



CONSUMER CURRENTS

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chairman is obsessed
by customers

Platform strategies

Should you defend
against, compete with
or join the disruptors?

Issue 25

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Consumer Currents



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“Platform businesses, a new breed of multinationals, are redesigning consumer and retail”

What do you really know about your customers? Their age, income, marital status? Sandy Friesen, who sells Welden handbags to China, knows what many of hers look like, their favorite opera and what colors they want (“everything red”). She knows all this because, advised by a Chinese online influencer, she set up an interactive livestream to China from her living room in Connecticut, US. After two days, she sold 1,000 bags, priced from US\$195 to US\$595, on Alibaba’s B2C platform¹.

This story fascinated me for two reasons. First of all, it shows the flipside of the platform business model. We scrutinize the activities of such giants as Alibaba, Amazon, Facebook, Google and Tencent so closely that it is easy to overlook the wealth they generate connecting millions of entrepreneurs to consumers across the globe. There are two million third-party sellers on Amazon alone and, in 2017, over 300,000 small and medium-sized businesses in the US started selling on its platform². The second lesson I take from this story is about the power of genuine customer centricity. Many executives talk the talk about putting customers at the heart of their business, but giving them an interactive livestream into your living room is certainly walking the walk.

Alexandre Ricard, Chairman and CEO of Pernod Ricard, is walking the walk in a different way. As you can read on p6, the drinks giant has changed the way it categorizes customers. With consumers becoming less loyal to – and more demanding of – brands, management now focus their marketing on “moments of consumption” rather than specific products. They recognized that a consumer is likely to buy different brands at an after-work drink with their boss than on a Saturday night out with friends. The task for Pernod Ricard is to identify the relevant moments of consumption and ensure they have a product to suit.

Like many consumer and retail CEOs, Ricard admits to being “obsessive” about customers and by the way technology – particularly artificial intelligence (AI) – can build a more accurate and nuanced picture of consumers. Platform businesses are already reaping these benefits, as we explore on p10, seven of the world’s 10 largest companies operate on a platform model³. Their growth shows that, in this new consumer economy, first mover advantage is more powerful than ever.

This new breed of multinationals is redesigning consumer and retail. In China, companies like Alibaba see no compelling distinction between online and offline, they see them both as parts of a concept called ‘new retail’ and their goal is to be wherever and whenever the customer wants them to be. The evidence suggests it is working. On 11 November 2018, known as Singles’ Day in China, Alibaba’s shopping sites did US\$30bn of business⁴. When you add JD.com, the total climbs to US\$50bn in one day.

In this ‘new retail’, established players have three choices: they can ignore platform businesses, defend against them or join them. There is no ‘right’ answer. The most effective strategy will be influenced by all kinds of things, from the size of the business, the sector you are in, and the scope of your ambitions. There may be no ‘right’ answer for incumbents but there probably is a ‘wrong’ one. Ignoring them is a choice you make at your own peril. Why take that risk?

We’re passionate about consumer and retail and I or anyone on our team are happy to discuss anything you read in this issue at any time.

¹Welden Makes Debut in China With Help from Taobao Buyers, *Alizalia*, April 2018. ²Amazon 2017 Annual Report.

³The Platform Economy, *The Innovator*, January 2019. ⁴Quartz report on Alibaba, 2018.

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 Today's consumer
 is radically different
 to yesterday's consumer
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Are consumers still app happy?

As smartphone shopping grows, apps need to clearly offer more value

You have probably heard of the phenomenon called ‘app fatigue’. Like Mark Twain’s demise, this has been much exaggerated. In the US, more than one in five Americans will use a smartphone app to buy groceries at least once a month this year, according to eMarketer. In 2018, AppAnnie estimates that global app downloads topped 194 billion, 35 percent more than in 2016.

Consumers aren’t tired of apps, but they are tired of slow to load apps with tricky user interfaces that aren’t obviously useful. Give them an app that helps them to instantly locate an elusive item and they’re engaged. They’re even more likely to be impressed by apps that offer them 2 for 1 price deals, enable them to reserve goods to collect and, using augmented reality, place 3D models of furniture into any space, creating an image they can share on social media.

Estimates of how many apps consumers typically download, how many they use, for how long and how satisfied they are with them vary so wildly that it is

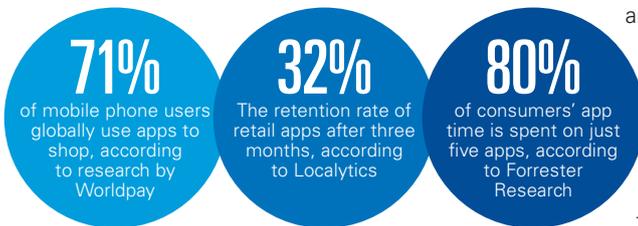
hard to authoritatively identify the extent of user fatigue – or what causes it. At the same time, given that Forrester Research estimates that by 2022 US consumers will make purchases on their smartphones that total US\$175.4bn, this is not an opportunity that any brand can afford to ignore.

Yet the battle to keep apps on a consumer’s smartphone is only going to get fiercer: a 2017 survey by internet developer Alligatortek found that 54 percent of US consumers said they delete apps at the same rate as they download them.

Social media companies such as Facebook, Instagram, Snapchat and Pinterest are also investing heavily to facilitate shopping – making their apps multi-functional. In China, 31 percent of users of WeChat, Tencent’s social media app, have used it to make purchases, according to eShopWorld Insight.

The key to success, says **Mark Larson**, Head of Consumer & Retail, KPMG in the US, is to put the customer at the center of your app development. “You need to define the most urgent customer needs your app has to satisfy. That will help you control costs and development time, focus on the minimum viable product – by testing that it can perform the one essential function – and let the users guide your development.

“Like the brick-and-mortar store, apps will always be with us – even if some of them evolve into chatbots – and the key, for retailers and manufacturers, is to ensure that they continue to meet rising consumer expectations.”



“It’s in my DNA”

Discovering your DNA profile no longer means going to a doctor. Around 12 million people worldwide have taken a direct-to-consumer DNA test. Most are looking for long lost relatives, but others want to know more about themselves and their likelihood to get certain illnesses. They could also be prepared to use the results to scientifically select products and services.

There are various companies

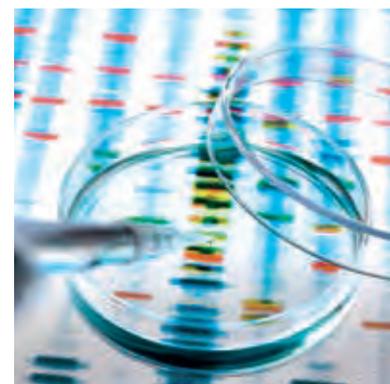
that offer DNA tests to help consumers use their genetic information to make healthy lifestyle changes.

Skincare is another sector where DNA is making an impact. UK company GENEU uses genes to determine the rate skin ages and prescribes personalized anti-aging serums.

Our genes can affect our taste buds too. Vinome analyzes consumers’ DNA to match wines

to their taste palate. And last year, Spotify in partnership with genealogy company Ancestry, introduced personalized playlists for subscribers, based on their DNA.

“But it is open to question whether DNA profiles really are the next frontier in customer segmentation or just a fad,” says **Joel Benzimra**, Global Leader Consumer & Retail, Advisory, KPMG in France.



Making in-store tech work

Is in-store tech actually helping consumers or not? Self-service checkouts with unfriendly voices that aren't as smart as they should be are often a major irritant. According to research by Cognizant, 26 percent of UK shoppers say in-store technology does not work properly. While research by the retail-technology company Tensator, found one in three shoppers in the UK had walked out of a store without completing a purchase, because of a bad experience with a self-service checkout.

But new technology – everything from mobile payments and smart sensors to automation and AR/VR experiences – can transform the in-store environment.

Chinese companies have embraced technology. JD.com's supermarket 7Fresh has smart shopping carts that

follow shoppers around the store, leaving them hands free. 'Magic mirrors' sense when an item is picked up and display information about it.

Yum China has unveiled AI-powered self-ordering kiosks and automated dessert stations for KFC stores in China, and is rolling out 'Smile-to-Pay' facial recognition payment. Such technologies are being tested in a pilot store in Hangzhou.

Businesses need to take the time to find out what would improve their customer experience, find the technology that can do this and then test it out. "Stores need to decide what aspects of the customer experience they need to improve most and ensure that the technology they deploy is fulfilling that need," says **Paul Martin**, Head of Retail, KPMG in the UK.



Technology needs to enhance the customer experience

On trend in-car retail

In the future, there will be nowhere consumers can't shop. The advent of autonomous vehicles could lead to 700 million virtual personal assistants being installed in cars by 2024, according to IHS Markit.

The GM Marketplace already allows drivers in connected GM

vehicles to press a button to order items from various food and drink outlets. Many car manufacturers are also integrating their infotainment systems with voice-controlled virtual personal assistants. Honda has

recently launched its voice-activated Honda Dream Drive prototype – which combines infotainment, commerce, services and rewards features –

partnering with chains such as Grubhub and The Coffee Bean & Tea Leaf.

The potential will only increase as driverless cars become a reality. "Once motorists don't actually have to concentrate on driving, they will want to do even more in their car," says **Katherine Black**, Principal, Consumer & Retail Strategy, KPMG in the US.

