

New formats – sharing bags or tablets of chocolate – can help. Yet sometimes, the brands themselves need to stand out. Dina Howell, Chief Executive Officer of Saatchi & Saatchi X, advises brands to appeal to shoppers' emotions, noting that

Twinkies had made a strong comeback in the US by reviving memories of childhood.

Fabien Lussu, Partner and Head of Consumer Markets of KPMG in Switzerland, says: "The key to success can be making a product's purpose clear. For example, Barry Callebaut is developing a dark chocolate that is good for the heart. The cocoa flavanols help maintain the elasticity of blood vessels and helps with blood flow."

Positioning and availability are key. Brands must work with retailers to ensure stock is in-store and displayed at eye level. If shoppers can find a product easily, they are less likely to buy a rival brand.

Traditionally, checkout lanes were the ideal spot for impulse purchases such as confectionery. Yet this positioning is under scrutiny in the UK. Many supermarkets have banned sweet treats from checkouts in response to concern about levels of obesity. Some US supermarkets have done the same and New Zealand could follow – 34% of Kiwi shoppers have called for confectionery-free checkouts.

Confectionery sales tread a fine line between customer loyalty and impulse buys. "The battle among confectionery brands to be noticed in store can only get more intense," says **Trent Duvall**, KPMG in Australia. "The winners will get the basics right while experimenting with new brands, limited-release flavor varietals, pack sizes and pricing strategies."

TREND SPOTTING



Why RFID matters

With the boom in omnichannel and online shopping, it's more important than ever to know where your stock is, says **Julio Hernandez**, Global Customer Lead for KPMG's Customer Center of Excellence

Radio frequency identification (RFID) will revolutionize the availability of stock and reinvent the shopping experience. Offering complete visibility of inventory, stock can be located anywhere in the supply chain, helping customers find products faster, eliminating shrinkage and reducing theft. Although RFID has long been used by the consumer industry to track inventory and shipments, the application of this technology to individual products is what will really make the difference.

RFID is made up of a smart electronic tag, which contains a unique number that describes the product; a reader, which sends a radio signal to the tag; and a central database. The reader sends the tag's location, and a date and time stamp to the database and, based on this knowledge, inventory is tracked.

Stores around the world have deployed RFID. Footwear retailer Deckers Outdoor Corporation, through its UGG Australia stores, and athletic retailer lululemon are using the technology to give customers access to online inventory.

RFID is even helping e-tailers into bricks-and-mortar stores. In New York and San Francisco, eBay has collaborated with fashion company Rebecca Minkoff, providing the technology for 'magic mirrors' which use RFID to identify items in changing rooms. These mirrors can then show alternative sizes and colors, and offer intelligent recommendations. This opportunity to cross-sell and up-sell to consumers helped eBay report profits of US\$622m between March and June 2014.

In the future, consumers will be able to instantly buy these items, reducing wait times at checkouts and enhancing the retail experience. RFID can also be linked to loyalty cards and apps, but RFID alone cannot transform the customer experience. There is more value when it is underpinned by data analytics.

Andy Robson, GS1 UK Supply Chain Solutions Manager, says standardization is imperative: "It allows retailers to talk to their suppliers wherever they are in the world. They can ask suppliers to fit electronic product code (EPC) tags, confident that it can be read wherever they are in the supply chain."

"Auburn University, which runs an RFID lab in Atlanta, US, estimates that RFID's return on investment is one to four years. Marks and Spencer, which has been using RFID for 12 years for general merchandise, has evidenced that there is a clear ROI."

"General merchandise is the key driver for RFID, but as sustainability becomes more important there will be applications in the grocery industry too. RFID could be used for expiry date management, cutting the need to manually check stock."

"RFID HAS A MUCH MORE PROFOUND IMPACT WHEN COMBINED WITH DATA ANALYTICS"



“UNTIL THEY
WORK OUT A
WAY TO DELIVER
FUEL ON THE
INTERNET, WE’RE
IN GOOD SHAPE”

Tom O'Brien, CEO of United Petroleum, explains how its unusual business model and aggressive pricing have made it such a success with Australia's shoppers



Know your customer. It's a mantra that seems absurdly simplistic, yet it's all too easily forgotten amid the turmoil of the rapidly shifting oil and gas marketplace. For Tom O'Brien, however, customer focus remains the key determinant of growth. Even as global prices have taken a downturn, the CEO of United Petroleum remains unflappable, probably because its vertically integrated supply chain and focus on shifting merchandise have distanced the business from relying on unpredictable income from fuel alone.

United's business model is unorthodox, but so far it seems to be working. Founded in 1993 as an independent chain of service stations and convenience stores in South Australia, it now operates right across the country. Crucially, it also owns fuel import terminals which allow it to control the majority of its oil supply chain and sell fuel to rivals.

But United – which has been valued by analysts at about AUS\$1 billion (US\$775m) – is no longer alone. 7-Eleven and Woolworth's are gaining traction in the same space, and Australia's subdued economic growth is causing concern for some. Price, O'Brien tells *ConsumerCurrents*, will become the key battleground. Four times a day each of United Petroleum's stations, all of which are franchises, sends someone to check prices at local competitors. These are entered into a central management system, which applies an algorithm and sends guidance back to the station. Will it be enough to help United win the price wars?

It has been a turbulent period, both for Australia and for the oil industry. What matters most in your business at the moment?

GDP growth and retail sales growth are important, but our business is slightly skewed because we deal in a commodity. Revenue is very much dictated by the value of that commodity, which is fluctuating quite dramatically on the international market, and has an impact in Australia, too.

Over the past 12 months, for example, the value of that commodity has fallen by more than 50% at times. United Petroleum's revenue is somewhat misleading: 25% of our business is more or less merchandise. The products that we sell in our stores are very much a revenue-driven business. Generally speaking, increased growth in sales is good for the bottom line – and in terms of the fuel, which is 75% of my business, this is a volume issue.

I'm constantly looking at trying to grow our volumes and I'm looking at around 10% growth per annum. But our business is still far

from mature. We're getting growth not just through like-for-like sales, but through organically growing the size and scale of the business, too.

You've picked up numerous awards from your customers. How do you keep them satisfied?

We know our customer base, and we're at the price-conscious end of the market. Outside a service station, we are obliged, as are our competitors, to inform the public of what price we're selling each grade of our fuel for. This is what entices our customers into the store.

We are generally very aggressive on price. We have a very lean operating model. All our stores are on a franchise basis, and we have about 250 employees nationwide, which is pretty lean for a national network. We obtain most of our fuel, at least two-thirds, from some of the most competitively priced refineries in the Asia Pacific. Hopefully, soon it will be closer to four-fifths.

What drives customers into the stores?

We're appealing to the price-conscious consumer who compares local prices. If you drive in any neighborhood here and you compare the prices at the various sites, you will find that we are typically equal to the lowest – or we are the lowest – in terms of fuel prices.

We don't necessarily have a better range inside the store, but we are trying to compete on the merchandise front too. We're always trying to improve our offering.

7-Eleven is an expert convenience store operator. We aspire to its convenience offering. But in terms of the fuel, and in terms of pricing, we absolutely nail it. That's what our customers like.

How would you describe your pricing strategies?

We pride ourselves on our model of monitoring competitor prices, which we do on a very localized basis. Every single one of our store operators literally goes out to check the prices in their neighborhood. We give them a specific set of service stations to monitor.

We have certain protocols for changing the prices accordingly. Nationally, we're monitoring the price at all of our competitor sites four times a day and reacting to it accordingly. This is different to the system that our competitors use.

The other national networks have come into some trouble with the market regulator, the ACCC (Australian Competition and Consumer ►



Tom O'Brien became CEO of United Petroleum in 2013. The group is the official fuel supplier to the V8 Supercars Championship and has a range of own-brand products

Commission), because a company conducting its own national monitoring has been feeding those prices to our competitors, who are all using this central system. The ACCC says this could be potentially described as price collusion.

From our inception, we have used our own mechanism because we want to compete not just on a regional or a state basis, or even on a national basis. We want to compete literally in the local neighborhood where our customers have a choice between a specific set of service stations.

In many ways, our business is old school. We could allude to electric cars and hybrids but until they work out a way to deliver fuel on the internet, we're in good shape.

How do you see the outlook for the market in the longer term?

Certainly on the fuel side, there's not much escape from it, as people use it either domestically for social or recreational, or for commercial purposes. There really isn't a lot of alternative at this stage, and especially in a country such as Australia, where people are more or less tied to their vehicles.

We've just been through a price cycle where the fuel price was very high last year and has now come down quite significantly, and we don't see a major impact on fuel volumes as a consequence. But we find that discretionary spending power – this means our merchandise in the convenience store – increases when the price of fuel is lower.

What are the challenges on your horizon as an organization?

We're looking at the general economic conditions, just as every other retailer is. There are inputs into consumer spending that do impact our sales revenue.

Although there's a bit of doom and gloom, the economy here is still growing. Our fuel station business is still relatively young and not a mature business. Equally, the country is not a mature country yet. It's still growing. There's population growth, there's infrastructure growth and there's a huge commodity base.

