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# Your success has made you a target

**How to defend and grow in today's consumer markets environment**

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## An Executive Perspective

"It's so easy to get focused on what you're working on and never look around at things that can come up…Those key indicators that I know are there, but I'm not looking at them day to day. I haven't built a strategy around them, or discussed them with the staff and CEO group. Those are the messages that we really need to focus on because, at the end of the day, they are what is going to affect our future."

— CFO of a large retailer

## For large retailers and consumer product companies, the days of continuous store growth and endless geographic expansion have given way to ubiquitous and chaotic competition.

Consistent sales comps and operating margin expansion—the Holy Grail for Wall Street—have been battered by an onslaught of numerous disruptive market entrants.

These are not just "traditional" competitors in a given space—they include start-ups, venture capitalists, tech giants, or tangential players actively seeking to take incumbents' margin. Most companies are well aware of the threat, but many of them fail to understand its scope or potential impact.

With brand new threats disrupting every aspect of traditional business and operating models, even the most insightful leaders do not automatically know who they are fighting these days—either because the competition is unrecognizable or because it might not exist until tomorrow.

What is more, an organization's current position usually cannot be blamed on faulty leadership. Instead, successful companies are at risk because the machinery and cultural fabric of their organizations are tightly aligned with their historical competitors and customers.

Paradoxically, the big contributors to large organizations' success may actually hamper their ability to adapt to new challenges and unlock the next wave of growth. Leaders are likely paying too much attention to emerging markets, traditional competitors, and other historic challenges—missing out on where and how their businesses are already at risk today and will be tomorrow and a year from now.

In this paper, we look at how large retailers and consumer product companies can assess the extent of the risk they now face. From there, we explain how they can recalibrate their organizations to compete in a new world, and then develop, prioritize, and execute specific initiatives that will help them shore up in the near term and invest for the long term (three to five years).

# Understanding the current environment

Large, successful consumer markets incumbents have been built and thrived with business models that rely on a "traditional" view of the value chain. Manufacturers developed and sold products to retail businesses, retailers received products and shipped to stores, customers bought, and the process repeated.

This linear formula of mass production, distribution, and advertising led to years of growth and expansion. Markets developed, shares reached new highs, big brands and big boxes dominated. It was a slow but consistent approach, but once scaled, led to steady, annual profitability that delighted shareholders.

In the last 10 years, however, a new world order has emerged. It is disruptive, nonlinear and requires agility, speed, and experimentation—three areas where most incumbents lag.

As the competitive landscape has shifted significantly from in-store to online commerce, platforms such as Amazon and Google have made control of demand (rather than control over supply) the core of competitive advantage.

**As platforms have become more powerful, distributors have been disrupted, suppliers have been squeezed, middlemen have lost their leverage, and standardized brands are losing market share. With multigenerational customer expectations and technology innovation affecting how all of us consume and pay, entirely new value chains are emerging. This chart below illustrates one of these value chains.**

# Emerging customer value chain

## New ways to explore, buy, and receive food

### Explore

**Inspiration**
*Social media & curated content*

**Information**
*Nutrition and product information, guides, and apps*

**Personalization**
*Marketing, coupon discovery, and loyalty*

### Plan

*Recommended meal planners*

**Quantified self** *food and nutrition personalization*

### Select

*Emerging brands and products*

**DIY** *meal assembly boxes*

**DIFM** *ready made meal boxes and meals*

### Purchase

**Source from multiple channels:** *restaurants, farmers markets, online channels, stores, and subscription models*

**New online grocery platforms** *and mobile ordering anywhere and anytime*

**Connected Kitchen** *and inventory management*

### Receive

*Click and collect*

*Curbside pickup*

*Delivery to home and same-day delivery*

### Engage

*Social media sharing*

*Loyalty programs*

*Advertising and influencers*

Numerous segments of **emerging competitors** are driving this marketplace transformation and positioning themselves to win (or disrupt along the way):

- **Tech giants** are scaling massive platforms that attract billions of users to engage in new forms of commerce.
- **Small manufacturers** are bringing unique value propositions to market.
- **Retailers** have become brands and are developing robust private brand portfolios.
- **Digital channels** offer superior execution of the basics of price and convenience.
- **Emerging business** models based on pricing, subscriptions and convenience are disrupting the traditional buy/sell paradigm.