700 million
virtual personal assistants will be enabled in vehicles by 2024

Customer First



Customers are assets

Meeting consumer expectations will deliver returns, says **Julio Hernandez**, Customer Advisory Leader, KPMG in the US and Global Lead, Global Customer Center of Excellence

The customer relationship has never been in such a state of flux. New experiences, new technologies and new competitors are redefining customer expectations. It has never been easier for your customer to walk away. It has also never been easier for them to vocalize exactly why they are walking away.

The opportunity is less obvious – but potentially transformational. With the right technology, data, organizational structure and mindset, you can, by building equity with a customer, turn them into an asset that delivers returns for a long, long time.

Forward-thinking CEOs are asking new questions. They are moving on from "What can we make?" and "How do we sell it?" to "What do our customers want? What do they not want? How do we calculate the value of our customers? And how do we improve the customer experience to increase that value?"

If companies could recognize a customer's future value, they would behave differently. Let me give you an example. In the US last year, the typical weekly spend on groceries was around US\$109. That equates to US\$5,668 a year. If they stayed loyal to the same grocer for 25 years, they would have spent enough to buy a new sports car. Crunching down on these kinds of figures helps companies change their mindset from purely transactional to a more balanced relationship focused on value.

Making businesses customer centric is not about pleasing everyone, all the time, in every way. Data can help managers identify the customer experience actions and changes that will generate the most financial value. To succeed, managers need to recognize that offering an experience that is slightly better than their nearest rivals is no longer sufficient. Today, as consumers, our expectations are increasingly defined by the best experience we have ever had – be it from a competitor or another industry.

Last year, the KPMG Global Customer Center of Excellence polled almost 55,000 consumers in 14 countries to discover which brands were delivering the best experiences. That survey showed that revenue growth among the 50 top brands was 54 percent greater than the bottom 50. The companies that prosper in a hyper-competitive market will be those that deliver tomorrow's customer experience today.

You can download the report *Tomorrow's Experience, Today* at kpmg.com/customerfirst

“What matters is that we continue to be obsessed with the consumer”

Pernod Ricard chief Alexandre Ricard explains how the drinks group is adapting to changing customer tastes

Alexandre Ricard, Chairman and CEO of Pernod Ricard, was once asked what kept him awake at night. “I go to sleep right away,” he replied. A better question, he countered, would be what made him get up in the morning? To which he answered: “this is a fun industry, full of great people, selling Scotch, vodka and gin.”

The 46-year-old grandson of Paul Ricard (who created the eponymous brand of anise in 1932) was born in Paris, went to school in Andorra and moved with his family to America when he was 10. He didn't live in France until he was 18. His career has been just as multinational. In 1996, after graduating from ESCP Europe, he applied for a job at Pernod Ricard. His interview with the head of HR did not go well and he accepted an offer from Andersen Consulting. He really learned the ropes, he says, working in mergers and acquisitions for Morgan Stanley in London. After eight years, he reapplied and this time the same HR director gave him a job. As painful as it seemed at the time, that first interview was, he says, one of the best things that could have happened to him.

Knowing Pernod Ricard from inside and out, he ran the group's duty-free business in Asia; Irish Distillers in Dublin; and the company's distribution network before becoming COO and Deputy CEO in August 2012. When CEO Pierre Pringuet retired in February 2015, Ricard became Chairman and CEO of the world's second largest wines and spirits group.

On his watch, the business's organic growth has quickened (from 3.6 percent in 2016/2017 to 6 percent in 2017/18), operational savings have been made, digital transformation has been accelerated and two of its best known brands, Martell cognac and Jameson Irish whiskey, experienced double digit growth in 2017/18.

Ricard is not complacent – as he said once “Does anyone ever know everything?” – but he is, as he makes clear in conversation at the group's Paris head office, enthusiastic about the business and its prospects. To succeed in today's fiercely competitive market, a multinational like Pernod Ricard must, he says, “stay true to its DNA yet be prepared to change its ways of working.” He acknowledges, with a quick smile, that striking such a balance is less about words than deeds.

What was your most urgent task when you took over as Chairman and CEO of Pernod Ricard in 2015?

The board asked me to select three areas I wanted to focus on. After two years looking at different aspects of the business, I had only two: growth and mindset. Does Pernod Ricard have the best strategy? I think it's pretty good but, as questions go, it is not as relevant as do we have the right mindset? By which I mean do we have the right people? You can have the best strategy and the best brands but if you don't have the best people you will fail. ▶





Pernod Ricard timeline

1805

Henri-Louis Pernod begins distilling an anise-based spirit in Pontarlier, near the Swiss-French border.

1932

Paul Ricard begins selling a pure anise-based spirit in Marseille.

1975

French-based spirits companies Pernod and Ricard merge to create Pernod Ricard.

2005

The acquisition of Allied Domecq, in partnership with Fortune Brands, doubles the size of the group.

2008

The acquisition of Absolut vodka, for US\$6.54bn, makes Pernod Ricard the world's second largest wine and spirits group.

2015

Alexandre Ricard, grandson of Paul Ricard, becomes Chairman and CEO of Pernod Ricard.

First person

How would you say Pernod Ricard's culture differs from your competitors?

I don't live the life of our competitors but it's part of our DNA to have a common-sense approach to everything, while having the entrepreneurial spirit to adapt when necessary. You can see that in our obsession with the consumer, the way that, at every level of the organization, we are building a truly customer-centric business.

What did you need to do to make the company customer centric?

There were four essential tasks – reducing complexity and fostering efficiency to achieve operational excellence; managing talent, by recruiting, retaining and developing diverse teams; leading the industry in sustainability and responsibility; and improving our route to market – to the consumer – by capitalizing on different distribution channels.

How difficult is it for a group your size to digitally transform its business?

It's not like you can press a button marked digital innovation. We have 19,000 people here and when it comes to such a change – which is important and transformative – the first question they will all ask is why? We need to be able to explain why and ensure that we have employees who, at all levels, share our obsession with the consumer.

From the outside, wines and spirits looks like an industry where things don't change very much. Most of our brands are more than 100 years old. Yet paradoxically, I would say that wines and spirits is one of the most innovative industries in the world – one-fourth of the industry's revenue comes from innovation, new products, line extensions and new experiences such as using virtual reality to enable consumers all over the world to visit our champagne yards. One-third of our sales come from innovation by which I mean either brands or extensions of brands that did not exist a few years ago, such as Jameson Caskmates, an Irish whiskey which we age in craft beer barrels.

What impact are disruptive new entrants, which are offering craft spirits, having on Pernod Ricard?

We see this as an opportunity. From our point of view, all our brands are craft brands – Martell was first made in 1715, that's 304 years of expertise, what's not craft about that? Wines and spirits is not a sector where there are two opposing groups, and



You need the right people to succeed, says Alexandre Ricard, Chairman and CEO of Pernod Ricard

only two or three brands. The consumer has so many options. We know that sometimes they will want a local brand – and we have local brands, such as Seagram’s Royal Stag and Imperial Blue whiskies in India – but we also know they want to drink something that has terroir, quality, authenticity, transparency and history. Where we see ‘demand spaces’ that we are not in and believe we ought to be in we will look to new products, bolt-on acquisitions or partnerships where the entrepreneur who created this new-to-the-world brand is still driving the business, which is what we have done with Smooth Ambler bourbon and artisanal mezcal producer Del Maguey Single Village.

How are consumers’ taste for wines and spirits changing?

Today’s consumer is radically different to yesterday’s consumer. In the past, they were loyal to one brand. We knew if we could persuade someone to drink Chivas, they would probably stay with that brand for life, so a lot of time and money was invested in acquiring that customer. Today, they may be loyal to four or six brands even within a single product. For example, in New York, someone going for a drink with their boss on a Thursday night might choose The Glenlivet, to show they had a discerning appreciation of whisky. If they were going out the next night with some old friends from college, they might choose a Jameson, which is more easy going.

In Asia, they call these MOCs (moments of consumption). In America, they call them demand spaces. In France, where we have a more romantic view of life, we call them moments of conviviality. In France, for example, we know that the biggest moment is the early evening aperitif, for which we would offer Pastis 51, Ricard or Lillet. In China, it might be a cognac over a meal – but that moment of consumption will differ depending on whether it’s a meal about a deal or a romantic meal.

We have reorganized our operations around these moments of consumption. We have a team selling, developing and marketing products for a demand space we call the high-energy party moment, where we might focus on champagne, tequila and vodka, rather than, as we used to have, teams dedicated to specific brands.

“We have reorganized our operations around moments of consumption”

What difference has digital technology already made to the business – and what changes do you want it to make in future?

It is already making our marketing more efficient. For example, if you’re driving to work at 7am on a Monday morning, what use is a poster advertising Martell? It’s just not relevant to you. If we’re promoting Martell in that same space on Thursday evening, on your drive home, it’s a completely different story. With digital technology, we can offer better, more relevant, more personalized experiences to our consumers.

We also need to leverage the technological revolution to automate the administrative aspects of people’s jobs – not because we want fewer staff but because we want to free them up so they can have their input

where it adds value, to help them focus on creativity. As we’re doing that, we will create the workplace of the future. We have to recognize that the corporation as we know it today – with pyramids, hierarchies, siloes and traditional

budgeting processes – will disappear.