The media, in particular, are very heavily focused on commodity prices and iron ore, which is one of the biggest exports from this country. The relative value of the Australian dollar versus the US dollar is a key metric the media uses to decide the status of the economy. I'm not sure if it's absolutely correct, because commodities only contribute approximately 10 or 12% of the economy.

The tax space is a concern, certainly. Australia is a relatively heavy tax space and compared to some of the problems the European economies are having, the deficit here is very modest – I believe it's 15% of GDP.

What sort of changes are you planning to your own business model?

One is the restructuring of the fuel business itself. We have, in the past five years, followed what has happened in Europe and to a certain extent in the US, whereby the marketer and distributor of fuel is being replaced by specialist retailers. Traditionally, major integrated oil companies had control of the entire supply chain right from exploration, digging it out of the ground, refining it, delivering it, distributing it and then retailing it in service stations.

When Mobil exited [Australia], it was replaced by 7-Eleven. And that's probably a great example, as it is a specialist convenience retailer. Shell recently left the country, so BP is the one major oil company left here following the old integrated model. Over the past decade, it's lost market share from 20% to 13%. Frankly, there's a big question mark over how long BP will remain in this marketplace.

"WE PRIDE OURSELVES ON

OUR MODEL OF MONITORING

COMPETITOR PRICES. OUR

STORE OPERATORS CHECK THE

PRICES IN THEIR NEIGHBORHOOD"

Once they depart – and my prediction is that they will – the whole industry will have been transformed from a major oil company model to so-called specialist retailers. This is a fundamental change that will be positive for us because we do put ourselves in a lean, specialist, consumer-focused retail model.

The other fundamental change is the retail changes that are happening. The marketplace is becoming more consolidated into three major categories.

One is your 'big box' multi-outlet that has every retailer you can imagine in one single location. A consumer might go there to meet a whole variety of their shopping needs. This is very big in the US and in Europe. Increasingly, supermarket groups like Coles and Woolworth's are playing in our marketplace and following that model.

Then there's internet shopping, which is growing here significantly, and that will continue. I don't see any reason why that would change.

The third major one is the convenience element. This is increasingly where fuel retailing is moving to, where consumers can shop to supplement with convenience items. For example, we have a line at the moment of pet food and pet accessories. It's amazing how many people will buy that in a convenience environment. Because we have the fuel which people are tied to, we have an immediate magnet to attract a potential convenience shopper.

7-Eleven is getting adept at digital and mobile marketing and using that to drive people into their stores. Where do you stand on that?

Currently, I think we feel deficient in that area but we're rapidly learning and playing catch up. It's something that we haven't focused on previously but now it's becoming our biggest challenge and part of our major strategy.

We can really enhance our revenue stream by upping our performance in that merchandise category. I think electronic media, for example, or connectivity with your consumer is a critical part of that. Currently we have an initiative where a consumer can log on to our website from a mobile device and can find out where the nearest United station is, just by pressing a button. That type of information is one of the first ways to get consumers to our stores.

How do you see the regulatory landscape?

This country is really tightly regulated. Health and safety and food safety issues are industry-wide, heavily monitored and are front and center to every retailer's strategy.

Environmental safety is very much an issue for us. Indeed, since we are handling dangerous goods, we need to pay particular attention to it, but we have an excellent track record in that respect. We have every single site audited on a monthly basis and scored. Health and safety is very important. This is a business control mechanism, especially since we are having these stores operated by non-company employees.

In terms of sustainability, we are the only fuel retailer in Australia that owns and operates an ethanol refinery. There are only three ethanol refineries in the country and in two of these, the ethanol is produced as a byproduct of other processes.

We retail fuel with a 10% ethanol component, and all of that is produced from grains that are grown in Queensland, in the area around the refinery itself. So, we believe that that is a step in the right direction from a sustainability perspective. New South Wales Government does have an ethanol mandate in place so all retailers have to abide by that.

It's an economic strategy, but it's also an environmental strategy and I'm surprised that it's not more heavily part of the political agenda here, as it is in Europe. ■

There are two types of big companies – those who've been hacked, and those who don't know they've been hacked

Protecting an organization from cyber attacks is more than just a technological challenge. Commitment from the top, instilling the right culture and identifying your weak spots are all essential

The way manufacturers and retailers think about cyber security is changing – and it needed to. It is becoming increasingly clear in boardrooms across the globe that cyber protection isn't just a matter of controlling business/financial risk. Breaches could have serious long-term implications for customer trust, with reverberations that could be felt long after the initial fallout and financial clear-up have been dealt with.

A single but devastating incident in which customer details, payment information, quality or continuity of service are compromised, could prove a traumatic test of customer confidence.

Cyber attacks used to be something that banks and sensitive government organizations worried about. Yet, as more retailers and consumer brands move their activities online,

and connect up their IT systems and other infrastructure over networks, the opportunity for attackers has multiplied – gone viral, if you will. The more difficult financial and national defense organizations make it for cyber criminals, the greater the temptation for hackers to look for weaknesses elsewhere.

Customer loyalty programs, detailed marketing databases, online payment information – all are highly prized assets in the wrong hands. Tales of costly breaches are in generous supply. One of the most expensive in the last decade was the attack on a major US retail group which, in 2007, revealed that more than 45 million of its customers' credit and debit card numbers had been stolen over an 18-month period. The fallout from this event cost the business US\$250m. Only two years

ago another major American retailer suffered an attack of similar magnitude and cost.

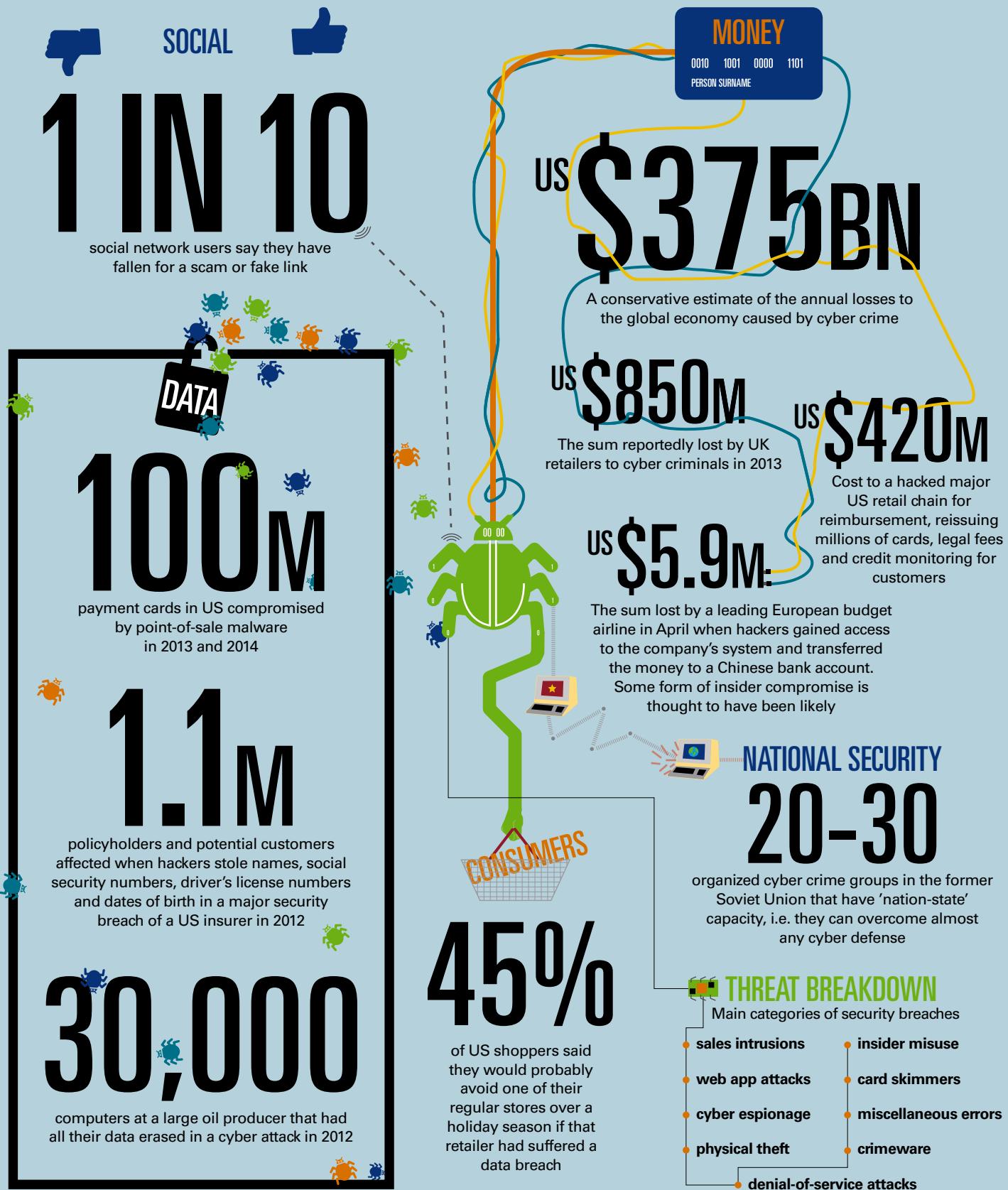
In its 2014 publication, data security provider Trustwave reported that retailers were the target of 35% of the cyber attacks they monitored, while food and drinks companies were victims of 18% of breaches.

