



Decoding disruption

How companies can navigate a world of constant change

Thriving on disruption series

When faced with the existential threats posed by disruptive technology today, leaders may be tempted to 'just do something'. But in their haste to address potential disruption, they risk making investments that destroy value. While ignoring disruptive forces is not an option, we believe a more measured, strategic response is needed.

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Navigating a disrupted world

Today, an unprecedented level of disruption is impacting virtually every industry - formulating a strategic response is critical to long-term survival.

The confluence of a range of interconnected forces – demographics, social values, urbanization, regulation, politics and technology has magnified their individual significance and catapulted the broader issue of disruption onto the C-level agenda. The increasing ubiquity of technology and pace of technological change is often regarded as the most enabling, yet most dangerous, of disruption drivers. CEOs are under pressure to act quickly and decisively – to embrace digital, to adopt new technologies and to reinvent their business and operating models. But with new, disruptive ideas coming thick and fast, how should they determine where the real threats or opportunities lie – and what action to take?

Those that are too slow to act could see their market share, and sometimes their personal fortunes, swiftly eroded. There are far too many examples of companies that went bust when they ignored potential life-threatening disruptors for too long. Similarly, those that focus only on the unwelcome consequences of disruption and fail to embrace the positive characteristics it brings as a catalyst for change, risk missing potential opportunities to transform, drive value and reimagine their role within an industry or a customer's life.

But this imperative to 'act now' can drive executives to act in haste. The 'need for speed' can short-change the depth of analytical rigor that typically precedes major strategic decisions, and could result in strategic misalignment, sub-par payback, and value destruction.

With disruption here to stay, organizations should avoid short-sighted, 'me too' or overly knee-jerk reactions, in favor of building a more holistic view and strategy on disruption. We propose a four-step approach to deciding where to play, how to win, and what actions to take:



Step 1: Map the disruption landscape

Filter through the noise to identify the most relevant disruptors.



Step 2: Conduct a threat assessment

Study the likely impacts of potential disruptors.



Step 3: Chart the course

Recalibrate the strategy and realign ongoing initiatives.



Step 4: Transform the DNA

Build the capability to recognize and harness disruption.

'Do nothing' is not an option

With the accelerating speed of technological disruption, CEOs are no longer questioning whether to act, but instead asking where and how.

The combined effect of several megatrends – technology-enabled capabilities, increasing scrutiny from a wide range of stakeholders, a stream of new regulations, and changing customer behavior, all add great uncertainty to the business environment.

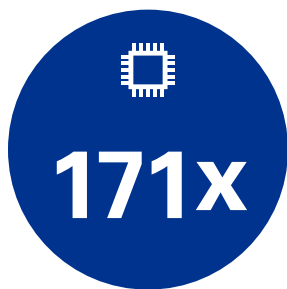
Technology is often seen as the biggest disruptor and disruption enabler. The exponential growth in the availability of computing power, network bandwidth and the penetration of mobile and connected devices, combined with the wide array of emerging technologies including Artificial Intelligence (AI), robotics, 3D printing and the Internet of Things (IoT), are all helping to bring to life products and value propositions that were until recently confined to the realm of science fiction.

But in addition to raw new capability, speed to market is now a major disruptive force. Available infrastructure and the ability to procure 'everything as a service' allows businesses to set up and scale at previously unthinkable rates.

These developments are already starting to push long-established business and operating models into obsolescence. As the boundaries previously delineating sectors dissolve, convergence is profoundly altering the competitive landscape, bringing new, unfamiliar, and unpredictable competitors, and threatening well-established ecosystems.