You remarked last year that large businesses like Pernod Ricard are experiencing a “new world order”.

What did you mean by that?

We are entering an environment that is much more uncertain and volatile. The uncertainties are geopolitical – such as protectionism – and monetary, but we have to live with that. What matters is that we are agile, fit for purpose and continue to be obsessed with the consumer.

We should also recognize that last year, for the first time, more than half of the world’s population had enough disposable income to be categorized as middle class. By 2030, there will be 2 billion more middle-class people in this world. In China alone, the middle class will have grown by 100 million people in two years’ time. People are drinking less, but drinking better – and we expect the premiumization of our brands, our strong position in luxury spirits, to be one of the factors accelerating our growth.

If we position our brands at each and every shared moment of celebration, premiumize the portfolio, innovate with new brands and services, and accelerate the integration of digital into everything we do, we will remain fit for purpose and succeed. ▮

Pernod Ricard in figures

6% organic growth in sales in 2017/18

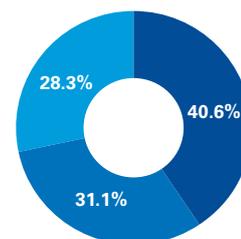
14% growth in sales for Martell and Jameson in 2017/18

17% growth in sales in China in 2017/18

2% in topline growth driven by innovation in 2017/18

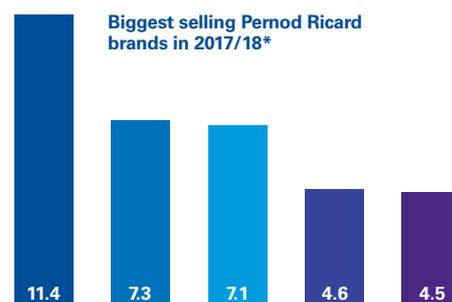
13% growth in sales for Seagram’s Indian whiskies in 2017/18

Pernod Ricard net sales by region 2017/18



- Americas
- Europe
- Asia/Rest of the world

Biggest selling Pernod Ricard brands in 2017/18*



- Absolut
 - Jameson
 - Ballantine's
 - Havana Club
 - Ricard
- *in 9L cases millions

The choice is yours: defend, compete or join

These are the strategic options facing traditional companies in the consumer and retail sector as they face the onslaught of powerful platform businesses

Build connections, not new factories. That is American management guru Seth Godin's advice to people – and companies – looking to prosper in “the connection economy” which, he says, will mark the greatest economic shift since the Industrial Revolution 200 years ago. Technology is connecting and agglomerating companies, transcending market boundaries and redesigning the global economy.

For decades, the dominant capitalist business model has been for companies to create stuff, push it out and sell it to customers. Platform businesses don't need to make stuff (although some do) and just push it out. Users are free to add value through such options as reviews. Such tools as Application Programming Interfaces (APIs) also encourage third parties to invent functions that make the platform more useful for consumers and developers.

If platforms optimize this network effect, says **Peter Evans**, Principal, Innovation & Enterprise Solutions, KPMG in the US, they can create a virtuous circle. With more users, the platform becomes more attractive to developers whose innovations attract more users which, in turn, attracts more developers. The network is often described as an eco-system because although it needs to be managed effectively, it also relies on the interdependence of the participants.

Popular explanations for the startling rise of platform businesses – especially in the retail, healthcare, real estate, banking and travel sectors – vary considerably. The business media lauds the quality of their leadership. For some, the disruptive power of technology is key. Others attribute it to a distinct lack of brand loyalty among Millennial consumers.

There is some truth in all those explanations but for Evans, the rationale is much simpler. “In reality, the reason we used to go to a mall is because that was the most efficient way to discover the product – TV commercials couldn't tell you every single thing that was on the market – and the price. Today you can do both those things quicker and more conveniently on your smartphone. If smartphones had existed in the 1960s, we'd have used them to shop back then.”

By 2025, the World Economic Forum estimates that digital platforms could generate more than US\$60trn in revenue – roughly 30 percent of all global corporate revenues. In the US last year, analysis of US Department of Commerce figures by

Internet Retail suggests that online spending rose 14.2 percent to US\$517.8bn.

Change is happening even faster in China where Alibaba estimates that online retail will be worth US\$1.7trn by 2020¹. **Anson Bailey**, Head of Consumer & Retail, ASPAC, KPMG China, says: “Traditional retailers are facing significant disruption from tech-savvy Chinese Millennials and it is vital that they adapt their strategies.” Anyone tempted to procrastinate should remember Jeff Bezos’s insistence that Amazon is always on a Day 1 footing, because after that: “Day 2: is stasis. Followed by irrelevance.”

Too important to ignore

The often-heard mantra is that incumbents facing disruption from platform businesses can choose to defend, compete or join. In practice, Evans says, the correct option might be to say “all of the above”. What incumbents should not do, he says, is ignore them. “At the MIT summit on platform businesses last year, one message rang out loud and clear: ‘Anywhere there can be a platform, there will be a platform.’”

The technology that empowers platform companies is also blurring the boundaries between markets, making it much easier for these companies to expand into adjacent sectors and create new ones.

The rise of the personal digital assistant is a perfect illustration of how their innovations can change markets. Five years ago, they didn’t exist. By 2020, according to Mary Meeker’s Internet Trends report, half of all searches will be conducted by voice. For platform businesses, this revolution could generate billions of dollars in revenue and give them another compelling competitive advantage. Platform businesses such as Rakuten and JD.com are also seeking to outflank rivals by investing heavily in drone deliveries.

If ignoring platform businesses is hazardous, even competing with them can be difficult, as Evans explains: “Because these companies are using digital technology to match supply and demand they are crushing transaction costs.

Whether you’re doing this for books, travel, music or clothes, the efficiency gains are outstanding.”

As platform businesses do not bear the same burden of fixed costs as traditional companies, they can cement their competitive advantage by investing heavily in R&D and technology. As companies created in the digital age, they do not need to invest time and resources in digital transformation. These disruptors can move into new markets at little marginal cost – all they need to do is to bring the right partner into their network. They have the data and the analytics to detect market opportunities and seize that increasingly significant first mover advantage. As the World Economic Forum has noted, platform businesses also typically spend much less on labor. A comparison of two companies with similar market capitalizations (around US\$39bn) is instructive: the incumbent Marriott International had 177,000 staff on its books in 2018; Airbnb just 10,000². (Marriott is moving into Airbnb’s territory with its new Homes & Villas initiative, offering 2,000 home rentals in over 100 markets³.)

Mindsets count. Companies built to prosper in an eco-system are better placed to manage them than legacy businesses. As Evans says, creating a successful eco-system means opening up what you do best to other parties and, for many managers in traditional businesses, that seems counterintuitive. It can also be ▶

IKEA is embracing different platform ideas such as renting furniture and launching an online marketplace



Actionable insights



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1 Successful platform businesses harness the power of openness. They encourage third parties to develop applications that enhance value.

2 Companies should consider whether it is best to launch their own platform, join one or purchase one. If you want to simply sell a product or service, think about how best to use existing platforms.

3 Many platform businesses are already using AI and machine learning. Traditional companies that don't act quickly could find themselves at a serious competitive disadvantage.

4 A platform model needs a mindset that encourages experimentation and lets other parties see what you do best.

5 Platform businesses have high reputational risks around data. There is an opportunity for retailers to help consumers become better custodians of their personal data.

“The best time to respond to the platform business model was five years ago. The second best time is now”

hard for companies, accustomed to being a leader in their own markets, to recognize the need to collaborate with other parties – or, having recognized it, to reinvent the organization appropriately.

Not Invented Here syndrome has afflicted too many managers in the past and may still prevent some companies from recognizing that they can't do everything themselves and have to acquire, hire – or partner with – the expertise they need to grow their business. As management theorist Rosabeth Moss Kanter noted in her prescient 1989 book *When Giants Learn To Dance*: “There is less ‘inside’ the corporation that is sacred but more ‘outside’ that is respected, representing opportunities for deal making or gaining leverage through alliances.” In this new corporate world, Kanter suggests, the old bureaucratic imperative to preserve the business has given way to an entrepreneurial imperative to grow it. You could take this one step further and make a case that it is becoming increasingly difficult to preserve a company without growing it.

The difficulty traditional retailers and manufacturers face, Bailey warns, is that they don't have much time to adjust –

especially in China where consumers are being offered such extraordinary levels of choice and convenience that maintaining loyalty and share of wallet is a constant struggle. The mega-platforms, Alibaba, JD.com and Tencent, have invested heavily in data analytics to fuel their growth. “Data is an incredible resource for any business but the Chinese internet companies have an incredible amount of it and have proved very adept at using it to offer compelling new services,” says Bailey.

Like American platform businesses, Chinese disruptors have the advantage of an enormous home market. If anything, the Chinese consumer is technologically savvier than their American counterpart: 53 percent have used a food delivery service (compared to a global average of 33 percent) and 566 million have used mobile payments⁴.

Winner takes all

It is possible that, with the emergence of the big three platforms in China, we are already seeing what some experts call the ‘winner takes all effect’ where the virtuous circle Evans described puts them so far ahead of the competition, their rivals struggle to catch up, let alone overtake

them. Even if these platforms can be caught, their rapid expansion encourages investors to make unflattering comparisons to the growth rates achieved by traditional businesses.