Size doesn't matter

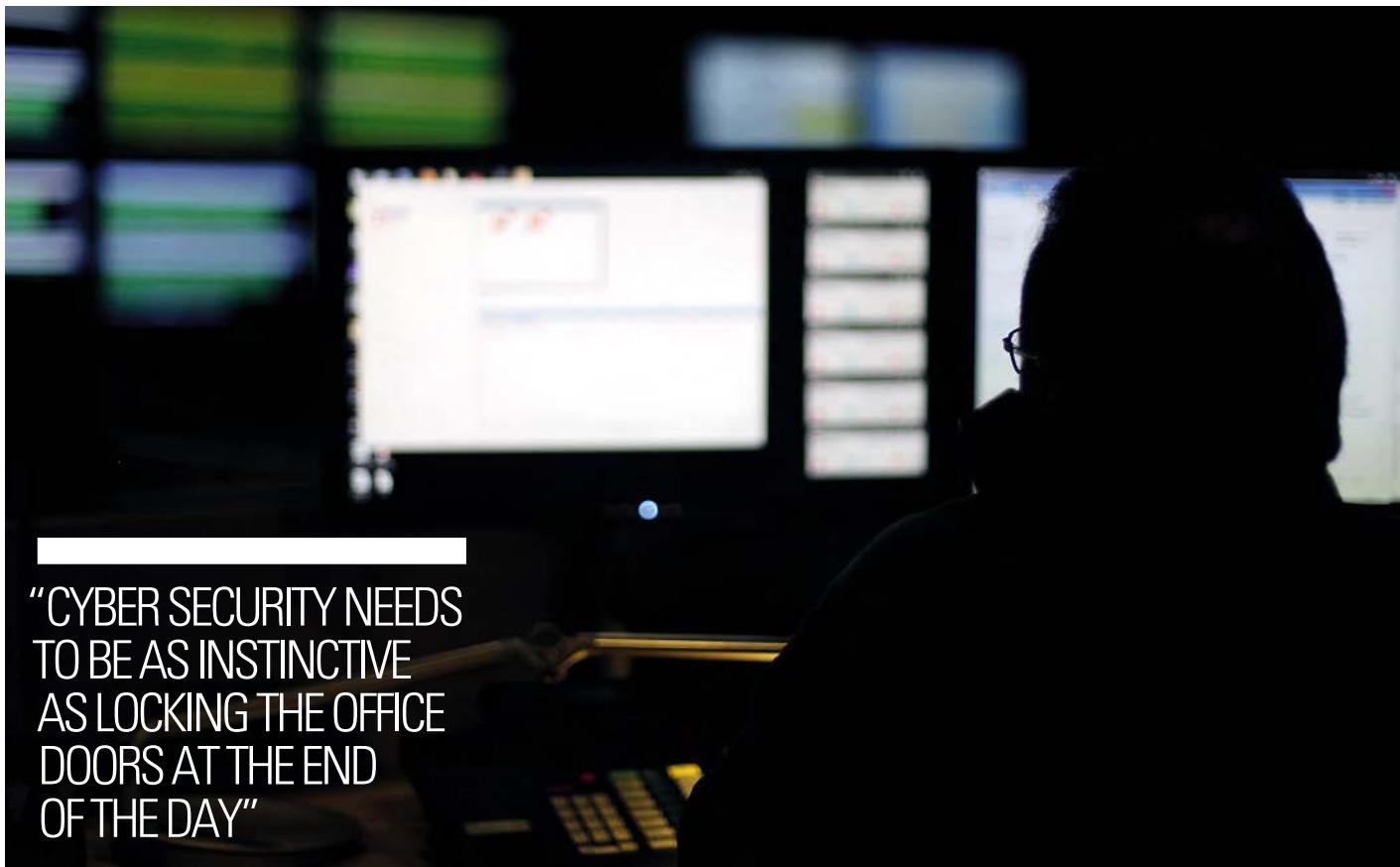
That such vast breaches are still happening indicates how sophisticated the attackers are. As quickly as new tools and techniques have been brought out, threats have morphed into something else and found a new way in.

Indeed, despite the security industry's best efforts, the number of breaches is increasing exponentially year on year. Attempts can take many forms, from Trojan attacks to distributed ►

CYBER SECURITY IN NUMBERS



Sources: KPMG; Center for Strategic and International Studies, June 2014; Verizon's 2014 Data Breach Investigations Report; HP survey 2014; GoGulf; Symantec



“CYBER SECURITY NEEDS TO BE AS INSTINCTIVE AS LOCKING THE OFFICE DOORS AT THE END OF THE DAY”

denial-of-service (DDoS) events – and the more systems and information that travel across digital networks, the more ‘treasure’ there is to lure the criminally minded.

The size and wealth of a company seem to have little bearing on how secure its defenses are. In 2013, a US retailer was attacked using malware that hacked into a server where payment details were stored, despite its use of security systems that met PCI (Payment Card Industry) standards. A well known online payment company was also compromised recently, with 233 million personal records affected. Beyond the immediate impact was a fear customers would lose confidence in buying online; having to contact millions of them to re-set passwords was a logistical headache.

Moving targets demand big guns

If it's becoming increasingly impossible to stay ahead of attackers, how can organizations protect themselves from the impact of cyber breaches?

The first step in developing a new approach to the problem is to understand that it is more than just a technology issue, despite the digital nature of these attacks. “Cyber security is a business issue and a conversation that has made its way to the boardroom,” says **Tony Buffomante**, Advisory Principal at KPMG in the US.

That's because the stakes are now so high – and because the best measures in the world won't automatically guard against negligent internal processes or shortcuts/workarounds by impatient employees. The direct costs of website downtime and lost revenues, added to

PERCENTAGE GAME
6.48%
of respondents in India to KPMG's 2014 cyber crime survey reported that they had suffered disruption of their business processes and reputation damage as a result of a cyber attack

71%
of the respondents to KPMG's 2014 cyber crime survey who believed that access to a company's confidential information is the foremost value gained by an attack

0.41%
cyber crime as a percentage of GDP in the EU. In the US it's 0.64% and China 0.63%

Sources: KPMG; Center for Strategic and International Studies, June 2014

the need to contact and reassure customers, the costs of lawsuits, any drop in shareholder value and reputational damage all provide motivation for the C-suite to make cyber security a priority.

Another driver of board-level involvement are the hefty fines which could soon be issued to organizations succumbing to security breaches. In the interest of building consumer confidence – and making companies more accountable for their cyber defenses – the EU is currently finalizing plans to introduce eye-watering penalties for organizations whose customer or employee data has been compromised.

“Companies may find they have to pay a fine of between two and five per cent of its affected global turnover,” says **Ken Hall**, Partner at KPMG in the UK.

Less obvious threats

Does all this mean that the Board should write a blank check for new cyber security measures? Buffomante suggests not, warning that there is no such thing as 100% guaranteed protection. “If organizations try to go down that road, it will be too costly. Instead, they should try to understand what's the most sensitive data that they're trying to protect, and what strategies and objectives may need reviewing.”

Hall echoes that view. “The key is to prioritize. Decision-support methodologies and tools can help quantify and rank cyber risks. This is what insurers use, and they can help assess the risks so companies can focus spending wisely.”

Hackers are continually active in their

CRITICAL YEARS

1971

The first virus, Creeper, was created as an experiment. It spread quickly. And a new program, Reaper, was created to kill it

1988

The first worm was created by a Cornell University student. It crippled 10% of the 88,000 computers on the precursor to the Internet

2000

ILOVEYOU worm affects over 45m computers, causing damage worth US\$5.58bn

Sources: GoGulf; Computer Economics

scanning of organizations' systems and there are many different areas of vulnerability that companies may be exposed to. Third-party suppliers or vendors are a big risk – data processors or marketing support, for example.

Other areas are less obvious. Overlooked weak links may include: remotely accessible services that are often unneeded for business activities but which provide an avenue of attack to compromise an organization; wireless access points to gain entry into an organization's internal network and steal sensitive information; and inactive user accounts left by temporary workers, contractors, and former employees (who may include the actual attackers).

Choosing your battles

Once the organization has a clearer idea of where its main areas of vulnerability lie, it can begin to look not only at how to protect itself as much as possible, but also how to be ready to respond if the worst happens.

"Achieving a state of readiness means that companies can minimize any damage in the event of an unforeseen attack," Hall says. "If a 'black swan' [extraordinary/left-field attack] does come along and do significant damage, at least companies can show the insurer or regulator how vigilant they've been, and that they did their best to protect the business and its data."

Assuming data is the only target for criminals is a mistake. There may be other vulnerabilities that brands and retailers are less aware of.

"For example, a retailer may manage a lot of its appliances digitally, such as the refrigerators

and freezers storing food products," Hall says. "If a hacker took control via the network – turning the temperature up overnight then back down again before morning, so that products thaw and then refreeze – the result could be a food poisoning crisis."