Exponential growth in enabling technologies

Computing power



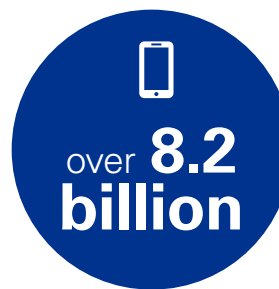
Growth in number of transistors in commercially available processors 2000¹ – 2016²

Network bandwidth



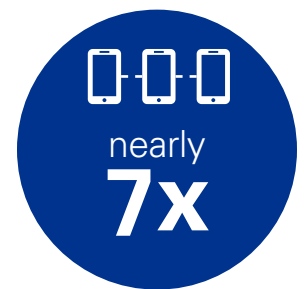
UK average broadband speed 3.6Mbit/s in Nov 2008³ compared to 36.2Mbit/s in Nov 2016⁴

Mobile penetration



Mobile connections⁵, and over 5 billion unique mobile subscribers⁶

Connected devices



Number of connected devices as compared to humans by 2020⁷

Take automotive for example, where we are seeing a redefinition of the car as a mobility platform, and a shift from car ownership to mobility as a service. The battle for dominance now involves traditional automakers, ride-sharing companies, technology companies, and new players including insurers and media conglomerates taking a keen interest in playing a role.

This scale of change brings opportunity for new entrants and disruptors, each vying to rewrite the rules of the game. Venture capital (VC), seeing this opportunity, has been highly active over the past few years, with deal volumes on a roller-coaster ride, from US\$12 billion in Q1 2010 to a peak of US\$47 billion in Q2 2016, down 14.2% to an estimated US\$40 billion in Q2 2017⁸. While this frothy environment tells us that we have not settled on the new normal yet, the upward trend is unquestionable.

More importantly, the proliferation of startups is not limited to Silicon Valley anymore. There has been a fundamental shift in mindsets around the world, with greater acceptance of the startup culture, increased willingness to experiment and fail fast, and government incentives to support innovation. Successful disruptors, such as Spotify, Supercell, Deep Mind, Alibaba, and Tencent have all originated outside Silicon Valley.

As the fundamental nature of business and competition changes, incumbents can no longer rely on traditional barriers to entry, or protective 'moats' such as core competencies, scale, customer ownership and supply chain relationships.

Companies and their leaders are increasingly realizing that disruption isn't just something that they need to respond to and instead of being disrupted, they are looking to disrupt. According to KPMG's 2017 Global CEO Outlook, which gauges the views of 1300 chief executives from many of the world's leading companies, 74% of CEOs want to make their company a disruptor in its sector⁹. 'Doing nothing' is not an option anymore. The question for CEOs is not whether to act, but where and how.

Five years ago, the banks stood by and said 'no chance'! Startups have no brand, and no regulator support. But in the last three years, they have been rushing to set up incubator units, hire senior heads of digital disruption, and building 'Fintech from within'.

– Founder, London-based fintech fund

Are incumbents taking the right action?

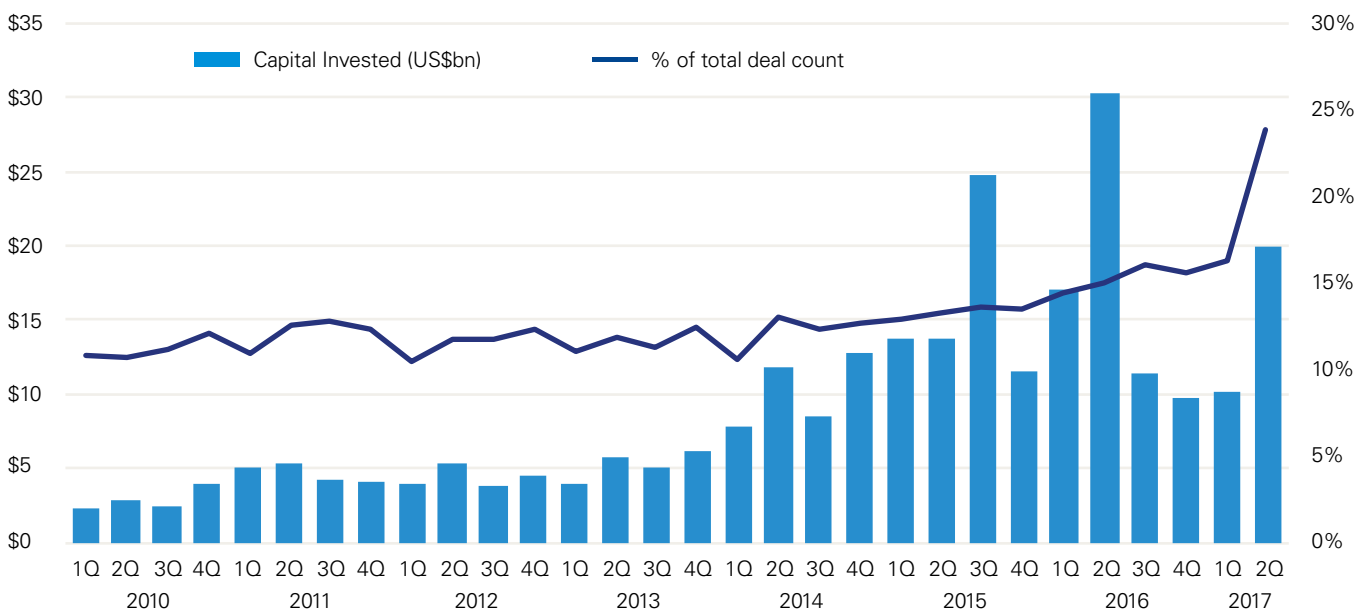
Unsurprisingly, businesses are taking action to meet this challenge. While the traditional 'do it yourself' model persists, it lacks the speed and agility that a disruption response requires.