Nor are the mega-platforms – most of which are based in the US and China – standing still. “We are already seeing the rise of AI-driven platforms,” says Evans. The 2018 KPMG Top of Mind Survey of 530 executives from the global consumer and retail sector, found that 72 percent of platform businesses will be using AI by 2020, compared to 27 percent of retailers and 15 percent of manufacturers.



Airbnb and its peers have disrupted the global travel sector



These miniature artworks by Ryan Terry were bought on eBay for US\$2,700 in 2008. Online purchases accounted for 27 percent of Christie's auction lots sold in 2018

The gap becomes even starker when you consider that, by 2020, platforms will invest 178 percent of revenue in technology, compared to an industry average of 7 percent.

It is easier to describe the might of platform businesses than it is to prescribe how incumbent companies should react to their threat – which is partly why Evans suggests that ultimately they could well end up doing several things at once – defending their business, joining some platforms and competing with others.

Finding the right answers is easier if you ask the right questions. The strategically critical issue is to define what makes your business relevant to consumers – and society as a whole. Once that is clear, management needs to identify how they turn that relevance into propositions that generate value. At that point, they can explore how platform technology can best help them to unlock that value.

A few companies, which envisage themselves evolving into a marketplace might, Evans says, choose to develop their own platform. For others, who are focused on selling products and services, it might make more sense to join an existing one. “Platforms work better if they’re neutral,” says Evans. A single company platform is not going to benefit from the virtuous circle that drives other platform businesses.

He draws a parallel with many companies’ approach to digital transformation: “Many senior executives struggle with the all-pervasiveness. Businesses tend to go for projects here and there rather than focus on the whole – and it’s the orchestration that is really critical.”

For a start, thriving in an eco-system requires a completely new way of dealing with customers, partners and traditional competitors. It may be useful to turn to a third party to help define, refine and challenge your platform strategy and empower a unit, reporting directly to the CEO, to invent the future.

Organizations can’t take a plug and play approach and think that allying with a particular platform has resolved the issue. The eco-systems are now so complex they embrace hardware, software, developers, applications, e-commerce, advertising, search, social media (especially in China where influencers are particularly powerful), location-based services, communications and many other things. Organizations need to build the internal capability to manage them even if, paradoxically, they require external expertise to do so.

Benefits of collaboration

That message does seem to be getting through. American grocer Kroger is using Microsoft’s cloud computing capability and, in February, inked a deal to develop high-tech futuristic stores that aim to redefine the shopping experience. Once the technology is developed and bedded in, the partners will jointly market it to other retailers. Last November, Kroger announced plans to build an automated warehouse in its hometown, Cincinnati, using technology developed by Ocado, the British online grocer, in which it paid US\$248m for a minority stake.

Furniture brand IKEA is embracing platforms too. The 2017 acquisition of TaskRabbit, an online marketplace for ▶

Platform models in figures

US\$7,176bn

The market cap of the top 242 platform businesses at the end of 2018¹.

12%

Proportion of global trade in goods that goes through e-commerce².

5bn

Items shipped globally through Amazon Prime in 2017³.

US\$54bn

Online sales for Alibaba and JD.com on China’s Singles’ Day online sales festival⁴.

1.1bn

Estimated number of monthly active WeChat users⁵.

15%

Growth in US e-commerce in 2018. Online shopping spend topped US\$517bn⁶.



Anson Bailey
Head of Consumer
& Retail, ASPAC,
KPMG China
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“The Chinese internet companies have an incredible amount of consumer data and have proved very adept at using it”



Internet pioneer: Sting's album *Ten Summoner's Tales* was the first e-commerce transaction in 1994



Online star: Drake was the most streamed artist in the world on Spotify in 2018

freelance workers, was the first step. Earlier this year, it announced plans to start renting and recycling furniture after a successful pilot in four countries. The scheme is part of IKEA's strategy to reduce its environmental impact by 70 percent by 2030 but also reflects management's sense of the consumer's changing priorities. CEO Torbjörn Lööf indicated that he was keen on collaborating with rivals to launch an industry-wide online platform.

In South Africa, the 100-year old newspaper publisher Naspers has reinvented itself as a digital and platform company in the past five years. Early investors in Tencent, the group has since built OLX, a global online classified advertising business. They have also purchased or invested in a raft of tech and platform businesses including mobile peer-to-peer selling app Carousell and payment and security firm Wibmo.

The Chinese insurance group Ping An crossed its own strategic rubicon five years ago, reframing itself as a technology business with financial licenses, creating a portfolio of platform companies in healthcare and automotive and investing heavily in GDS, a wholesale data group. Ping An's market value has more than doubled in three years to exceed US\$200bn⁵.

Chinese consumers' hunger for technology has helped pave the way for Ping An's reinvention. "Consumers in mainland China and Hong Kong are among the most active internet users and mobile adopters in the world," says Bailey. "Engaging with consumers on digital channels has never been so important." In his view, Alibaba, Tencent and JD.com have built quick, easy, user-friendly mobile products and services. They have also set out to build 'stickiness' into their apps, by adding functions, services and capabilities.

Data concerns

While the platform economy is growing fast, bells are tolling for platform businesses too. The first big challenge is data. "At some point, the consumer may ask 'do I want this company having all this data about me?' Retailers can then position themselves as the people who help you manage – and monetize – your data," says Evans.

Even in China, where people have been more willing to swap personal data for benefits, KPMG's research shows that 18 percent of consumers don't shop online

because they worry about data privacy⁶. "As we have seen, the reputational risk is high for companies that prove to be untrustworthy guardians of our data," adds Evans. One driver of the European Union's General Data Protection Regulations was a growing concern about lack of trust and transparency. The 2018 law has set a regulatory precedent which California has followed and Australia looks likely to emulate in the near future.

Data is often said to be as integral to the 21st-century economy as oil was to the 20th century. Yet tycoons like John D. Rockefeller had to invest a lot of money to find oil, drill it and sell it. At the moment, consumers are effectively giving away data as part of the cost of purchasing a product or a service. Although our individual personal data may retail for less than \$1, it is supporting a global multi-billion dollar industry⁷.

To some regulators and politicians that looks iniquitous. The UK government has already commissioned an inquiry into the use of data and algorithms to drive online pricing and investigate whether consumers are really paying for 'free' services by handing over their data.

The greatest challenge is at what point do governments decide that platform businesses are too powerful for society's good. Although the mantra "What's good for business is good for the country" still influences political attitudes in the Anglo-American model of capitalism, history shows us that governments will, in extremis, act to disrupt monopolies.

That prospect should not distract incumbents in the consumer and retail sector from defining, agreeing and executing the strategies they need to defend their business. "The best time to figure out how to respond to the platform business model was five years ago," says Evans. "The second best time is now." □

¹Alibaba Eyes Expansion of Physical Stores, *Dtcdaily.com*, January 2018.

²Platforms and Ecosystems: Enabling the Digital Economy, World Economic Forum, February 2019.

³Marriott International Launches Home Rentals In Over 100 Markets, Marriott International News Center, April 2019.

⁴Me, my life, my wallet report, KPMG, 2018.

⁵China's Ping An Insurance finds success with focus on tech, *Nikkei Asian Review*, March 2019.

⁶Tapping into Smart Retail: A survey of CEOs and Consumers in the Greater Bay Area, KPMG, 2018.

⁷How much is your personal data worth?, *Financial Times*, June 2013.

What does Alibaba mean by ‘New Retail’?

The giant Chinese e-commerce platform Alibaba is transcending the divide between offline and online to meet the needs of consumers at every point. Next stop: the world

You may have heard that in China you can buy a car from a vending machine. Sorry to disappoint but the truth isn't quite that simple – though it is still, in its own way, remarkable. In Guangzhou, car maker Ford and Chinese e-commerce group Alibaba are trialing a system that lets you select a model you're interested in, pay an electronic deposit, schedule a pick-up time and take a selfie so that the machine can recognize you when you arrive to take the car out for a three-day test drive. If you have the app, you can just take a photo of a car you see on the street and you will be directed to the nearest machine that has that model in stock. There is one catch – you can only do this if you have a good credit rating. The machines are cat themed, as Chinese merchants traditionally regard felines as lucky.

This audacious project is only one manifestation of Alibaba's determination to keep diversifying its revenue stream and reach out to new sectors. Founded as a B2B marketplace by Jack Ma and 17 associates in April 1999, Alibaba began moving into other markets soon after it made its first profit in 2003, launching the Taobao online shopping marketplace and digital payment platform Alipay in 2004.

As the company has grown, so has its drive to diversify. Today, the group's businesses span logistics, distribution, movies, music, television, health, video games, newspapers (notably the *South China Morning Post*), sports, live events, ride-sharing, food delivery, marketing, restaurants, hotels, travel, coffee, finance and groceries.

The data that Alibaba has amassed about Chinese consumers has been put to good use by the company itself and, through the Tmall innovation center, for partner brands such as L'Oréal, Mars and wellness brand Emergen-C. The company also has more than 100 luxury brands – including

Burberry, Maserati and Tag Heuer – selling their wares on its upscale online offering Tmall Luxury Pavilion.

In 2018, Alibaba reported revenues of US\$53bn and, despite its drive into new sectors, 86 percent of that came from its traditional e-commerce business, according to investment analyst Daniel Laboe. By his calculation, the company has grown its revenues by an average of 44 percent over the past five years.