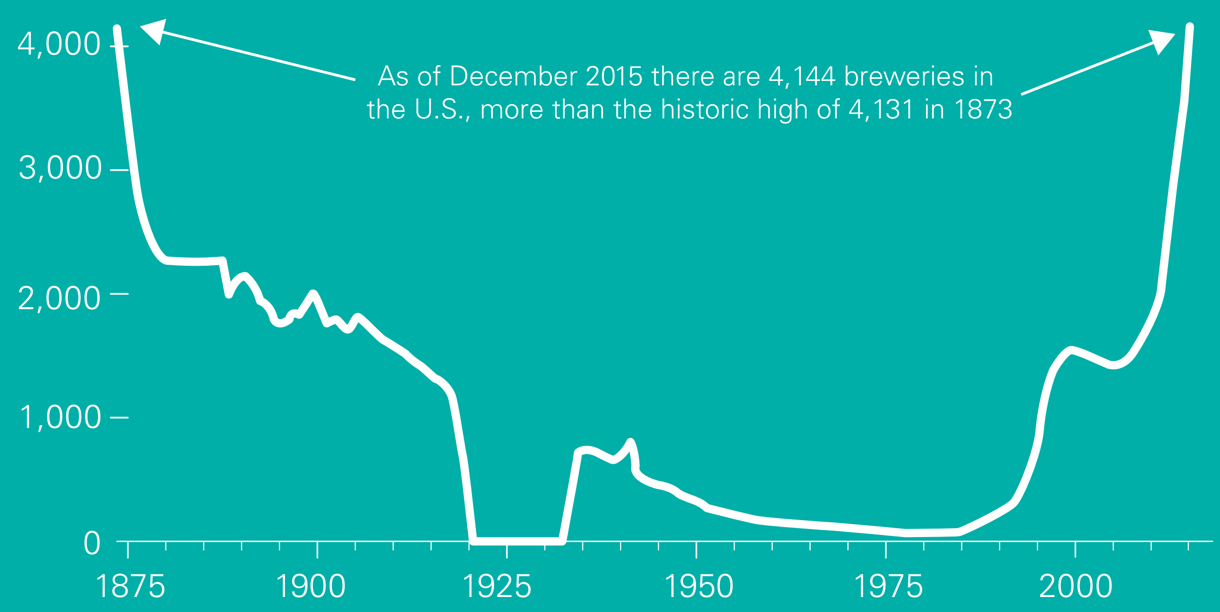
These competitors often start slow but scale quickly. They attack the core of the business and, as they gain users, they take share at an exponential pace. Legacy businesses, purpose-built for massive scale and big infrastructure, put up walls and create moats to defend markets. Inevitably, basis points are lost to an emerging competitor and disproportionately deleverage the Profit and Loss (P&L) that incumbents worked so hard to build (see example on next page).

Sustained future success will require a delicate balance of defense, transformation, and an uncomfortable approach to investment in a series of options that go well beyond the core business. Not every incumbent will be prepared, or successful, at seizing the opportunity.

## Beer Culture: From Beverage to Craft

For an example of a rapidly evolving value chain, look no farther than the beer industry. It went from fragmentation (lots of micro brewers) to consolidation (few brewers each with massive market share based on a proven formula of a few big brands and expansive marketing). The industry is now in flux due to further consolidation of the largest brewers, driven by a massive reemergence of micro brewers taking small pieces of share and consumers seeking choice, "authenticity," and local, artisanal products they can call their own.

### Number of U.S. Breweries, 1873 to 2015




*Source: Brewers Association, 2015*

**One new CEO of a business under intense competitive pressure told us that when he joined the organization, it had too few spans and too many layers.**

**Over the course of 18 months, he streamlined the organization.**

**Many complained the organization would implode, tasks would go unfulfilled, and store shelves would be empty. The opposite happened—people became empowered, efficient, and focused.**

# Now what?

Given these rapidly evolving circumstances, how do incumbents break free of the inertia and organizational DNA to create step-change transformation? In our experience, market leaders rely on three distinct activities to get moving in the right direction:

1 Determine the true level and pace of disruptive risk.

2 Get the organization in shape to fight back and transform for the future.

3 Develop and execute a set of initiatives to shore up the near-term "goals" and create future opportunities.

## First, determine the true level and pace of disruptive risk.

Remove the blinders and take a truly open-minded view of the business. Start the exercise as if the organization were building from scratch. What is the "need to have" today? What will be the "need to have" in the future?

Leaders start by determining how much they are actually at risk. Rather than rely on typical market projections, they expand the aperture to take a much wider view across four dimensions (see below). They build a fact base of trends, insights, and signals that are usually indiscernible within the current construct of most organizations. And they dig deep to try to assess the potential impact on customers, markets, or competitors—today and over the next several years.

### Consider these questions

#### People and social

- How are changing customer and employee demographics, behaviors, and expectations affecting the business now? How might their effects change or grow over the coming one to three years?
- How are key segments, such as Millennials, interacting with emerging technology and platforms and changing the way they interact with legacy businesses?

