



On your agenda

Innovating for tomorrow

U.S. CEO Outlook 2016

Manufacturers move closer to the customer

Hybrid, electric, connected, and autonomous vehicles. App-based mobility services. Smart buildings and smart cities. Commercialized low-earth orbit space flight.

In the industrial manufacturing industry, profound technological change driven by ubiquitous access to information, near-limitless data storage capacity, and speedy broadband communication is turning product structures upside down and disrupting business models. In fact, the industry has reached a customer inflection point: Manufacturers that take advantage of rapidly evolving technology, evolve the product into solutions for the ultimate user can expand their market access and court their customers or their customer’s customers much more intimately than they ever have before. At the same time, these trends also reduce some barriers to entry, and non-traditional competitors arise every day, with cheaper start-up and operating costs, easier access to large financial backing, and the power of the network driving massive scale for platform companies threatening to overshadow some of our oldest and most venerated manufacturing giants of today. It is no wonder CEOs say technological change will be the biggest factor impacting manufacturing company growth over the next three years, according to KPMG LLP’s (KPMG) U.S. CEO Outlook 2016.

“This is an unprecedented time in industrial manufacturing. Many CEO’s ask ‘Will my products still be competitive and relevant three years from now?’ No wonder, with new technologies, non-traditional competitors, and lower barriers to entry driving disruption.” — **Brian Heckler, National Sector Leader for Industrial Manufacturing, KPMG**

Manufacturing CEOs recognize that they are operating in a new world — one full of unprecedented opportunity, threats and risks. But they will have to be more agile, adaptive, and evolve to operate differently if they hope to thrive, let alone survive.

The next 3 years will be more critical for the industrial manufacturing industry than the previous 50.

Completely agree	15%
Agree	49%
Somewhat disagree	36%

Innovation and customer centricity

Manufacturing CEOs are facing the reality that the nature of what products do and how they are designed is changing very quickly.

As consumers become empowered with more information and insights, and as attitudes embodied in previous generations evolve, product value is moving away from price, functionality, performance, and even brand. Instead, product value is tied to how well the product solves a basic customer need or fulfills a specific customer desire, as other fundamental mandates around trust, loyalty, and customer priorities rapidly change.

At the same time, expanding market access is disrupting traditional distribution channels for customers and reshaping traditional B2B business models in manufacturing. Manufacturers now have the opportunity to leapfrog intermediaries, like dealer networks, and connect directly to the end customer. For example, an earth moving equipment manufacturer could transform into a surveyor while an air conditioning manufacturer could become an installer or an environmental management company.

For some manufacturers, shifting from product to product-enabled consumer company might be more than just an exciting prospect for growth. It might be an imperative in order to compete with new entrants from outside the sector. Consider how Uber is influencing automotive OEMs not by building a better, safer, cooler vehicle, but by providing people with reliable, economical, and readily available transportation in any car and changing buyer preferences and automotive functional application and productivity changing how we look at automobile ownership.

Fostering innovation

Given the disruptive forces at play, competing and achieving new growth will demand manufacturers to innovate new products and adapt business models at a faster pace and on a larger scale than ever before. Over the next three years, fostering innovation often is at the top of most manufacturing CEOs' strategic priorities, and new product development is the top area where they plan to devote significant investments. From a business model perspective, nearly half of CEOs (49%) acknowledge that their organizations will likely be transformed into significantly different entities over the next three years.

49 percent

of industrial manufacturing CEOs say their organizations will likely be transformed into significantly different entities over the next 3 years.

Industrial manufacturing CEOs' top strategic priorities over the next three years

Fostering innovation	26%
Stronger client focus (or to better meet customer needs)	24%
Improving the relevance of our reporting to investors	22%
Stronger marketing, branding, and communications	22%
Responding effectively to regulatory change	20%
Managing our ecosystem of partners/alliances	19%

Dealing with the accelerating speed of innovation and the shortening technology innovation cycle are major challenges for manufacturing CEOs. They are realizing that developing new products, managing the faster "clockspeeds" of technology and connectivity within longer cycle traditional product lifecycles, new competencies, or business models and adapting their in house capabilities to manage these new demands may not achieve the speed-to-market or product relevancy and agility that today's competitive environment demands.