Internal teams are weighed down by the status quo – well suited to 'continuous improvement' projects, but less successful at fostering major shifts in business and operating models. As a result, alternate approaches, such as setting up a corporate VC arm or establishing accelerator programs are being increasingly used.

A corporate VC arm scouts and invests in disruptive startups. This brings influence and early access to technology and new business models as they emerge. We are witnessing a steady growth of corporate participation in VC-backed companies.

Corporate VC participation in global venture deals¹⁰

2010 — Q2'17



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An alternate model is the sponsorship and running of 'accelerator programs' that incubate startups, providing first-mover access to the associated technological advancements but with sufficient autonomy and independence from the current core business. In financial services, for example, several leading firms now run accelerator programs, covering everything from lending and payments to insurance and investment management, incorporating a wide range of technologies. Citi was one of the first banks to launch a FinTech accelerator in 2013, and has now supported over 55 startups¹¹ from its Tel Aviv program, while The FinTech Innovation Lab in London helps startups refine and test their propositions with the support of many leading banks. Similar innovation labs are also being set up in Shenzhen, Beijing and Hangzhou.

Both these approaches can consume considerable sums of capital with an unreliable payback. Larger businesses – like banks, or big technology firms – may be able to absorb and sustain this level of investment, but few others have

such deep pockets, especially when casting the net wide in hope of returns. Funding new ventures and managing accelerators requires effort and patience, to constantly explore new ideas, rationalize existing efforts, and wait for results. This is a significant departure from 'standard' internal project models, with returns being highly probable, and achieved in months, rather than years. Working with startups can also bring culture clashes, a very different perspective on risk and regulation, and, sometimes, a lack of mutual respect.

In addition, startup success is notoriously elusive. KPMG's research indicates that only 10-15% of startups survive to Series C funding¹² (Series C is the third round of fund-raising, usually indicating healthy growth and success for the startup).

These factors add to the risk and cost of investing in startups, making it important for companies to choose and design the overall portfolio of disruption responses with care. However, there are indications that this may not be the case.

There is a lot of chaos and a lot of experimentation going on. Some banks have started their innovation thinking late. But no one has cracked the code here. We will see a lot of changes in the next decade.

– Former Head of Group Digital Strategy, Top five UK bank

KPMG's 2016 Global CEO Outlook flagged that 86% of CEOs do not have the time to think strategically about the forces of disruption and innovation shaping their company's future¹³.

Our survey of senior technology executives also indicated that most firms were casting the net widely, investing in a number of different technologies simultaneously – potentially reflecting the lack of a clear and coordinated strategy¹⁴. While in a disruptive age, speed of response is evidently important, this should not be at the expense of a more holistic and strategic vision.

We believe that an unfocused approach to dealing with disruption can lead to a skewed portfolio of investments, low success rates, sub-par payback, and value destruction. Perhaps more importantly, investing in startups is primarily an investment play. It does not make the company, its business model or its operating model any more resilient to disruption.