An increase in discretionary spending. Millennials' burgeoning interest in brands and the public's apparently insatiable appetite have made China one of the world's most dynamic consumer markets. At the same time, fierce competition from local rivals Tencent and JD.com has meant that Alibaba could not afford to complacently rely on rising consumer demand.

'New Retail'

The company estimates that it has 700 million users on its platforms and expects significant growth in cloud computing, subscription entertainment services and retail where it is looking beyond the traditional division of online and offline to create a concept it calls 'New Retail'.

What does 'New Retail' mean? This is how Jack Ma defined the term in his 2017 letter to shareholders: "The boundary between offline and online disappears as we focus on meeting the personalized needs of the customer." For Alibaba, supermarkets are not just for shopping – they are customer experience centers and logistical hubs where deliveries can be sorted. In the store itself, you can shop traditionally and use the app to click and collect or, if you live within 1.8 miles, order free delivery within 30 minutes. You can complete your purchase using the app or through facial recognition. Not every aspect of 'New Retail' is driven by technology. Alibaba encourages shoppers to visit its stores daily, partly, by packaging fresh food to display that day of the week.

Jon Bird, who covers retail for *Forbes* magazine, says 'New Retail' may not be entirely new – some Western retailers have already put some of these initiatives in place – but adds: "What sets it apart is the scale and the speed of the implementation and the variety of formats to which it is being applied."

Through Alibaba's Ling Shou Tong (it means 'Integrated Retail') program thousands of mom-and-pop convenience stores are being technologically upgraded so they can use data to hone their product



For Alibaba, 'New Retail' embraces online and high-tech stores

selection, centralize and simplify their purchasing and offer such digital services as top-up data for mobile phones.

The question is when – rather than if – Alibaba looks to expand overseas. In his most recent letter to shareholders, CEO Daniel Zhang made the company's strategic ambitions clear, saying: "Globalization has always been Alibaba's long-term strategy. We are making progress towards our goal to realize 'global buy, 'global sell', 'global delivery', 'global travel' and 'global pay'. This will ultimately create one truly globalized digital economy where goods can move freely around the world, and not just from China to the world."

Zhang does not put a definite timeline on that strategy being realized although he does suggest that, by 2036, Alibaba expects to be serving two billion consumers globally.

As you might expect, Southeast Asia is the first region to attract the company: it has acquired the Southeast Asian e-commerce business Lazada, led US\$1.1bn of funding for Indonesian online shopping platform Tokopedia and bought Daraz, the platform founded by Rocket Internet, which runs marketplaces in Bangladesh, Myanmar, Nepal, Pakistan and Sri Lanka.

Anson Bailey, Head of Consumer & Retail, ASPAC, KPMG China, expects to see this convergence continue: "Alibaba – like the other e-commerce players in China – will look to the rest of the world and the rest of the world will look to them."



Alibaba's car vending machine, developed with Ford, facilitates test drives

Do 'sin taxes' change anything?

Consumers are paying for their 'vices' as public health concerns and government enthusiasm fuel a global boom in product taxes

You have to be careful when taxing products. Levies on tea have been known to inspire wars of independence. Yet governments, having set a precedent by taxing alcohol, tobacco and fuel, are asking consumers across the world to pay for the privilege of consuming a range of hitherto-blameless items including sugary soft drinks and high-fat fast foods.

"We have seen a huge growth in the whole area and expansion into new products," says **David Duffy**, Partner, Indirect Tax, KPMG in Ireland, and Head of KPMG's Global Indirect Tax Policy Group. It is estimated that there is now a tax on sugary drinks in at least 35 countries, he points out, some 20 of which have been introduced since 2015. This shift is partly driven by changing public attitudes to what it is – and isn't – acceptable to tax. Governments are also reacting to worries over the health and environmental impact of consuming certain products and have also found these taxes to be a politically

convenient way to increase revenue. For all of those reasons, this looks like a trend that is only going to gather momentum.

"My expectation is that there will be more of these taxes, perhaps on high-salt and high-fat containing foods, for example. Health will continue to be a focus in response to obesity, and environmental taxes are also well established," says Duffy.

The attraction for governments is obvious. In marked contrast to traditional revenue raisers such as taxes on corporate or personal income, 'sin taxes' on consumption can be less troublesome politically – voters at least have the choice of whether to pay up and continue to enjoy their favorite vice, or save money and abstain. "The feeling is that governments have to start somewhere, and it can be more difficult for people to argue against a tax, which at least in theory is designed to make them healthier," Duffy adds.

Reducing sugar consumption

In 2013, the Mexican government introduced a tax on high-sugar soft drinks and on calorie-dense foods like national favorites tacos, tortillas and fried chicken in what was, ostensibly, an effort to tackle the country's growing obesity crisis. Type 2 diabetes kills an estimated 70,000 Mexicans every year.

Before the tax was introduced, the average Mexican drank no fewer than 163 liters of sugary carbonated beverages a year – 40

percent more than Americans. There's even a word in Spanish for soft drink addicts – *cocacolera*. The argument was that taxing the stuff would raise prices and cut consumption, boosting the nation's health and generating much needed revenue. It seems to have worked, on one level at least – consumption fell by an average of 7.6 percent per year in the two years following the introduction of the levy, roughly equivalent to 5 US cents per liter.

Perhaps encouraged by Mexico's experiment, the UK followed suit in April 2018, introducing its own Soft Drinks Industry Levy. This amounts to a tax of 24 US cents per liter for drinks containing over 5g of sugar per 100ml, and 31 US cents for those with over 8g per 100ml.

Although obesity and diabetes levels are lower in the UK than in Mexico, they are among the highest in Europe. There is widespread concern that British children consume too much sugar – research from Public Health England recently claimed that the average 10-year-old child in the UK has already had enough sugar to last until they are 18, were they to consume 'only' the maximum recommended daily amount.

However pressing the need to take action, the government response did not impress the industry. Tim Rycroft, COO of UK trade body the Food & Drink Federation says: "The Soft Drinks Industry Levy was unnecessary. It came as a complete surprise to the industry. There was a real sense of anger over being singled out. Good progress was being made on reducing sugar anyway – 60 percent of the market was already low or no sugar."

The levy is expected to generate annual revenues of around £313m (US\$405m), about half of what was promised at launch. Soft drink producers have been particularly adept at bringing forward new low sugar recipes and formulations. "There has been an undue focus on sugar," says Rycroft. "If you are trying to reduce obesity and you tax just one product, consumers can substitute another one that isn't taxed."

One aspect of 'sin taxes' that appeals to cash-strapped governments is that whatever happens, it can be painted as a win. Either revenues go up, or consumption falls. No wonder the motives for applying sin taxes can



Mexico introduced a tax on calorie-dense foods in a bid to tackle the country's obesity crisis

be mixed, says Professor Mohan Sodhi of London's Cass Business School. He points out that in India alcohol consumption is rising despite heavy taxation. "Alcohol advertising is illegal but companies find a way around it. Almost all the big TV shows feature people drinking heavily, which creates huge demand."

So what has turned out to be a lucrative source of tax revenue can be justified as an attempt to reduce consumption.

"There is asymmetric information between the consumer and the company. If governments really want to reduce consumption of harmful substances, the only thing that works is addressing that asymmetric information through public education campaigns. Education works, but it makes governments poorer not richer because those campaigns cost money," says Sodhi.