That is why manufacturing CEOs are focused on sharing ideas and resources outside of the traditional manufacturing ecosystem and building networks that can leverage internal capabilities with external resources to create the bandwidth they need to get new, more relevant products to market. Almost all (8 out of 10) CEOs agree that it is critical to connect with suppliers, start-ups, academic and research institutions, and other external parties to drive innovation.

8 out of 10 manufacturing CEOs say that it is critical to connect with suppliers, start-ups, academic and research institutions, and other external parties to drive innovation.

Leadership and culture will also play a role in fostering innovation. Manufacturers today need to be more aggressive and demonstrate outside-the-box thinking about new products, services, and business models.

And, many organizations are adapting their organizational design, processes, capital allocation, resource deployment, and compensation measures to allow the duality of managing existing traditional businesses and products with potentially new solutions, products capabilities, and business models with different innovation requirements, success criteria, and organizational mandates.

While 84 percent of manufacturing CEOs say innovation is on their personal agendas, and as a group they largely view themselves as organizationally agile with innovation acumen — a management trait they view as helping to drive innovation — only one-third of CEOs say innovation in their organizations is strategic. More often, innovation is ad hoc, reactive, or occurring on a siloed basis with unpredictable results. That is an issue manufacturers will need to address as innovation becomes an increasingly critical differentiator in the industry.

“There needs to be a C-level focus on innovation and the disruption that is going to be coming. We are seeing lots of very traditional approaches and that’s very dangerous considering what the new demands are.”
— **Doug Gates, Global Sector Chair of Industrial Manufacturing, KPMG**

Building the future

In this extraordinary and disruptive time in the industry, it is clear that many industrial manufacturers will need to reshape their businesses to best capture new growth opportunities enabled by technological change. The transition is likely to require some serious soul searching.

Here are three key considerations for manufacturers as they consider their long-term futures.

- 1. Your customer focus:** Today, end users have a bigger influence on what your product is, what it does, where it comes from, how they buy and consume it, and how it is used. As such, manufacturers should increase their focus on end customer need. Managing and transforming today’s operating model for the challenges of being more customer centric, developing mass customization or Lot Size One capabilities will be challenging. To win in the marketplace, products and services must be more tailored to the end customer desire. Be aware: If you’re not able to meet their specific needs, your products are more likely to be commoditized, substituted for, or replaced.
- 2. Your competitive advantages:** Traditional competitive levers — cost, performance, brand, scale and distribution channels — may not matter as much in the customer-driven, platform company marketplace of today and tomorrow. Ask yourself: Are there new, nontraditional competitors creating different competitive advantages? What competitive advantages should you emphasize to better satisfy and solve consumer demand?
- 3. Your business and operating model:** As the race for the customer changes, so must your way of aligning to the marketplace. Given the influence of the end user, manufacturers will need to adapt their traditional way of interacting with customers — relying on relationships with dealers, intermediaries and traditional buyers. Is your business and operating model aligned to meet the needs of the new requirements of customers?

About KPMG's U.S. CEO Outlook 2016

This *On Your Agenda* is based on responses to KPMG's U.S. CEO Outlook 2016, a survey of chief executives representing key industries, including 53 CEOs of U.S. industrial manufacturing companies with revenue of \$500 million or more. Featuring the perspectives of industrial manufacturing leaders and frontline insights from KPMG partners, the report presents a forward-looking examination of the next three years in the industry.

Why KPMG's Industrial Manufacturing practice?

KPMG's Industrial Manufacturing (IM) team understands the complexity now flowing through the industry. We leverage our deep industry insight and our hands-on experience to help manufacturers shape a successful future while strengthening performance today. Using a cross-functional approach, KPMG's IM team empowers the world's leading manufacturing companies to achieve their goals. We put our breadth of experience and industry-specific knowledge to work for our clients, guiding them to make better decisions today to potentially create the greatest impact tomorrow.

Download KPMG's U.S. CEO Outlook 2016



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About KPMG

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KPMG delivers a globally consistent set of multidisciplinary services based on deep industry knowledge. Our industry focus helps KPMG professionals develop a rich understanding of our clients' businesses and the insight, skills, and resources required to address industry-specific issues and opportunities.

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