Sealing the leaks

Attacks can also happen because of gaps in security at different links in the supply chain. When 2,240 emails and passwords were stolen from a leading UK supermarket chain's loyalty card scheme website in 2014, the damage was exponentially greater than such modest numbers suggested. The loyalty scheme had many different participating players, sharing a lot of data. One breach in the supply chain was enough to put each of these parties (and their customers) at serious risk.

Dangers are not only external; internal threats are also rife. Current and former employees are often to blame for security breaches. Although not all incidents are intentional, the issue highlights the need for organizations to consider weaknesses inside as well as beyond company boundaries.

Assigning accountability

As cyber security comes into the boardroom, it ceases to be an IT-only problem and becomes the responsibility of every member of staff. Creating a shared responsibility culture, where each individual understands the part they play, is the foundation for any effective modern cyber strategy.

This doesn't mean the IT team are the only ones who need to be vigilant. Organizations increasingly realize that chief information officers and chief information security officers have a crucial role in developing strategies that are tightly linked to business drivers and innovation strategies.

One increasingly popular strategy is to set up 'hunting teams' of experts who build up a proactive, network-centric view of the business, which they can then monitor for unusual activity. Having access to filtered, relevant and timely threat intelligence information can help guide teams like this in terms of what to look out for.

'First response' plans

Where rogue activity is identified, organizations should establish a 'first response' approach and plan, mirroring what happens when an accident occurs and urgent, early intervention is required. This first response might be outsourced, managed internally, or a combination of the two.

Remaining vigilant also means keeping connected to peers and expert sources, who may have detected new threats on the way.

In the UK, the Government Cyber Security Information Sharing Partnership (CISIP) – part of CERT-UK – is a joint industry-government initiative set up to share information about cyber threats and vulnerability. Equivalent groups exist in most developed countries. "Groups of like-minded organizations need to share intelligence about the issues affecting their industry, and threats they have detected," Hall says. "There's no competitive compromise by sharing what you've learned, and you could gain a lot in return."

KEY LEARNINGS



Ken Hall

Partner, KPMG in the UK
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1. Effective cyber security needs a holistic approach so that investment in protecting one area isn't undermined by complacency in another. Remember: hackers and attackers will always look for points of vulnerability.

2. Board-level buy-in is a no-brainer.

If security practices aren't driven from the top and don't permeate the entire company culture, the best measures in the world can be breached.

3. Budgets need to be prioritized, but take professional advice to find out where your sensitive assets and potential weak spots might be, in case some are not on your radar.

4. Draw on the help available. Be prepared to exchange concerns, experiences and learnings with industry peers so everyone is in a stronger position.

5. Use experts. Security threats change and need the attention of someone who's at the forefront of the latest techniques. Targeted protection and readiness to respond are the best insurance.

Empowering employees and customers

As well as being vigilant at a network level, organizations need to embed security into their cultures and everyday practices. "Cyber security needs to be behavior that's as instinctive as locking the office doors at the end of the day – it needs to be part of business as usual," Buffomante says.

Maintaining a pan-organization awareness of cyber security threats will pay dividends as employees seek more freedom in the devices they use for work. The last thing employers want to do is clamp down on productivity and demotivate staff by taking away devices and tools that help people do their jobs, so the best solution is to educate them.

The same goes for extending new channels and means of payment to digital-savvy consumers. The need to innovate should not clash with the need to maintain optimum levels of security. Achieving a pragmatic balance is preferable. "The best approach here may be to control the risk such as placing a limit on the value of transactions," Hall says. "By focusing on what people should be able to do rather than what they shouldn't, organizations will retain the ability to be ambitious and creative, which is critical to their competitive edge and to maintaining the customer – and employee – experience."

For more information on KPMG's Cyber Security practice see p27

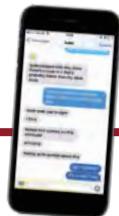


HOW TO WOOTHE MILLENNIALS

They're the biggest generation in history and they have enormous buying power. Yet they lead very different lifestyles from their parents and have distinctive skills, goals and expectations. Who are the Millennials, and how are they radically transforming the consumer goods industry?



WHO ARE THE MILLENNIALS?



114 mins

Average time Millennials spend text messaging each day in the US

33%

of Millennials in the US consult a blog before making a purchase

Sources: emarketer; Elite Daily Survey

CONSUMER TRENDS



Millennial consumers want purchases to be personalized and like to share experiences with their peers

Experienced executives in the consumer goods industry could be forgiven for greeting the topic of the Millennial generation with a certain skepticism. Do today's consumers between the ages of 18 and 34, dubbed the "Me Me Me Generation" by *Time* magazine, really differ from their predecessors? The 1970s were dubbed the "Me decade," while as long ago as 1907, *The Atlantic* magazine complained about the "worship of the brazen calf of the Self" that was afflicting society. Yet each generation reaches maturity at its own point in time, in its own context. And the distinguishing characteristics of the current generation of prime spenders – those born between the early 1980s and the turn of the millennium – are that they are, as the marketing term goes, 'digital natives', who have grown up with digital technology and whose priorities and values have been shaped by the most severe economic crisis since the 1930s. There is something markedly different about Millennials, even if analysts differ as to exactly what that is.

As a result of the interplay between that economic trough and consumers' worldly awareness – facilitated by greater access to information, commentary and communication – there can be no doubt that a new kind of consumer has been created.

Their opinions have been influenced not just by their immediate family and peers, but by a global pool of 'infotainment' and viral message-sharing. They may be gadget-hungry, but they aren't necessarily consumers in the way some older, more materialistic generations were. Just look at the way this age group enjoys music, books and films – it's downloads and subscriptions rather than physical purchases.

Saddled with student debt, struggling to get on the housing ladder and often living at home with their parents, they find fulfilment in different ways – through experiences, sharing and feeding the mind. They're more likely to rent than to own, more likely to share than hire.

These are sweeping generalizations but they are identifiable qualities that brands can turn into

MILLENNIAL PROFILE

- Born between 1980 and 2000
- More likely to be highly educated
- Less likely to watch TV or have traditional reading habits
- Lovers of technology
- Highly social online
- Lovers of bite-sized information, particularly anything about themselves
- Time and quality of life (including health) seen as more important than a big salary; experience valued over product ownership
- Willing to rent, share or recycle as an alternative to buying new
- Entrepreneurial/open to new ideas
- Highly influenced by peer opinion
- Likely to research online before making a substantial purchasing decision
- Expect to be listened to by brands



1.12%

of US Millennials are faithful vegetarians

51%

of Chinese Millennials say they feel bad about themselves if no one comments on their social media posts



16.6%

of Millennials in the US snack for dinner

"MILLENNIALS ARE USING TECHNOLOGY TO OUTSOURCE THEIR LIVES, ACCESSING SERVICES THAT FIND THEM A TAXI, DO THEIR LAUNDRY, POST THEIR LETTERS AND PACK THEIR SUITCASES"

opportunities with some personalization here and there – because, let's not forget, this is a generation that likes to feel that a product or service has been designed, created or reconfigured to suit them.

"The Millennial generation consumes differently," says **Vera Nieuwland**, Senior Project Analyst at KPMG's Innovation Lab. "There is a big shift from acquiring traditional assets – cars and houses, for example – to consuming services as and when they need them in a trend known as the 'collaborative economy'. The rise of services like Uber and Zipcar confirm this trend. It's less about owning the asset than having access to the facility when you need it and in a way that suits your individual needs. Technology and a new labor market are also encouraging some of them to collaborate in start-ups."

'Digital connectedness', now pervasively mobile, is a major facilitator and perpetrator of all of this, she says: "Millennials are using technology to outsource their lives: they can have instant access to services that can find them a taxi, do their laundry, post their letters, cook their dinner and pack their suitcase."

Misunderstood Millennials

Certainly this is a generation that likes to be served. There should be no wish not catered for, no information not forthcoming. One aspect of this trait is a trend called the 'quantified self' which captures and shares information about how well an individual is performing (miles run, calories burned, etc.) – albeit these tools often masquerade as health and fitness or performance improvement apps.

One of the more intriguing trends is their growing desire to shape the products they buy. This is more than a need for personalization. Millennials feel so connected to the market, and

so influential in their feedback, that they can't see any reason why brands wouldn't heed what they are saying and respond in the form of new product releases and feature enhancements.

"Millennials are seen as having a sense of entitlement but we think this is a misunderstanding. They like to use technology to do things 'smart' and what's changed is that this is now available, encouraging them to try out new things. They like things to be personalized and cool, and that can pose a challenge for those brands whose business is built on economies of scale," notes **Tom Herbert**, a Business Innovation Manager at KPMG's Innovation Lab. "Digital technology, and the rise of the Millennial, is accelerating the pace of change, and increasing the complexity of change. A brand could face changes to the way it develops products, how it markets them, the channels it uses to distribute them, and the supply chain it uses to create and deliver them."

According to a Millennial Consumer Trend 2015 Study by Elite Daily, an online news site, 42% of Millennials are interested in helping companies to develop products and services. Social media can help foster the closer communication that might enable this.

These shifts are being reflected in companies' fortunes. More health-conscious fast food brands such as Chipotle are on the up. Whole Foods is looking to launch a chain of supermarkets to woo Millennials. Sales of children's cereals in the US have, Euromonitor estimates, fallen 10.7% over a decade, whereas organic snack producer Hain Celestial – which explicitly targets Millennials – has become a stock market darling.