#### Technology

- How are traditional business models affected by the exponential acceleration of technology innovation?
- How can the organization anticipate or plan for the effects of near- and long-term innovation, in an age when the vaporization of traditional products, companies and entire industries is ongoing?

#### Economics and markets

- To what extent are customer expectations and technology innovation challenging the existing business model? How are these influences enabling new operating models among competitors?
- How are start-ups, and the VCs who are funding them, reinventing business models in the markets the organization serves? How could these developments play out over the next several years?

#### Political and regulatory

- How can the business protect itself—now and in the longer term—from market uncertainties driven by political or regulatory change?
- As regulation and politics lag behind the marketplace, how is the business disproportionately impeded?

> **Would existing customer care—or even notice—if your product or store disappeared? Or would they simply click to another page, drive to a new shopping center, or choose another product off the shelf?**

Based on these inputs, leaders should ask and answer honestly if customers actually *need* the organization and its products.

More often than not, large incumbents are replaceable, yet they fall into the trap of believing past loyalty is a guarantee of future loyalty. In fact, too many companies mistake current market share for ongoing market relevance (although 66 percent of participants in KPMG's 2015 CEO Outlook Survey indicated they are concerned about the relevance of their products[1]). Take steps to assess the unfiltered trends that may be challenging to confront. How susceptible is the organization to significant disruption?

Moreover, has disruption already begun or is it on the horizon? It is one or the other for 99 percent of the marketplace. Leaders should consider themselves lucky if they can spot it and react before it begins. Whatever the scenario, avoid the "comfort trap." The marketplace is littered with brands and names that falsely assumed they were in a strong position and were impenetrable to competition.

## Second, get the organization in fighting shape.

Regardless of where the business falls on the disruption scale, leaders are taking action now. They construct an infrastructure, team, asset-base, and go-to-market plan as if it were Day One. Done effectively, the margin improvement gained in these efforts is often more than sufficient to fund growth opportunities. Therefore, it is critical for leaders to be ruthless, go deep, and get it right the first time.

Too many organizations are in perpetual "cost mode," often because they lack the wherewithal to fully embrace the severity of market conditions and react and plan accordingly. This kind of denial is a disservice to customers, shareholders, and associates. All three constituent groups, and particularly the latter two, will ultimately be grateful for bigger, bolder action as opposed to death by a thousand cuts.

For starters:

- ☑ **Transform the team** – Get the spans and layers of reporting relationships right, accelerate decision making, and position business stars to perform. Aggressively recruit talent that brings new capabilities into the organization.
- ☑ **Move towards zero-based budgeting** – Capital and expense should be justified based on future potential, not historical trends. Do not accept another budget that represents the same as last year with incremental (and often too optimistic) improvements.
- ☑ **Cut underperforming assets** – Close, monetize, or optimize underperforming and low potential stores and brands. One company president used to joke that customers never "got the memo" that, when a new fiscal year starts, growth curves miraculously change trend and they need to behave accordingly.

## Third, develop and execute a set of initiatives to shore up the near-term goals and create future opportunities.

Leverage the revamped organization with a plan encompassing near-term quick wins and long-term growth strategies. It is a tricky balance, but too many organizations sacrifice long term optionality and brand loyalty for this quarter's EPS target. Resist the temptation and get started on moving ahead of the curve.

At this stage:

- ☑ **Optimize and reallocate** – Use existing data to make informed decisions and trade-offs. Leverage historical initiatives to predict future performance and improve the mean. Look across marketing spend, promotions, store hours, etc. for reinvestment opportunities in emerging channels (i.e., digital).
- ☑ **Disrupt the status quo** – Explore and scale new retail models, pricing structures, or product segments that could siphon off customer segments. Ignore concerns about "too small to matter" and develop a set of options that could work. Understand the viability of new platform models, partnerships, and alliances. Could anyone have ever imagined that a small online bookseller would eventually be a major force in cloud computing and global logistics?
- ☑ **Be visible and committed** – Support and communicate progress against new initiatives. Outline the need for change and the plan to deliver it. Celebrate both successes and failures. Make calculated risk tolerable and a new part of corporate DNA.