Banks have realized that things are changing quickly, and their business is getting dis-intermediated. Banks are trying to innovate, but the returns are not lucrative for internal investment in disruptive innovation. Another major issue is the speed at which they operate. With legacy processes and systems, they lack nimbleness and agility. By the time they move, the market evolves further. You cannot afford to wait for three years to come out with something that would work today. By that time someone else would have captured the market.

– Former Head of Group Digital Strategy, Top five UK bank



A four-step approach to address disruption

So how can companies navigate disruption? How should they avoid the twin traps of either waiting too long and acting too late, or acting too quickly and investing in areas that don't pay out?

Our experience points to a measured, four-step approach that can give a better chance of success:



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Step 1

Map the disruption landscape

Filter through the noise to identify the most relevant disruptors.

The first challenge is to cut through all of the noise surrounding disruption. Not every new upstart is going to be the next big thing, and not every new technology will 'redefine the rules of the game'. Furthermore, the true threat posed by disruptors varies by sector, and can in fact, be specific to individual businesses.

Companies need to build an up-to-date understanding of the landscape of disruptors around them and continually scan the horizon for potential game-changers. To do this effectively, we believe that three distinct perspectives need to be considered: current trends in the industry sector, new and emerging technologies, and relevant disruptive patterns.

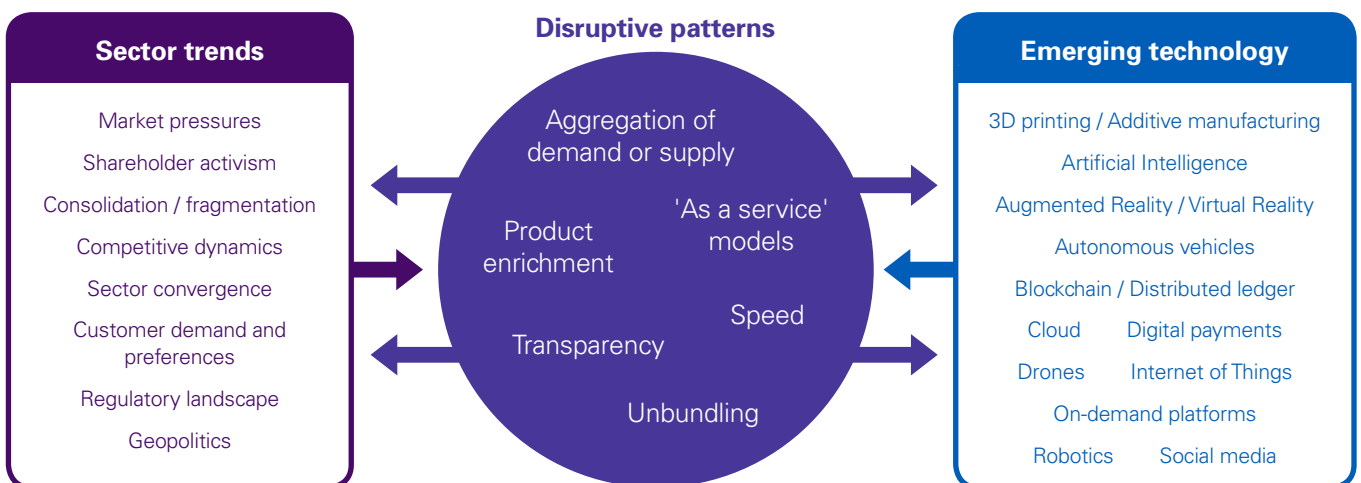
Studying trends within the industry sector can uncover ongoing disruptive investments driven by competitors or adjacent value chain players, as well as threats from sector convergence. Further, it can help predict potential areas for future disruption. Taking a critical look at the value chain can identify areas of frustration or complexity that a

disruptor could seek to remove, or pockets of waste that a new or different approach could eliminate. Assessing new and anticipated regulations can identify where there are likely reputational issues or a potential breakdown in trust that new competitors could play on to gain share.

New and emerging technologies bring capabilities that can significantly reshape the business environment. Each potentially disruptive technology should be studied for its possible applications within the sector. To support this assessment, it is key to review the activity of startups as well as the levels of funding, both of which provide a reliable indication of the momentum gained by specific technologies.