The phenomenon of the Millennial generation has been thoroughly analyzed and extensively documented, so brands can spot and adapt to the changing needs of their target audience. ▶

KEY LEARNINGS



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1. There has never been an audience so connected and freely giving of information online. Use analytics tools and services to filter this information. This will help you understand and reach your targets with timely and context-appropriate messaging.

2. Millennials love finding and connecting with 'people like them' online, so foster and engage in digital communities by adding value that will be appreciated.

3. Show you're listening. Millennials can be very loyal if they feel a brand is trying to give them something that adds value for them, which they will pay a premium for. For a retailer this could be as simple as providing reviews in-store; for a brand it could mean involving consumers in product decisions. Innovation should be a priority.

4. Have a global plan. Millennials make up even more of the population in emerging economies: 28% in China and 30% in Brazil and India. However, their wealth, habits, values, interests and preferences will vary, so each target market will need its own strategy and delivery plan.

5. Become more agile. Untether the business from fixed working ways. Millennials are open to new ideas but not tuned in to conventional marketing, so new competitors can swoop in. In a digital-social world, with fewer barriers to entry, it's much harder for brands to defend their territory.

6. Speed of response is everything – whether it's consumers' comments, suggestions and (especially) complaints, or a shift in market mood. Brands need to monitor social behavior closely (using data analytics) for early signs of change, and be agile enough to take advantage (see 5).



52%

of upscale Millennials in India are saving for their first home...

...compared to the US

37%

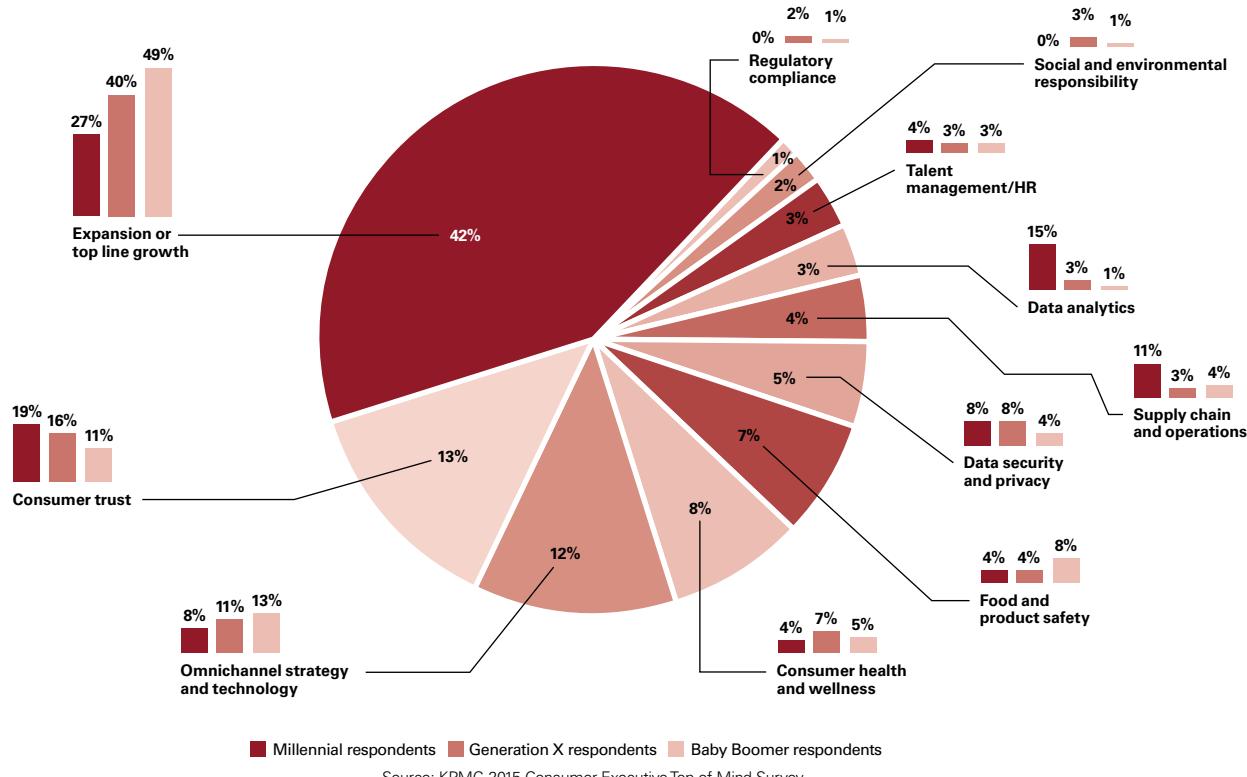


Sources: Hartman Group; JWT; Euromonitor; Nielsen; MTV

CONSUMER TRENDS

GENERATION GAME

A recent KPMG survey asked 539 consumer company executives to identify their top priority in the coming year. The Millennial executives were much less likely to be focused on top-line growth, and much more likely to be focused on building consumer trust, data analytics and supply chain issues than their older peers.



Channels are important. This is a generation that watches much less TV, and reads far less. Millennials (typically) like their content in bite-sized form, often recommended by respected peers, set in an interest-group-specific context, and right up to the moment. This makes them hard to reach with traditional marketing techniques. Only 1% pay heed to advertising, yet 33% consult a blog before purchasing, according to the Elite Daily study.

Power of peers

Of these, peer reviews have become very powerful. In recognition of their impact on Amazon's sales, UK high-street book store chain Waterstones has for the last few years placed mini-reviews on its product shelves to help customers choose a book. Other brands have achieved a similar effect using mobile apps so customers in bricks and mortar stores can check how items compare and are rated online as they browse the aisles.

Millennials are certainly worth engaging with. Despite an apparent preference for sharing and recycling instead of ownership, they have substantial spending power – US\$200 billion a year in America alone by 2017. It is a huge market too: in the US there are more 23-year-olds today (a whopping 4.7 million) than any other age, according to US Census Bureau data. By 2020, Millennials will account for one-third of the adult population in America.

Getting their attention means catching them at the right moment in the right place with the right message about the right product. As hard as that might sound, this generation likes to give feedback, so there are plenty of clues on social media about what they want, need and will spend money on. If brands respond with the right offer, word-of-mouth will carry them a long way, as happy customers' freely given reviews are shared widely. Win the Millennials over and the prize is powerful brand ambassadors passing on the message for free.

Anyone doubting the power of social media with this generation need only look at the finding from the Elite Daily study that 62% of Millennials are more likely to become a loyal customer of a brand if it engages with them on social networks. It's partly why brands are generally more responsive to customer service requests or complaints if approached via Facebook or Twitter. (That and the fact that bad feedback spreads frighteningly quickly online.)

Brand loyalty

Reaching this audience with something relevant and different is not easy. Preferences can appear to change overnight, and market disruptors can appear from nowhere – as in the case of ride-share service Uber – suddenly changing the way this generation thinks about and buys into a product or service.

A brand's corporate social responsibility (CSR) agenda matters to Millennials too. Growing social awareness and peer pressure not to

80% of US Millennials tune into Internet radio...
...but still listen to over-the-air radio



200-399 cal
Definition of a low-calorie meal according to Americans aged 18 to 34



Capturing Millennials' attention means getting them at the right moment with the right message about the right product

associate with brands who waste food/pay staff a pittance can be very powerful. In the US, fast food chain Firehouse Subs is making inroads partly because it has a rich back story: founded by firefighters, it donates some of its sales to help the emergency service. It's vital that FMCG companies think very carefully about how their business will be perceived by Millennials.

Another challenge is how to cater for these changing preferences while keeping existing older customers happy. What's right for the Millennials may not resonate with their parents, or older siblings, so a balance has to be struck.

One positive finding is that despite a profusion of choice, Millennials can be loyal to brands. This bond is based on something greater than convenience, so brands need to work harder to differentiate themselves – by genuinely being better and going that extra mile. They can't afford to take loyalty for granted; if they become complacent or stop innovating, the affiliation could soon wane – especially as, with

technological barriers to entry coming down – and social media spreading the word instantly – it is easier for new contenders to step into the gap.

Much of the hype relating to the Millennial generation has focused on the US, but this is a global phenomenon. The Internet is an international utility and a unifying force – disseminating similar information in Brazil, China and Africa as in the US and UK.

Global phenomenon

"The Millennial trend may be more advanced in western economies like the US," Herbert says, "but in terms of a shift in demographics, use of technology, and attitude, it is a global phenomenon. It may just play out in different ways in different countries. In China, for example, Millennials may be just as technologically driven as in the West but, because the family is such a strong institution in Chinese society, this too will have a bearing on how these consumers behave."

Whichever way the FMCG industry segments the Millennial generation, the important thing is that companies don't ignore the evidence that something significant has changed.

Whether or not you accept that Millennials represent a milestone in the evolution of the consumer, some common denominators do set this generation apart. "The digital age, and its economics, challenge many of the established norms in the consumer goods industry," says Herbert, at KPMG's Innovation Lab. "Brands and retailers, no matter how well established they may be, ignore this at their peril."