Influencing citizens

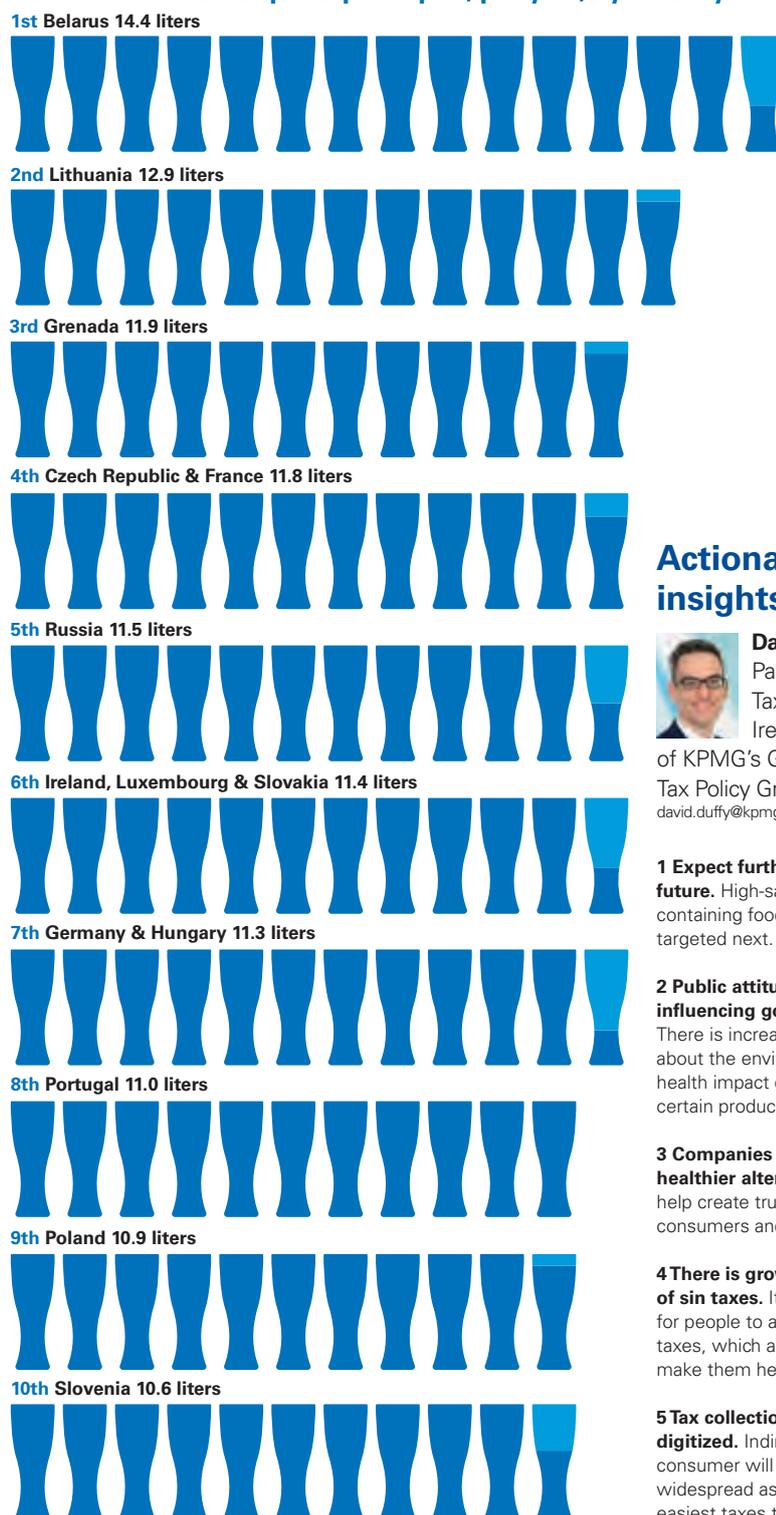
Excise duty on alcohol is seen as one of the original sin taxes – duty on spirits was introduced in the UK in 1643, and on beer in 1690. But the concept of taxes aimed at influencing or controlling consumers' behavior goes back much further. The Roman sumptuary laws were introduced to underline social status and limit what people could spend on food, clothing and luxuries.

Taxes on tobacco substantially pre-date the discovery in the 1950s of the link to lung cancer, being first introduced in England in 1660 and the US in 1864. Even the sugar tax has a longer history that you might think – the Danes introduced a tax on soft drinks in the 1930s. By 2013, it was bringing in US\$68m a year, but the government repealed it anyway. Why? Because illegal sales of soft drinks smuggled across the border were also costing an estimated US\$44m in lost sales tax, as well as fueling something of a crime wave.

To these historic trends, add the impact of modern globalized markets and you have the perfect economic climate for indirect taxes aimed at consumption rather than production.

"In most countries, excise taxes are a substantial source of revenue. But the trend for lower tariffs on international trade and more global trade means that those revenues tend to be reducing. The authorities are looking for new taxes to replace them, ▶

Pure alcohol consumption per capita, per year, by country



Actionable insights



David Duffy,
Partner, Indirect Tax, KPMG in Ireland, and Head of KPMG's Global Indirect Tax Policy Group.
david.duffy@kpmg.ie

1 Expect further taxes in the future. High-salt and high-fat containing foods could be targeted next.

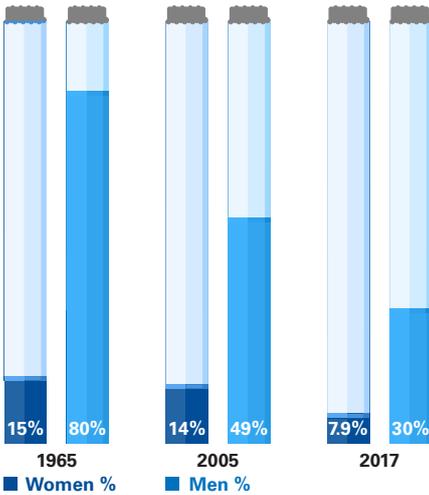
2 Public attitudes are influencing governments. There is increasing concern about the environmental and health impact of consuming certain products.

3 Companies need to provide healthier alternatives. This will help create trust from consumers and governments.

4 There is growing acceptance of sin taxes. It is more difficult for people to argue against taxes, which are designed to make them healthier.

5 Tax collection will become digitized. Indirect taxes on the consumer will become more widespread as they will be the easiest taxes to collect.

Smoking in Japan has fallen since the government's 2010 tax hike



and social taxes are among the options," says **Warwick Ryan**, Director of Government Relations, KPMG in Australia.

Yet these social – or sin – taxes come freighted with a range of problems, he adds. "Many governments don't analyze tax revenue enough. Good tax policy is about reducing the size of the grey market by having a lower overall rate and a simpler tax structure, which leads to more sustainable tax revenue growth in the long term."

Take alcohol for example. "Our clients want to understand global benchmarking and which improved tax structures can be applied in their various markets. Global best practice policy is a tax on the amount of alcohol in the product – volumetric taxation," says Ryan.

That's because a tax on the amount of alcohol has the best chance of discouraging

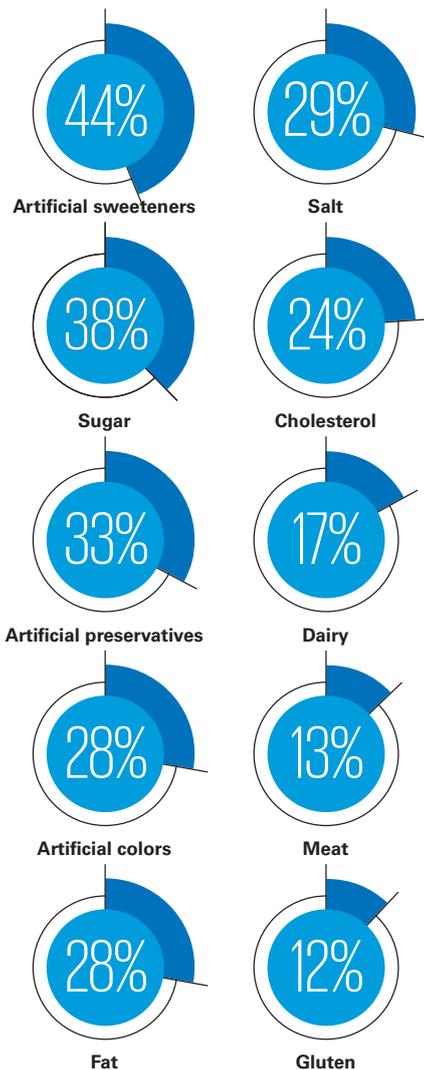
The tax on tobacco is perhaps the purest of 'sin taxes'. Smoking is a proven cause of cancer, which is why many countries tax them heavily. A 40 percent tax rise in Japan has driven down consumption significantly but if the goal is to eradicate smoking then more is required.

"Unless you provide smokers with an alternative that provides the same experience and enjoyment, you will never stop smoking completely. You can keep increasing taxes but there will always be a core number of smokers who carry on almost regardless," says Martin.

"You have to provide consumers with a healthier and enjoyable alternative – the same is true of alcohol and sugar too. More broadly, reducing usage requires the pulling of many different levers rather than just using the one

"Global best practice policy is a tax on the amount of alcohol in the product – volumetric taxation"

Percentage of US adults that say they restrict or limit each of the following on a regular basis



excessive consumption, while still allowing those who want to drink moderately to do so. "The alternative approach is a tax on price. The flaw in this approach is that a premium product will attract more tax than a lower priced one, even if they both contain the same amount of alcohol," adds Ryan.

Price-based taxes can encourage fraud, he says, by providing perverse incentives to adjust prices in line with tax thresholds. "Price based taxes drive dysfunctional behavior around invoicing and price."

Health benefits?

The primary purpose of 'sin taxes' was to benefit society, and such effects are much harder to measure. Correlation is not necessarily causation. Mexicans may be drinking less fizzy soda, but that's only a good health outcome if it results in less obesity and fewer cases of diabetes.

"There are many questions still to be answered on the extent to which sugar taxes lead to improvements in health. There is a superficial attraction to this tax in many markets, but I have yet to see any compelling evidence of an overall improvement in health as a result," says Ryan.

When it comes to how companies should respond to 'sin taxes', there are lessons to be learned from the markets where they are best established, says **Joshua Martin**, Partner, Deal Advisory, KPMG in Switzerland, who has worked with several clients in the tobacco industry.

blunt instrument that is sin tax," he adds.

Hence the rise of vaping, and also less-harmful ways of using tobacco such as 'heat not burn' technology, which results in far fewer carcinogens being produced.

More broadly, sin taxes present authorities with a dilemma. Thanks at least in part to some of the highest tobacco taxes in Europe, smoking in the UK has fallen dramatically. In 1974, over half the adult population smoked – that figure is now just over 15 percent. But the government is by far the largest beneficiary from the sale of tobacco, collecting US\$15.7bn in taxes. The Department of Health may want to stamp out smoking, but the Treasury couldn't afford it if they did.