[1] KPMG, CEO Outlook Survey, 2015

## A self diagnostic

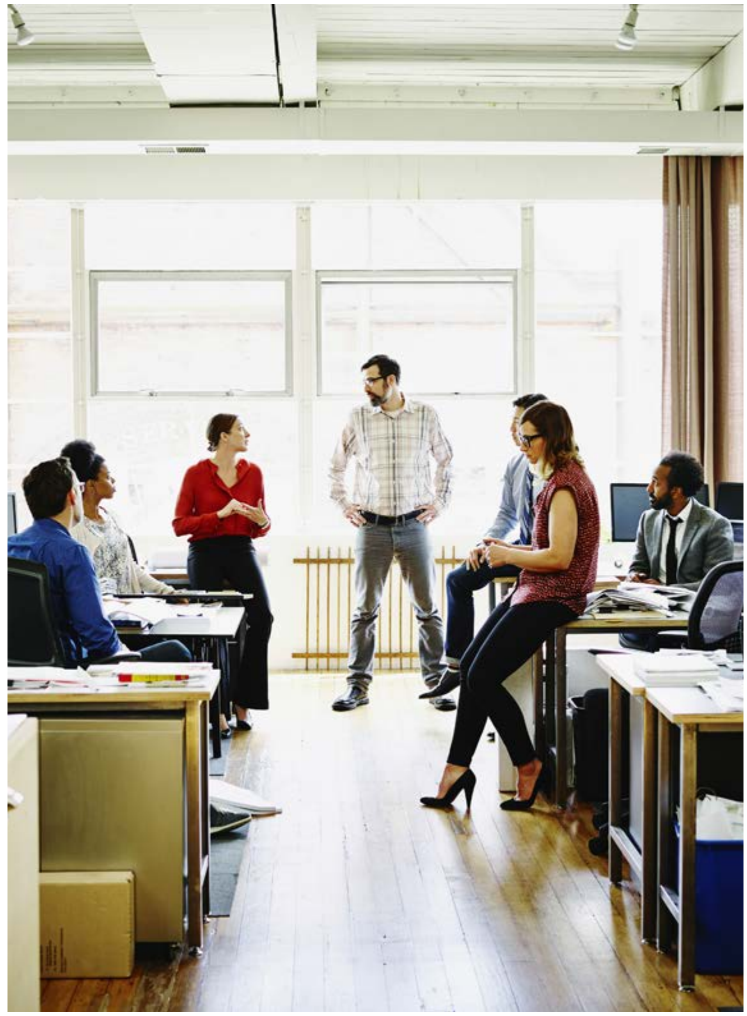
Getting started can be as easy as providing honest answers to the questions below.

**Markets and competitors**

- Who are the emerging competitors in your market space? Do you know how much is being invested and where? Do you understand the new business models and value propositions against which you are competing?
- How are you investing vs. upstarts, incumbents and VCs?
- Are your core product categories declining, flat, or growing? What are key inflection points? Are you well positioned and will customers accept new offerings from you?
- Can your products be effectively and efficiently sold online?

**Customers and business model**

- How has your customers' shopping journey evolved? Where are you exposed?
- Are customers more or less loyal to your brand than five years ago?
- Is your capital going to maintain legacy operations or building new capabilities?
- Where has share migrated in the past five years? What do the next five years look like? What implications does loss of share have on your business (assets, people, economic model, Wall Street commitments)?
- What are your true competitive advantages, i.e., why do customers buy from you and what cannot be replicated? Can they find better prices elsewhere?
- Are you sacrificing the long term for this quarter's earnings?
- Is your organization capable of dealing with change and building for an ambiguous future?



# Conclusion

### Our work with consumer markets companies shows us there is a path to tackle these questions.

The road ahead is treacherous for large incumbent retailers and consumer products companies. A multitude of competitors are well capitalized, aggressive, and gunning for margin.

Act now – Take an expansive view of the marketplace and ask the tough questions to understand the true level of disruption facing the organization. Leaders who do so can then build the appropriate plan to get the organization into fighting shape and develop a strategic plan to ensure competitiveness in the years ahead.

# About the authors

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# About KPMG

KPMG International and its network of member firms (collectively KPMG) are a global network of professional firms providing Audit, Tax, and Advisory services operating in 155 countries and employing more than 174,000 people. Our U.S. member firm, known as KPMG LLP, traces its origins all the way back to 1897 and became a limited liability partnership in 1994. As a leading professional services firm, KPMG LLP has more than 30,000 partners and professionals providing services throughout all 50 states. With 90 offices, we are a significant presence in your current markets and in those locations where you may want to expand.

Our high-performance culture promotes using our experience and insight to simplify complex challenges, seek new opportunities, and deliver informed perspectives and clear methodologies of value to clients and stakeholders. Our client focus, commitment to excellence, global mind-set, and consistent delivery build trusted relationships that are at the core of our business and reputation.

The KPMG Innovation Lab focuses on sensing and understanding signals of change through a people-first lens. Leveraging design thinking and an outside-in perspective, we help identify how these signals may impact the growth and relevance of organizations—based on our decade of research and knowledge in neuroscience and human creativity, as well as leadership in technology innovation, trends analysis, and start-up scanning.

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