Finally, applying recognized disruptive patterns from other sectors or fields can help visualize new business and operating models, and triangulate which technology or combination of technologies may be central to future disruption.

Applying three perspectives on disruption (based on KPMG's 'Wheel of Disruption')¹⁵

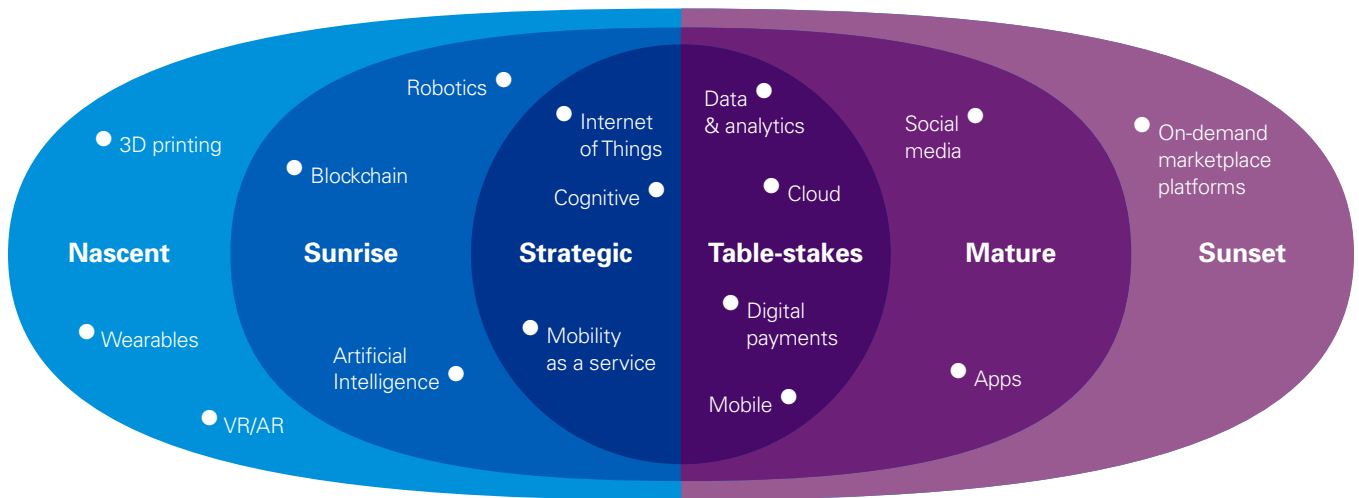


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Based on the application of these perspectives, we recommend the creation of a 'disruption radar', categorizing the underlying technology along the spectrum from nascent (very early and unproven), to sunrise (clearly on the horizon), strategic (not mainstream yet, and can provide an advantage), table-stakes (adopted by leading players), mature (a standard application, well

embedded), and sunset (end of life). Such a disruption radar helps prioritize technologies for further investigation, clearly differentiating between table-stakes investments required to remain relevant, strategic investments that can help leapfrog the competition, and a host of 'other' technologies that should continue to be tracked and monitored prior to action.

Disruption radar (Telecommunications sector example¹⁶)



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Step 2

Conduct a threat assessment

Study the likely impacts of potential disruptors.

The next step is to assess the impact these potential disruptors could have on the business. It is important to recognize that this may mean different things for different companies, even within the same sector – one size will not fit all. For example, the rise of travel aggregator websites, which has wreaked havoc on the pricing models for premium airlines, has been a growth driver for low-cost carriers.

To evaluate the impact of the ‘most promising’ disruptors, we propose looking across the financial, business, and operating models of the company. These three perspectives are not mutually exclusive, but are in fact inextricably linked. Applying all three points of view helps identify where the impact will be felt first, as well as its cascading implications, to create a holistic picture.



Financial Model

The financial model encompasses revenue, cost, profit, investment models, and tax structures and could be impacted in a number of ways:

- new models for revenue generation, for example selling a service or experience rather than a product, could disrupt existing financial models
- profitability could be challenged due to revenue shifts, customer turnover, pricing pressures, and cost increases
- threats to the long-term competitiveness of a business could directly impact its ability to raise capital
- increasing volatility and the introduction of new competitors could shorten investment horizons, as long-term bets are no longer considered safe.