Even if you feel your organization is already moving in the right direction in terms of business agility and customer-centricity, it is worth analyzing your entire proposition from a Millennial perspective – from product development and business models to brand values and methods of engaging consumers. Millennials can still be sold to but, more than anything, they want to be heard. If they're not, they will look elsewhere. ■

70%

2,339,907,074
9,437,723 1,270,633

of 14-24 year olds in the US say they would like to become a star on YouTube

15%

of French Millennials think their children will be better off than their parents were

43%

US Millennials are more likely than other consumers to buy Mexican foods



Sources: Edison Research; Mintel; Pew Research; Symphonyiri

CASE STUDY

Name **TCHO** Founded **2005** Headquarters **Berkeley, California** CEO **Andrew Burke** Website tcho.com



RAISING THE BAR

Chocolate maker TCHO has used technology and fresh thinking to reach out to farmers and shoppers and build a cool brand

The last thing the world needs is another chocolate company. That was entrepreneur Timothy Childs' first thought when, 12 years ago, a former colleague suggested they form a business to create the perfect dark chocolate. As an outsider who had made his name in real-time 3D web graphics, he regarded the chocolate industry as a small, crowded market. Yet, after another project fell through, Childs did some research and was intrigued enough to visit Interpack, the food processing and packing exhibition, in 2005. What he saw blew his mind. As he told *Wired* magazine: "I had no idea how large an industry chocolate was. A light bulb went off. And I said, 'OK, we are making chocolate.'"

The company Childs set up with chocolate expert Karl Bitton, and with the interest of *Wired* founder Louis Rossetto, was called TCHO, a name that would help distinguish their brand, capturing the mix of technology and chocolate.

Chocolate is a deceptively simple product. The basic ingredients are straightforward enough – cocoa fat and solids; sugar; some vanilla to accentuate the flavor and sometimes lecithin, which acts as an emulsifier and stops the fats and solids separating. Yet the production process that creates the perfect chocolate is varied and elaborate. The hundreds of interrelated chemical reactions that create flavor are imperfectly understood and depend on incredibly minute changes made during fermentation, roasting and conching (in which the chocolate is warmed and ground).

The supply chain makes the process even more variable. Fermentation, arguably the most critical stage of the journey from bean to bar, is thoroughly unpredictable. After harvesting, the beans are piled together for several days and heat – created by a reaction between the sugar glop that surrounds them and the yeasts on

their surface – raises the temperature and helps create the sugars and acids that define flavor. Even at this stage, when the beans have not been roasted, they will have a crude chocolatey taste. The trouble with this process is that some fermented beans are packed with flavor while others can just taste flat.

The flavor factor

With chocolate for the mass market, the industry's usual *modus operandi* is to mask such variations in taste by blending in other beans. Yet at the more luxurious end of the market, where TCHO wanted to be, chocolate comes from one source. So they either had to control the fermentation process more effectively or accept that each harvest would produce a slightly different flavor, like grapes in winemaking.

As men of science and technology, TCHO's founders were perplexed by the industry's

traditional practices and they, like many executives at some of the industry's established players, felt it was necessary to change them.

They started with taste. For TCHO, this had become a subjective, even capricious, business which the industry had obscured by adopting the descriptive jargon popularized by winemakers. The company's founders wanted to replace this with transparency – it still hosts tours of its premises for keen tourists and intrigued rivals – and scientific precision.

In place of jargon and percentages, TCHO developed a flavor wheel consisting of six segments – chocolatey, nutty, fruity, citrus, floral and earthy – so the company could talk about taste in a way consumers instinctively understood. Such information, illustrated as a pie chart on bar wrappers, helps alert consumers to the range of flavors they can expect from good chocolate.

That transparency was built into the firm's R&D. In 2007, with versions of its chocolate ready to market, and Rossetto on board as CEO, TCHO eschewed market research, instead selling beta versions of its bars on its website for US\$5 a bar and asking for consumer feedback. The first batch of 4,000 soon sold out and, responding to feedback from eager beta testers, new bars were issued within days. By the end of 2008, after 1,026 iterations, the company launched version 1.0 of its product, TCHO Chocolatey.

To deliver that product, the company didn't just change the way it interacted with shoppers, it had to redefine its relationship with cocoa farmers. As Rossetto noted: "Cacao farming is a commodity business, with no incentive for farmers to focus on quality, as most chocolate made is milk chocolate. And milk chocolate was sold on the basis of the flavors of milk and caramelized sugar, not the chocolate."



A taste of the future

To ensure that its suppliers use the most flavorful raw material, the company launched a program called TCHOsource, under which it partners with farmers in Ecuador, Ghana, Madagascar, and Peru, to improve the way they ferment and dry beans. Digital technology has rendered distance and time zones irrelevant, with TCHO launching 'Flavor Labs', using cloud-based software and laptops to share and discuss data with farmers. By discussing a sample of beans, TCHO and its partners can ensure the harvest meets the company's specifications and reduce the risk that an order would not be placed. As Rossetto said: "For the first time, these farmers can taste the chocolate made from their own beans and understand how their efforts affect the result."

In tasting sessions via Skype, chocolate makers at TCHO can evaluate the unsweetened ground cocoa beans with farmers across the world, analyzing such characteristics as acidity, bitterness and nuttiness and compare their scores.

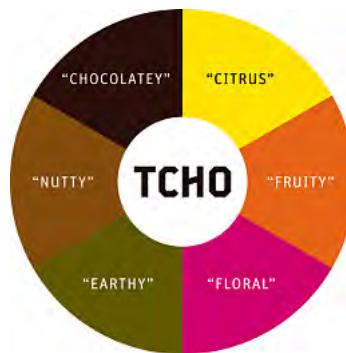
The first Flavor Lab – TCHO now has nine – was set up in Peru in 2009. It was a hasty improvisation using hair dryers, a modified coffee roaster, Indian spice grinders and custom temperature control boxes. The labs have become more sophisticated since – though they still use a fair amount of retrofitted off-the-shelf appliances to keep the cost of each installation down to US\$10,000 – embracing the cloud and drawing on data from local weather stations, so that such variables as ambient temperature and humidity can be monitored.

This collaboration with the cooperatives has enabled farmers to taste their products, calibrate their palate with TCHO's and make the appropriate corrections. The feedback is very specific but the aim is clear, for example, "Leave that batch of beans for another day" or "Consider adding orange peel to the mix." What TCHO is trying to do is find ways to quantify subjective experience and replace the subjectivity with replicable systems.

Consumer behavior expert and retail veteran Todd Hale has said that chocolate makers need to look at other consumer brands and learn how to "win with cool". With its Silicon Valley savvy, TCHO has done precisely that.

In 10 years, TCHO has established itself as a high-end yet large-scale chocolate maker. The famous flavor wheel remains at the heart

THE TAO OF TCHO



1. TCHO has married Silicon Valley innovation to San Francisco food smarts to create a distinctive company culture.
2. By applying technology to fermentation, TCHO has improved the process and kept flavors consistent.
3. Collaboration with suppliers through the TCHOsource program and innovation labs has encouraged farmers to reinvest.
4. Using a flavor wheel (above) TCHO communicates clearly with consumers, helping them understand its taste range.
5. Transparency is one of TCHO's core values – it has given rivals tours of its premises and it encourages consumers to help it test and develop new products.

Source: TCHO

of the company's product range, although it has launched milk, coffee and strawberry rhubarb pie products – and it still runs a program in which consumers beta test new bars at its head office.

Invention and innovation

The approach seems to be working. TCHO outgrew its 29,000 ft² space on Pier 17 in San Francisco and has just moved to 49,000 ft² premises in Berkeley. New CEO Andrew Burke says this will give them scope for expansion, room to experiment and raise awareness of what the company does: "We always felt like Willy Wonka and now we can do that well. People can come to the store, interact better and see how the chocolate is being made."

Burke's appointment reflects another stage in the company's growth. Childs and Rossetto have stepped back (the former is still a shareholder, while the latter remains on the board of directors) but TCHO is well on track.

Revenues have soared from US\$4.5m to US\$6m in the past year. Burke has considerable experience in the food and drink industry with Kraft, Gallo Wines and, most recently, as Executive Vice-President, Chief Marketing Officer and General Manager of Diamond Foods.

TCHO remains, in the words of one executive, "a young, scrappy company" and has succeeded in not being another me-too chocolate maker through its relentless focus on innovation and inventing the future. ■

Turning weak signals into strong growth

The pace of change in today's marketplace often takes retailers and brands by surprise. By monitoring signals of change – and making sense of them – companies can develop the right strategies to survive and thrive in an increasingly disruptive environment

The consumer goods marketplace can sometimes appear to be in a constant state of change. Millennials, who represent about a third of the world's population, are coming into young adulthood with a consumer mindset and behaviors that are very different from those of past generations. Meanwhile, venture capitalists are investing in start-ups hoping to remake old industries. And tech giants are ploughing significant sums into technology platforms and applications that create new marketplaces for goods and services.

The cumulative effect?