Taxing questions

So, is there such a thing as a perfect 'sin tax'? Probably not, but the economics can be reasonably sound provided they are approached in the right way, says Kate Smith, Senior Research Economist at the Institute for Fiscal Studies. "Why do we have sin taxes? Because there are costs associated with the consumption of some products that are not accounted for in the price – what economists call externalities.

"So if you smoke, or drink too much, and get ill as a result, your healthcare will end up costing more than it would for someone who did not indulge. The key when devising sin taxes is to focus on matching the cost of those externalities," says Smith. "If there are

Sources: Smoking Prevalence, World Health Organization, Global Health Observatory Data Repository, Pew Research Center, Public Perspectives on Food Risks, survey conducted April 23-May 6, 2018.

no externalities there is no reason to tax the goods. Revenue raising is not the objective.”

Sin taxes are also regressive, in that the people who can afford them least tend to take the greatest hit. In the UK, for example, the poorest tenth of the population spend 34 percent of their income on indirect taxes, while the richest tenth spend just 14 percent¹.

If the aim is to encourage a behavioral change, these taxes should be applied with care and only as part of a wider range of measures. If they are seen as merely punitive they may not endure – in 2017, Chicago repealed its soda tax.

As flawed as sin taxes are, businesses had better get used to them because, in most jurisdictions, they are increasingly more socially acceptable, politically attractive and economically practical than many of the traditional alternatives.

What’s more, adds KPMG’s Duffy, there is one final technological advantage coming down the pipe that may yet eclipse them all – the digitization of tax collection. Split-payment of sales tax is already in limited use in Poland and Italy he says, a system in which the tax on a purchase effectively becomes a separate parallel transaction at the point of sale, going directly to the revenue authority.

“Looking ahead to the use of tax collection technology, the taxes of the future will be those that are the easiest to collect using that technology,” says Duffy. Collecting taxes direct from the consumer will be a simple, popular and effective option. [▶](#)

How does your company adapt to new trends in tax regulation? Learn more about KPMG’s Tax practice on page 31.

¹ Effects of taxes and benefits on household income: historical datasets, Office for National Statistics, June 2018.



Managers at a Tokyo IT company exercise after lunch. Japanese companies are legally obliged to measure employees’ waist sizes



Canada is the first G7 nation to legalize recreational cannabis. More could follow

Legalized cannabis products could be as big as the tech boom

Partakers of cannabis have long proclaimed its relaxing effects, and some national and state governments are now responding by dropping their legal objections to the recreational use of marijuana.

In Canada, marijuana was legalized at a federal level in 2017 and sales began across the country late last year. It’s a huge experiment in market liberalization, which is being studied closely by governments and businesses across the globe, says **Allan Colaco**, Audit Partner for KPMG in the US.

Availability is currently restricted to so-called ‘flower and leaf’ marijuana, which is only sold in government-licensed outlets – rather like the strict control of alcohol in some Nordic countries. The staged legalization process will complete when cannabis-containing products such as beverages and snack foods hit the shelves later this year.

“The initial control of supply and distribution is being handled by the state,” says Colaco, who has worked with several clients which are investing in the Canadian cannabis market. “The really big opportunity will be in the new cannabis-infused consumer products.”

The move, he adds, is being driven by a combination of factors – not least historic lessons from the failed attempts at alcohol prohibition in the US in the 1920s. “All prohibition did was drive consumption underground. It turned out that it was better to permit it and tax it. I think there is a slow realization that the same might apply to cannabis.”

The trend towards sin taxes as

a way to manage the social costs associated with consumption of potentially harmful products has also played its part, he says. The sense of what is and isn’t socially acceptable is evolving. It’s more a question of deciding what the price of consumption should be.”

Currently that taxation takes the form of a levy applied nationally through Canada’s private and government-owned cannabis outlets. The details of how taxes will be applied to cannabis containing products are still being thrashed out, a ‘pass through’ consumer tax seems the preferred outcome. The revenues will be shared between federal and provincial government, and could be earmarked for healthcare and health education.

However, uncertainty over how sin taxes will be applied is unlikely to deter companies looking to invest, not least because there are no existing revenues for them to protect. “The imposition of taxes on existing markets limits growth,” says Colaco. Companies resist them because they damage their future revenue potential. “But in a new market like cannabis, being able to sell a product with a sin tax is much better than not being able to sell a product at all.”

And besides, for the biggest players, the real commercial prize lies in the US, where although cannabis use is legal in 10 US states it remains illegal at a federal level.

If full legalization does go ahead in the US, Colaco adds: “I wouldn’t be surprised to see alcohol and other beverage companies, tobacco companies and CPGs all entering the market in the future.”



Launch schedule

If consumer and retail companies treated innovation as a disciplined, predictable, risk-managing process, would more new products succeed?

One significant leap in consumer technology in the past 50 years was inspired by the boredom of a frequent flyer. Having to fly back and forth between Tokyo and the US, Sony's co-founder Masaru Ibuka expressed the desire to have a small device he could listen to a full opera on. His business partner Akio Morita briefed the engineers to create a portable stereo-cassette player. They exceeded the brief by including a recording function which, to their mystification and dismay, Morita asked them to remove.

As Rory Sutherland writes in his book *Alchemy: The Surprising Power Of Ideas That Don't Make Sense*, "The technology involved, given the economics of mass production, would have added no more

than a few dollars to the final purchase price, so why would you not add this significant extra?"

Sutherland writes that Morita's veto showed an astute grasp of consumer psychology. "By removing the recording function from Walkmans, Sony produced a device that had less functionality but more potential to change behavior. By reducing the possible applications to one use, it clarified what the device was for."

Such clarity paid off. The Walkman, launched in 1979, was a success – both commercially for Sony and as an ancestor of the iPod. (Later, when the product's purpose was widely understood, the recording function returned.) Yet it might not have existed if Sony had listened to the market research.

Few consumers seemed interested in the idea. Many were actively hostile, asking: "Why would I want to walk around with music playing in my head?" Luckily, Morita trusted his instincts.

Point of difference

Today stressing a product's point of difference is even more critical. Research by consultant Jack Trout suggests that, on average, American families repeatedly buy the same 150 items, which account for 85 percent of their household needs. To break those habits, consumers need to have heard of you and to understand what your product can do for them that existing ones don't.

Many of the issues that bedeviled the Walkman are still hampering product



The Cannes Film Festival is a key event in a global calendar the movie industry uses to market itself, its new films and its stars

innovation, according to Josh Valman, CEO of RPD International, which advises several large companies on this issue. "One in every thousand products gets to market but so many end up in a Museum of Failed Dreams, which is expensive and wasteful."

There are, he says, so many ways that a company can kill innovation, starting with the idea that innovation is an enormous system diagram with 300 stages to get to market. "Each has a conversion rate, a percentage of times that something doesn't make it to the next stage. With 300 stages with losses at each of them, you've got this tiny success rate, so companies end up looking at the 99.9 percent of the times it doesn't work – and that makes innovation look terrifying." ▶

Product launches

Companies may fail because they lack internal belief – nobody expects this innovation to happen because the last few haven't. It's also possible that the frontline staff, who probably know what the market really needs, are disconnected from the leadership who want the business to innovate but aren't quite sure how – and whether it is worth the risk.

There are, Valman adds, many points where the process can be blocked. Good ideas can die in safety, training and certification, in finance, at a management meeting or, as the Walkman so nearly did, in market research. "It's astonishing that so many companies are still using one-way mirrors and focus groups to test new ideas," he says. "How representative are these people of the typical consumer? And how do you know they're telling the truth?"

And new products that take two years to go from concept to market may be launched after the trend they were supposed to meet has already passed.

Procrastination can have many causes. The internal desire to perfect a product is often counterproductive. Conflicting market research can confuse matters. Management can become obsessed by long-term sales projections. Many product innovations are delayed by internal interference. The clarity of purpose that initially inspired an innovation can get lost or confused.

Test it out

This needn't happen, Valman says, if companies take a more disciplined approach to product innovation. "Companies could say: 'If you have a good idea, I will give you \$3,000 of time and materials to flesh it out and write a business plan. This year, we'll invest in 10,000 of those ideas and we'll give a hundred of those \$12,000 of time and materials to prototype them. One in ten of those will be given \$60,000 to launch and five of those will get to market.'"

Under this approach, a launch can be just a test run in the market. "If you're trying to capitalize on a trend you've spotted, you need to get something to the market in six months, maybe less," says Valman. "You would probably be better off just trying out your minimum viable product with a run of 10,000 or 100,000 units. Be upfront with consumers and say this is something we're trying out and we'd like your feedback. Consumers love to feel they are involved in the development of a product."

That way, companies can also get a sense of the new product's potential. The fact that



"The fact that there is a gap in the market does not mean there's a market in the gap"

Sony co-founder Akio Morita made sure the ground-breaking Walkman had a clear purpose

there is a gap in the market does not mean there's a market in the gap. A product may not be different enough – and, even if it is, distracted consumers may not understand why they need it. Among the radical ideas that have tanked since the turn of the century are a lip balm that tasted like a snack, sunglasses that played music and a social media platform for baby boomers. Some ideas – such as Nokia's N-Gage smartphone which users could play video games on – were just too far ahead of their time. (Nokia has disposed of its mobile business and since 2012 is a networks company.)

The most effective feedback can help bring some objectivity into what often, within an organization with so many stakeholders, becomes a subjective debate. It can, to take just one example, tell companies where their product packaging is a help or a hindrance.