The financial model is also especially vulnerable to macro-changes. As an example, with Brexit, the sudden weakening of the British Pound has had a major impact on UK businesses that earn revenues in one currency and incur costs in another. The greater the political interference and uncertainty, the higher the risk to the financial model.

The potential impact of disruptors on the financial model can be assessed by designing and running scenarios that stress-test key underlying assumptions in the model, testing its resilience, and highlighting points of vulnerability.

Business Model

A company's business model comprises the markets it operates in, the propositions and brands that it takes to market, the customers it serves, and the channels it uses. Usually, competitive disruption is first perceived within the business model.

New entrants can disrupt value chains and redefine or reshape markets, impacting the 'deep wiring' of the industry, and challenging fundamental assumptions. For example, platform-based or 'marketplace' businesses can change the composition of buyers and sellers – sharing economy platforms allow new sellers to participate, while 'peer-to-peer' platforms can bring access to new customer groups not served by traditional models. If we look at the top 25 most valuable startups, the majority are platform-based businesses.

Emerging technologies could disrupt existing product propositions by offering better value through superior quality, convenience, and customization. As an example, the Internet of Things allows data to shape product behavior, making them more intuitive, responsive, and useful.

The customer is another key disruptor. With different social values, a greater openness in sharing personal information, readiness to participate in trials and beta tests as well as to share or rent rather than own assets, millennials are proving to be a very different breed of customer. If companies don't act now, they will be well behind what the customer has started to demand. They need to find ways of offering a fundamentally different experience – a true 'segment of one'.

Disruptors could make a play to disintermediate and 'own the customer'. For example, comparison websites could know more about the customer than vendors, and tailor and bundle offers that cannot be easily matched by single providers. Customer bases could be disrupted through new channels, as demonstrated by mobile-based businesses offering completely new levels of quality, convenience, price and choice.

Many social media platforms were slow in realizing how quick and fundamental the migration to mobile would be. But once they did, they aggressively migrated their technology and advertising push to mobile, effectively cannibalizing their desktop-based revenues. This is the behavior that most incumbents struggle with, as short-term financial results drive behavior.

Future value comes from owning the customer interface. Incumbents should assess their roles in the value chain and in their customers' lives, and build on their many strengths, like regulatory expertise and consumer insight. They may want to assess joint ownership of revenue-sharing models with partners, while outsourcing back-office processing.

– Founder, London-based fintech fund

Each element of the business model should be studied to identify potential areas of weakness that a disruptor could exploit. Incumbents should explore new capabilities that enable distinctive value propositions, are more tailored to customer needs, reduce wastage and improve coverage.



Operating Model

An organization's operating model comprises the key elements that allow it to deliver the business model and accomplish its financial ambition. This includes its business processes, supporting systems and data, infrastructure, organizational structure, people, culture, and management systems. Advancements in technology are accelerating the disruption of operating models, enabling a step-change in capabilities and reshaping the cost profile.

New capabilities can fundamentally alter core business processes. For instance, Artificial Intelligence and machine learning enable certain insurance claims to be handled in a matter of seconds – upending the traditional model of human investigation, evaluation, and decision-making.

Cloud computing has made it possible to instantly scale a business and reduce investment cost. Where in the past, IT assets

were major investments, and in some cases brought competitive advantage, businesses being set up today are largely oblivious of the hardware they use, enabling newcomers to grow and scale up operations at previously unthinkable rates.

In addition, new operating model capabilities could power business model change – for example, platform business models have been made possible by online, networked and integrated back-end IT systems.

Looking at each potential disruptor through these three lenses provides an in-depth and holistic understanding of the possible impact. This approach helps segregate the truly transformative disruptors from those driving incremental improvement. Identifying where and how the impact will be felt is key to assessing vulnerability and planning an appropriate response.



Step 3

Chart the course

Recalibrate the strategy and realign ongoing initiatives.

Large scale disruption is likely to fundamentally shift the underlying assumptions underpinning key components of an organization's existing strategy and will drive the need for recalibration. It is important to revisit the relevance of the existing portfolio of strategic initiatives. Critical sources of value will need to be identified, assessment criteria agreed, priorities redefined, and areas for investment re-selected.