"The pace of change is unrelenting and now outrunning the company strategy," says **Colleen Drummond**, Head of KPMG in the US's Innovation Lab at WeWork in New York. "The traditional planning cycle is failing to keep pace with technological and digital disruptions. Their rate of growth is in many cases exponential."

The dangerous thing about an exponential growth curve is that they feel gradual, and then change feels like it happens suddenly and rapidly, leaving little time for companies to react. "The threat can feel gradual and even insignificant at the start and yet very quickly become a game changer," says Drummond. "Uber is a good example in the taxi industry, but there are examples of this kind of

"WEAK SIGNALS HELP YOU ADJUST YOUR STRATEGIC PLANNING BEFORE YOU HIT THAT THRESHOLD OF CHANGE"

disruption taking place in almost every consumer category, from movies (Netflix) to hotels (Airbnb)."

A recent round of financing for Uber effectively valued it at US\$41 billion. Delivery start-up Shyp has raised US\$10m to finance its expansion and TPG Capital, whose advisers include the actor Ashton Kutcher and Bono, are helping to fund Airbnb and laundry service Washio. All this activity begs the question: which sector will next be surprised by a challenge to its business model?

How to tune in

In an environment where change is the new normal, and success favors agility, flexibility and preparation, how can companies stay



ahead of disruptive implications that challenge investment and operational priorities? And how can they profit from them by developing strategies that turn those disruptions into new opportunities?

Drummond says companies must first dedicate time and resources to picking up on the "weak signals" or subtle signs of potential disruptions or marketplace game changers. "Our approach includes scanning the marketplace, from an outside-in perspective, to identify changing customer demographics and behaviors, technology innovation, VC investments and start-up activity, plus tech giant innovation investments. Then applying sense-making techniques to understand the real implications," Drummond says.

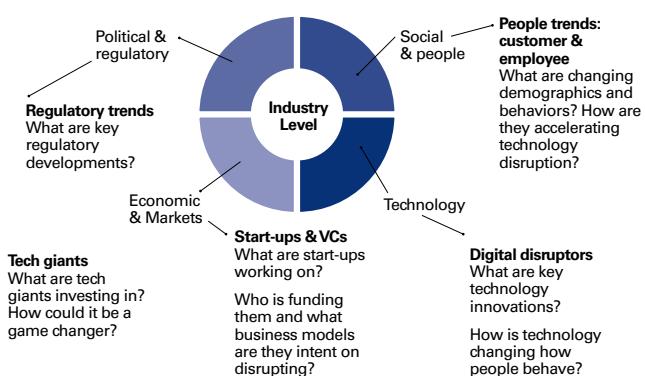
"Weak signals help you adjust your strategic planning before you hit that threshold of change. At that point it becomes much more difficult to reposition."

Jeanne Johnson, Principal at KPMG Advisory with a focus on omnichannel and changing operating models, says that weak signals help formalize "a critical set of capabilities and insights" into potential disruptions to their business, sooner and with more focus. Weak signals can complement traditional trend and market intelligence methods by highlighting "unknown" or "unexpected" factors influencing consumer behavior. In many



Leap Transit
San Francisco's Leap – a start-up bus service aimed at Millennial connected commuters – provides a smart-phone operated alternative to local mass transportation

Drivers and disruptive forces of change



Source: KPMG Innovation Lab

cases, these signals give companies insights into emerging business models being deployed by would-be competitors.

"The pace of change isn't just quicker, but also more disruptive to operating models. This isn't about tapping into insights that will help companies tune-up merchandising or supply chain management capabilities," she says. "Instead, they might realize they need to integrate and collaborate with somebody else's supply chain. Or it may be realizing they need to interact with suppliers and manufacturers in a different way than distribution models of the past."

At KPMG's Innovation Lab, a team bringing together backgrounds in trends research, customer experience and motivation, technology innovation and start-up scanning, offers an "outside-in perspective" to help clients identify signals of change within the context of their businesses.

"It is about identifying the weak signals you can know, but don't," says Johnson. "Then it is about putting those signals into context: what are they actually telling you so that you can do something about it?"

People first

At KPMG's Innovation Lab, the methodology starts with consumers. That is why it is made up of a cross-generational team of Millennials, ▶

KEY LEARNINGS



Colleen Drummond
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Customer demographics

Millennials are the largest generation in history, and a key accelerator of technology disruption. They spend more time online than previous generations, and expect digital to be integrated into their customer journey. They are fueling Collaborative Economy businesses, which seek to match independent supply and demand in real-time. Diving into the generation's behaviors and expectations can yield valuable under-the-radar insights.

Technology innovation

Tech giants have already proven a game changer in commerce, communications, payment systems and health. What are they investing in now? How could that accelerate change? Look at Apple, which could revolutionize healthcare with the iWatch,

challenge Tesla with exploratory investments in electric cars and is looking to place Apple TV at the heart of a home automation system.

Start-up activity

Venture capitalists get up every morning thinking about which business model they can disrupt next. Companies need to scan the landscape to identify relevant start-ups and the venture capitalists who are funding them. KPMG's Innovation Lab also goes 'divergent' in its scan of start-ups; adjacent possibilities could represent threats and opportunities (for partnership, for instance).

Political and regulatory trends

Companies like Airbnb have met with some resistance from local and national governments around their business models. How successful have they been in forcing governments to change the rules? How could those regulatory trends accelerate change to other business models? Governments worldwide have also shifted towards programs that support entrepreneurship, a trend that has implications for big business and mass-produced goods.

STRATEGIC INNOVATION

Gen Xers and Boomers of varied expertise who put their desires, behaviors and expectations under the microscope. Field research is also done through a customer lens.

Given they're digital natives and two times more likely to be early adopters of new technology, Millennials are perhaps having the most impact on consumer changes, making them a key area for gleaning weak signals.

Recently, the Innovation Lab completed a two-day session for a major beer company on the rising popularity of craft beers in the US. According to the Brewers Association, the trade association representing small and independent brewers, craft brewers had 11% of the total beer market in 2014, the first time they've claimed double-digit market share. (The trade association defines craft brewers as companies that produce less than six million barrels annually that are not owned or controlled by a large conglomerate).

Craft beer volume increased 18% last year in the US. Growth for the overall beer category, however, was only 0.5%.

"What we started with was: how are people changing and what is causing them to prefer craft beer? We put a lot of work into seeing if there is a correlation between food and alcohol

"START-UPS SUCCEED BECAUSE THEY DEVELOP SOLUTIONS TO UNMET NEEDS AND CHANGES IN BEHAVIOR"

preferences," she says. "We absolutely did see Millennials making different food purchases than past generations. That in turn has shifted beverage choices. We also saw that Millennials have a strong preference for authentic and local. There is a pervasive rejection of mass production. It is a huge challenge for a lot of major companies," Drummond notes.

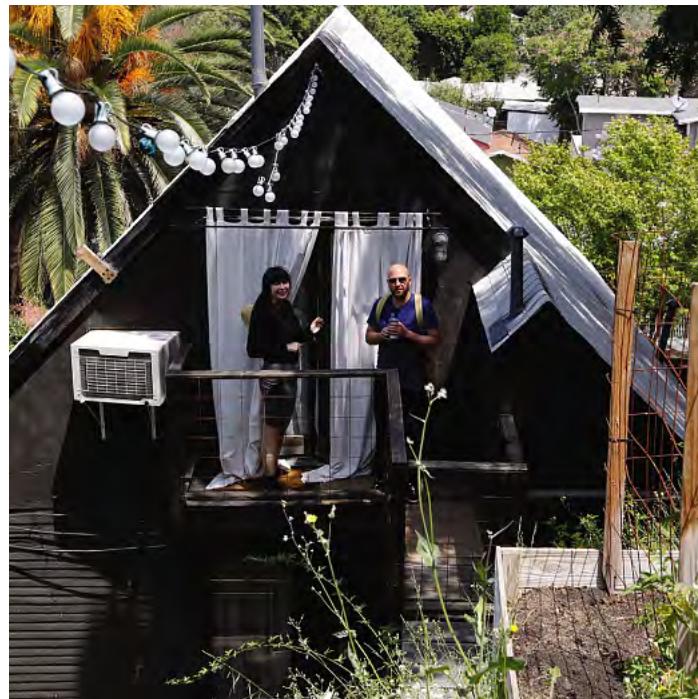
But insights into demographic shifts alone don't tell the whole story of a potential business disruption.

Accelerating innovation

KPMG's Innovation Lab also maps technology innovation to provide a snapshot of how new start-ups and companies could accelerate consumer adoption of certain behaviors.

To help facilitate this process, KPMG partnered with software company Owlfin to create the KPMG Technology Trends Index, the first index in the world to provide a dynamic, real-time view of technology trends in eight large industry sectors. Consumer markets is one of the sectors.

Every day, over 500,000 online sources (such as tweets, press releases, annual reports, magazines, forums, etc) are filtered through an algorithm designed by Owlfin,



Disruptive start-ups
(Clockwise from left)
Airbnb challenges the hotel model; Netflix has changed how audiences watch movies and TV; Connecticut brewer Two Roads provides facilities for craft brewers to make their own products; Uber's taxi service is now available in 58 countries



which measures articles for timeliness, weight and relevance. "It helps you determine what is trending and what needs your attention," says Drummond. "Within those trending areas, you can also get a better sense of whether people are just talking about it or actually acting on those trends."