In our experience, we find that it can help to think about the most important disruptive forces and identify where there is scope for bold, first mover advantage, where a defensive play is required or where a fast follow could be advantageous. We believe that there are four broad stances that organizations can consider: defend, adopt, disrupt or retreat.

The chosen response to disruption should drive a recalibration of the strategy. This will impact priorities, and requires clear and visible commitment towards identified investment areas. In our experience, we find that selecting a few 'themes' or 'platforms' to focus on, rather than specific technologies or applications, is an effective means of prioritization. While it is difficult to single out individual winning applications of technology early on, it is much more likely to identify the broader trends and technology areas that will drive disruption.

Defend

Potential disruption can sometimes be countered by raising barriers or other similar defensive moves. In our experience, however, this tends to be a short-lived response. For example, music labels initially deterred peer-to-peer music-sharing service Napster through legal action over copyright infringement. But Spotify and other music streaming providers soon found a legal way to commercialize streaming and have come to dominate the sector.

Adopt

Another response could be to jump onboard, actively trying to integrate the disruptive technology or disruptive force into the company's business or operating model. As an example, the financial sector has started exploring the applicability of blockchain, setting up consortiums and working groups to jointly address the disruption. Recently, AXA (a large French multinational insurer) released 'fizzy', providing insurance for flight delays that is fully automated using a blockchain back-end.

Disrupt

Businesses could decide to be the trailblazer, disrupting the market and themselves. Such a move invariably results in cannibalization of the existing business model, but can also provide an invaluable first mover advantage. When Netflix first introduced the streaming service in 2007, it did so in competition with its mail-order DVD service. It has now grown its streaming service internationally, while the DVD service remains domestic and is now a small fraction of total revenues¹⁷.

Retreat

The final option is to accept defeat and try to extract maximum value, while simultaneously focusing on growing other business areas. As an example, Fuji maximized revenue from its declining film photo business, as it prepared for the switch to digital, while also developing alternate new business lines. Today, it has a market capitalization of US\$12.6 billion, whereas its once famous rival is no longer in business¹⁸.

To partner or to go it alone?

The pace of change, and the constant emergence of new technologies and niches, makes it hard for organizations to confront disruption on their own. Earlier we talked about the role that M&A and alliances have already been playing in companies' distribution responses. Collaboration is fast becoming the norm as players recognize the need to be part of a wider ecosystem, building on, and leveraging advances made by others.

Partnering with startups is increasingly viewed as an attractive option, as these smaller businesses have the agility to move quickly to adapt to new trends and market demands. In addition to bringing talent, technology and ideas, startups are typically unencumbered by the infrastructure, culture and regulatory burden of established institutions. A startup's prime reasons for partnering are to access a broader customer base and benefit from the resources and brand of a major corporation – something that the incumbent should recognize. A well-planned exit strategy helps ensure that both parties get what they want from the partnership.

Strategic alliances with other bigger players is another potential model, although many companies struggle to make these succeed, due to a range of factors including cultural differences, revenue-sharing disputes, and conflicts over future direction.

The future for some large corporations lies in being a distribution partner to bring scale to startups.

**– Former Head of Group Digital Strategy,
Top five UK bank**



Step 4

Transform the DNA

Build the capability to recognize and harness disruption.

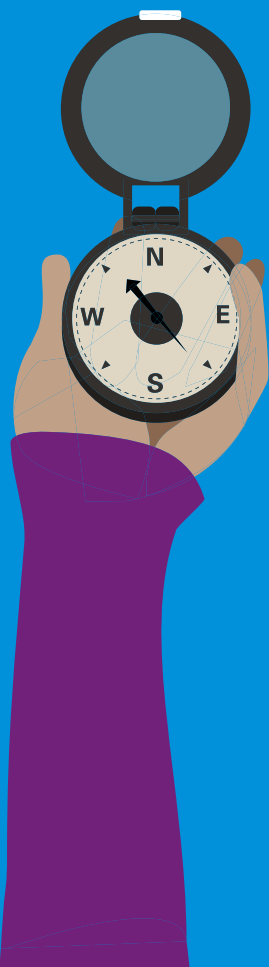
We believe that technology-led disruption is a permanent, systemic change to the business landscape. To go beyond incremental improvement and craft truly innovative responses to disruption, organizations need to embed steps one-to-three – mapping the disruption landscape; conducting threat assessments; charting the course – into their DNA.

Organizations must crack the code of incubating innovative ideas, allowing them to develop, monitor and manage the portfolio of investments, and when they are ready, find effective ways of integrating the innovation ‘back’ into the business. Unfortunately, many traditional organizations are not good at encouraging ideas, taking risks, experimenting and failing fast, making both the incubation and reintegration of ideas a challenge. They carry huge overheads, with big IT departments that make it difficult to integrate new ideas and move swiftly. The committee-based decision-making model hardly helps the cause, encouraging the status quo and slowing down progress. Classic linear approaches of phased planning and 2-3 year implementation programs need to be replaced by the well proven agile approaches and a culture of ongoing experimentation, challenging the status quo, and quick decision-making.

Everything you do has to go through a Board-approved decision process, and anyone can kill it. Key decision-makers’ P&L depends on keeping the current models alive. It becomes impossible in the governance structure to get these things approved.

– Digital lead, North American Retail giant

According to one senior manager at an American retail giant, it is extremely hard to integrate an innovative business with a traditional one: “We tried to mix the core business and the innovative business, but it does not work. There are conflicts of interest on both sides of the equation. Our core business is focused on the short-term, quarter-by-quarter, rather than on longer-term innovation. Keeping them together will kill it – you need to create separation.”



The success of internal incubation ecosystems requires them to be distinct from and untainted by existing practices, and free from the pressure to deliver immediate returns. However, running such a parallel organization is costly, and needs to be carefully managed. Startups and incubators need room to grow, but cannot be indulged indefinitely. A venture fund mindset can help organizations take objective decisions on whether to continue or whether to terminate investment. Finally, to improve the chances of reintegration, managers and leaders from the core business must participate and become champions for the new innovative projects. Once these initiatives have proved successful, their leaders should then be incentivized to bring the innovations back into the main business.

Successful disruption response will require a culture shift. Employees will need to be more open to change, and encouraged and incentivized to innovate and disrupt the status quo. This is easier said

than done, as our entire process and reporting apparatus rewards 'playing by the rules', and delivering consistently on set metrics. Risk-taking, experimentation and failure are seen as negatives. The culture change needs to be driven from the top. Senior leadership – the CEO and the Board – should have disruption high on their agendas. It should be discussed regularly and form a core part of ongoing strategy.

Even in a young business like ours, 'change' is hard to manage over time. We are looking for constant change as part of an evolutionary process but also need ongoing transformation to continue to be a leading disruptor.

– CEO, leading Japanese internet retail platform

What is your disruption strategy?

The winners will be those that embrace the opportunities that disruption presents, respond in a measured manner and embed a culture of reinvention into their DNA.

Every stage in the evolution of industries brings winners and losers, but the devastating speed of technological disruption has caught established businesses unawares. The experience of many incumbents suggests that acting hastily may be just as risky as doing nothing.

Disruption is not a passing phase. The rules of engagement have changed fundamentally, and companies cannot afford to play at the edge of change, but must embrace it fully – even if it means dismantling their own, historically successful business and operating models.

The four steps we have outlined in this paper can help organizations understand the competitive environment, address the threats and embrace the opportunities of disruption.

Cultures, incentive models and organizational constructs should encourage all employees to be on the lookout for disruption, be open to new ideas, constantly challenge the status quo, embrace reinvention and change, balancing the needs of a ‘startup like culture’, while running an established business.

But this can only happen if CEOs are fully behind change, placing disruption at the top of their agendas. Visible leadership support is a critical factor in driving innovation as an essential response to disruption. A measured, holistic, strategic response to disruption, driven from the top and embedded in the culture is key to longevity in today’s business environment.



Step 1: Map the disruption landscape



Step 2: Conduct a threat assessment



Step 3: Chart the course



Step 4: Transform the DNA

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Actions:

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