Start-ups with big ideas

The Lab also scans the landscape to identify relevant start-ups and the venture capitalists who are funding them, as well as tracks tech giant activity.

"Start-ups are real companies with real products and customers. They're agile and succeeding because they are developing solutions to unmet customer needs and changes in behavior," says Drummond. "And it is not just the start-ups but also the venture capitalists who are backing them. What do you think venture capitalists do? They get up every morning and think: 'What industry can I disrupt today?'"

Drummond says they will also "develop a value chain from the customer lens, and then layer the start-ups across it to see where they are trying to innovate. And what we're seeing is start-ups even changing the definition of

what it means to be fast and convenient. Today you can have virtually anything delivered to your door with a few clicks on your mobile."

Deep dives into new business models and the companies that compete in them can also help identify insights. One of the most important points of research for the Lab has been Collaborative Economy businesses, which enable consumers to get what they want from each other rather than from established brands that used to be the only options in the marketplace.

Start-ups founded on the principles of this model, such as Airbnb, Zipcar and JustPark (in which, yes, you share parking spaces), number more than 9,000. They are funded by more than US\$7 billion in venture capital with the express goal of disrupting existing business models.

The growth of these start-ups is being accelerated by a range of factors. These range from technological (mobile devices, social networks, payment systems) to demographics (Millennials – especially during the economic downturn where their financial prospects have been limited – support sustainability and sharing) and to political/regulatory shifts (by which government programs such as the

US's Patient Protection and Affordable Care Act – commonly known as ObamaCare – are being created for a growing number of freelancers and small entrepreneurs).

The start-ups cover a vast range, from services, food, goods transportation, space and money. This increasingly popular business model is even being applied to the contractor marketplace, which has major implications for businesses, such as leading paint manufacturers. (See panel below.)

Evolve or die

There is no shortage of accelerating trends, new technologies and breakthrough innovations. But by tuning into weak signals, companies can start creating organizational awareness and capabilities that allow them to proactively address disruptive forces of change and take corrective action.

"Companies constantly have new competitors coming at them with completely different business models," says Drummond. "Their ability to adapt and pivot is critical, but they can't do that if they don't recognize the drivers and disruptive forces of change."

For more information on KPMG's Innovation Lab see p27

CASE STUDY

Don't paint the home improvement business model into a corner

KPMG's Innovation Lab recently completed an 'outside-in perspective' for one of the world's leading paint manufacturers to identify signals of change in context and to help them adapt

The client's challenge

The session looked at changing customer demographics, innovations in technology and start-up/venture capital activity particularly in the home renovation sector. The insights revealed that disruptions to the sector include start-ups introducing a technology-enabled layer between consumers and contractors (who offer painting as a service).

How KPMG helped

"We first looked at behavior changes as it relates to design, and Millennials want to go from idea to execution through a mobile-enabled experience," says Colleen Drummond of KPMG's Innovation Lab. "They start online with idea board apps like Houzz and Pinterest."

"Boomers would tend to start with paint and build from that, but now the process has changed and paint is just one source of inspiration," she adds.

While Millennials are willing to create idea boards, generally speaking they're not interested in going to the hardware store, picking up the paint and actually

doing the job themselves. During their childhood, Millennials typically spent more time on extracurricular activities than household chores.

Their lack of home improvement know-how, along with a preference for spending time on other experiences, has given way to what Drummond calls the DIFM (Do-It-For-Me) phenomenon, in which seemingly every consumer good is being turned into a service.

This is in stark contrast to the Do-It-Yourself model popularized by baby boomers.

A scan of start-ups in the paint/painting industry revealed disrupters to the home improvement market.

A range of them, such as Porch, Pro.com and Handy, enable mobile engagement of contractors to get work done.

"We found they will send you samples of the paint color, and that the contractor will show up at the door with the paint to do the job," says Drummond.

One e-commerce start-up that enables individuals to book, schedule and pay for home and office painters, recently secured



investments from a number of venture capitalists, squarely putting a new light on the business of paint manufacturing.

The bottom line

By putting the market signals together, the company now has actionable insights by which to move forward and protect its relevance, says Drummond.

"We identified a lot of operating model implications for the company, from change management in terms of how the paint gets delivered to how it interacts with contractors," she says. "It has to do two things: focus on meeting the expectations of changing customer behaviors and simultaneously calibrate its operating model across channels."



PERSONAL TOUCH

Have luxurious hotels discovered the secret of customer loyalty?

Keeping customers loyal in a competitive, constantly changing marketplace is the toughest challenge for any brand. For boutique and luxury hotels, getting closer to customers – for example, through social media, mobile media, deep data mining and advanced analytics – is essential, as they seek to offer a truly personalized experience.

The hotel industry has long looked to the personal touch to retain customers. The five-star chain Four Seasons are famed for their customer service and understated helpfulness of their staff. This has been emulated in the retail industry – putting experts, consultants and personal shoppers in place of sales people. The holy grail is to keep good customers coming back. To do that, hotels need to know who these guests are, how they behave, and treat each customer as a valued individual. In times gone by, long-serving staff were key. Today, those stalwarts' encyclopedic memories and attention to detail can be recreated by data analytics and customer relationship management systems.

The original 'grand' hotels attracted guests with a distinctive grandeur that was hard to replicate. Their guests chose to stay not in any top-class hotel, but specifically at the Waldorf Astoria in New York, or Raffles when in Singapore.

Other hoteliers globalized their brand, so that wherever travelers went they would find, say, a Hilton or Marriott offering a reassuringly similar experience. The industrialization of the hotel chain met a previously unanswered need for predictable facilities from business travelers and satisfied less adventurous voyagers seeking a home-from-home in a strange city.

The danger with this approach is that it can degenerate into a 'vanilla' experience that

engenders no customer loyalty. With the big chains, reservation and enquiries services are often centralized, standardized and heavily scripted – some insist on a set list of phrases to greet guests. One group even stipulates that guests' pets can weigh no more than 75lb (34kg). This may be efficient, but it doesn't make customers feel so individually valued that they want to return. This approach may already be alienating richer guests: only a third of the top 100 hotels ranked by readers of *Condé Nast Traveler* magazine last year belonged to chains.

Small is beautiful

The advent of the boutique hotel in the 1980s marked a return to some of the old values – particularly the idea of offering a differentiated experience. In place of piped elevator music, each establishment creates its own ambience targeted at a particular kind of customer.

By creating strong customer connections, facilitating feedback, they inspire word-of-mouth recommendations, while reducing the cost of future sales, market research and product development. A recent Gallup study found that the more engaged guests were, the less they worried about the price of their room.

Boutique hotels are well placed to meet the growing demand for personalization. Aimed at niche markets, they are closer to their customers, who are distilled into ever more discrete 'tribes,' such as 'bar crowds of 20-35-year-olds seeking social bonds.'

As the sector matures, this deep customer knowledge – boosted by social media and discrete analytics – is helping owners do more good things. These smaller, more nimble organizations can react quickly to new market

developments, such as the internet-driven rise in private rent-a-room/apartment services. These hotels may not have worked out definitively what their customers want but they are constantly monitoring evolving preferences.

The larger hotel chains are waking up to social media. Four Seasons Hotels & Resorts encourages guests to share vacation photos on social networks (using the hashtag #FSFotog), using satisfied customers to present a positive story to potential customers. Such proactive social media activity can have a huge impact: TripAdvisor's research found that 93% of people value peer feedback when selecting a hotel.

The new trends on the boutique hotel industry's agenda are being driven by guests' ever more intricate needs. These range from more sophisticated customer segmentation to mobile check-in facilities to reduce front-desk traffic and replacing standard rate cards with more personalized, adaptable pricing.

Technological advances can help – the latest offerings include in-room facilities that can pre-set a room's temperature to a guest's preferences – but innovations need to offer a tangible benefit, and all businesses have to get the basics right. In the case of hotels, that's a good night's sleep in a comfortable room. ■

KEY LEARNINGS

1. Know your customers. Don't try to second-guess them: get feedback via social media so you can track changing needs and preferences. And remember: rules alone don't guarantee good service.

2. Use data analytics. Microsegment your target market to identify what particular 'tribes' of customers really want.

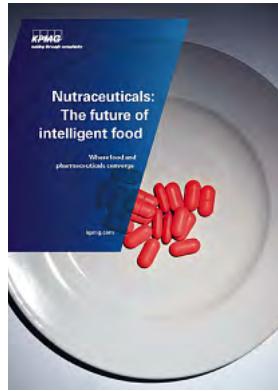
3. Adapt your pricing. Be flexible, with personalized and seasonal special offers.

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.

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For more information or to request a proposal, contact us at consumermarkets@kpmg.com

KPMG Innovation Lab

With our people-first approach to innovation, KPMG in the US's Innovation Lab can help you identify signals of change that may impact the growth and relevance of your organization. Based on a decade of research and our knowledge in neuroscience and human creativity – as well as leadership in technology innovation, trends analysis, and start-up scanning – our team of cross-generational Millennials, Gen Xers and Boomers has the ability to take your business to the next level.



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