The impact of inappropriate, extravagant or aesthetically displeasing packaging can be devastating. Companies need to ensure the packaging – often described as "the silent salesperson" – appeals to their target demographic and adds to, rather than detracts from, the user experience. Packaging that doesn't please the eye is less likely to be shared on social media.

Product innovations work best, Valman suggests, if they are effectively separated from the rest of the company. In this way you encourage the kind of clarity of purpose that Morita maintained at Sony and, just as importantly, control the chaos of innovation within the organization.

That separation might even extend to the supply chain. "If you're a large FMCG company and you're going to trial a new product with 10,000 or 100,000 units that isn't necessarily something your supply chain is geared up for," says Valman.

Experimenting with new products is not high on supply chain leaders' radar and that is why RPD International helps some clients get to market by creating an alternative supply chain. If the new product works, the company's supply chain can take it over. If it doesn't, the company's supply of its other products has not been interrupted. This strategy also reduces the risk that, if the product does take off, the traditional supply chain can't cope with demand.

Social media has not made product innovation any easier. "The blowback can be so brutal that, in just a few days, a product can almost be ridiculed to death," says Valman. This is especially true for products that don't quite do what they claim to do. The power of negative feedback on social media has, in the past 12 months, forced various FMCG groups to rethink, withdraw or abandon marketing initiatives. Such instant response underlines the point that getting a product innovation out there sooner rather than later could, at worst, reduce the cost of failure and, at best, increase the chances of success.

Product innovation does not have to be messy, Valman says. "People will tell you innovation is something to do with drawing on walls with marker pens. Actually, it's predictable, disciplined

"Innovation is not about drawing on walls with marker pens. It's predictable, disciplined and about controlling risks"

and about controlling risks."

The statistics for product innovation are daunting. Depending on which estimates you believe, between 70 percent¹ and 95 percent² of new products are said to fail. This narrative has been challenged by John Stanton, contributing editor of *Food Processing*, who analyzed 1,500 food products launched between 2010 and 2012 and found that two out of three were still available 18 months later which, in his view, meant they were a success.

As Stanton wrote: "One of the difficulties is that there is no real consistency in how the success or failure are defined. Each new product may have a strategic purpose and once that purpose is served, it can be removed from the product line." He cites one FMCG company which introduced new products to make it harder for a rival to launch theirs. Once the competitor had failed, the new products were withdrawn.

Research by Nielsen suggests that companies would do better at product innovation if they focused on three issues. Does the product address a broad consumer need? Does it provide a good user experience? Is there enough marketing support? The agency's analysis of 80 US product launches found that actual marketing spend was, typically, 30 percent lower than planned spend³.

Manufacturers can learn from the way Hollywood launches movies. Film researcher Stephen Follows estimates that 29-40 percent of the budget on films costing more than US\$100m is spent on marketing. Their campaigns are predicated on the fact that producers know their blockbuster will only be 'the big movie' for one or two weeks, so they build awareness ahead of that critical period.

The value of the new

The fact is, as Valman says, companies have no choice but to keep innovating. Young businesses such as Halo Top, Chobani and Dollar Shave Club have shown they can disrupt even such large, relatively mature sectors as ice cream, yoghurt and razors. (It is also true, and often overlooked, that for every Dollar Shave Club there are several wannabes that never make it.)

In the 21st century, we live in what American writer Matthew Crawford has dubbed the "attention economy". As he put it: "Attention is a resource – people only have so much of it." In the relentless struggle for a consumer's attention, successful launches can raise a company's profile, make it appear relevant, strengthen existing customers' loyalty and reach out to new ones.

At the turn of the 20th century, it could take decades to throw away a leading position in a consumer market. One hundred years later, it could take two years. []

¹ *7 Reasons Why A Great Product Launch Can Fail and How To Avoid It*, Manufacturing Advancement Center, 2019.

² *95 Percent of New Products Fail. Here Are 6 Steps to Make Sure Yours Don't*, Inc., July 2018

³ *Setting the Record Straight on Innovation Failure*, Nielsen, 2018.

⁴ *China's Connected Consumers: The Rise of the Millennials*, KPMG China, 2017.

What Chinese consumers want

Chinese consumers are on a constant quest for something new. "Today, the consumer industry is less about what companies can create and more about what consumers want," says **Jessie Qian**, Head of Consumer & Retail at KPMG China.

Two out of three consumers posted comments on an online store after their purchase, according to KPMG research⁴. Such comments – along with the social media influencers – are often the major factor behind purchasing decisions, and are changing the relationship between consumers, retailers and brands.

"Companies increasingly analyze valuable consumer data via information received through online platforms. This essentially reshapes the production process into an information loop between the R&D unit and consumers," says Qian. This can help ensure product innovations are truly customer-centric.

The real-time nature of online customer feedback and data analytics are forcing their brands to update their products more quickly and more often.

"Look at what Alibaba is doing with its Tmall innovation center," says Qian. "It is using the data it has on 500 million consumers to develop new products with other brands. For example, its data suggested there would be a market for a spicy Snickers bar." By March 2018, the bar had delivered revenues of around US\$1.4m.

In China, where hundreds of products are launched every day, and where historical attachment to brands is weak, Qian says that innovation is not an option, it's a necessity.

Name **Shinola** • Founded **2011** • Headquarters **Detroit, US** • CEO **Tom Lewand** • Website **shinola.com**



Everything in Shinola's Detroit hotel is designed to reflect its brand values

Immersed in luxury

Will a new hotel in Detroit help upscale goods company Shinola offer consumers a complete brand experience?

How can retail brands deepen their emotional connection with consumers? American luxury watch and leather goods maker Shinola is one company that believes a move into hospitality and travel could be the answer. A hotel stay allows guests to be totally immersed in a brand for a long time. Something stores just can't offer.

Tom Lewand, Shinola CEO, says: "We are about more than beautiful product. For us, great design and quality extend beyond product to experience. Whether you are in one of our stores or on our website, your experience should be comfortable, positive and rewarding. The Shinola Hotel allows us to create that experience in a much more immersive and comprehensive way."

Launched in 2011 by Tom Kartsotis (who also co-founded watch brand Fossil and Shinola's parent company Bedrock Manufacturing), Shinola has expanded from

watches to bicycles, leather goods, jewelry and speakers and turntables, to become a lifestyle brand. The company's products have a classic, vintage look intended to give the feel of an American heritage brand even though it is less than 10 years old.

The business was founded to help regenerate Detroit and provide training and employment for local residents. Kartsotis has said: "At the core of what we are doing is job creation so when we look at a new category we ask ourselves whether this category can bring manufacturing jobs back to the places in America where jobs are needed."

Today, Shinola employs over 600 people, with an average of 200 in manufacturing. More than 30 people are involved in the assembly of a single watch.

The Shinola Hotel, which opened in January this year, is located in downtown Detroit. The city forms part of the company's DNA – it created a watch and

“For Shinola, great design and quality extend beyond product to experience”

leather factory in the historic Argonaut Building, the former site of General Motors’ research lab. (Some of its leather goods manufacturing now takes place elsewhere in the US.) And its bicycles are assembled by hand in its Detroit flagship retail store.

Opening a hotel is another way to cement the company’s ties to the city. When Detroit was struggling financially in 2013, Shinola ran a full-page ad in the *New York Times* with the slogan: “To those who’ve written Detroit off, we give you the Birdy.” (One of Shinola’s watch brands is called Birdy.)

As Tim Calkins, Marketing Professor at Northwestern University’s Kellogg School of Management, said: “You can’t go to New York City or San Francisco and expect to build a unique brand – there are so many of them. That’s why Detroit is so compelling.”

To many Americans, the city is associated with hardship, craftsmanship (both in cars and Tamla Motown records) and resilience. As Stacy Perman wrote in *Inc.*: “The brand is selling more than watches; it’s selling a comeback” – in other words, the economic and social revival of Detroit.”

Platform for innovation

From clocks to audio speakers, Shinola’s products are a natural fit for a hotel environment. Guests can even rent the brand’s bikes. The setting has also helped management drive product innovation.

“The hotel has become a platform to expand our offering,” says Lewand. “For example, we made a smaller version of our Runwell wall clock to go on every nightstand, crafted pillows with our signature leather, created an Alpaca throw blanket in a custom stripe, and developed a scent for the Shinola Hotel candle. We also created a special Runwell timepiece to complete hotel employees’ uniforms, which guests can purchase in the hotel store.”

Every aspect of the hotel is designed to reflect Shinola’s brand values – and showcase Detroit. Blending old and new, the hotel consists of two carefully restored old premises – a T.B Rayl & Co. hardware store (built in 1915) and Singer sewing machine shop (built in 1936) – and three new buildings. The 129-room hotel is a partnership between Shinola and real estate company Bedrock. Experienced management: boutique hotel group Mac&Lo has provided its services.

The lowdown on Shinola

1 Founder Tom Kartsotis purchased the brand’s name from an early 1900s US shoe-polish brand called Shinola.

2 Shinola’s Detroit factory assembles between 500 and 700 watches per day using Swiss and other imported parts.

3 The company has more than 30 retail stores in the US and internationally. New York-based Gachot Studios (designer of some of Shinola’s flagship stores) also helped design the hotel, which has an on-site 16,000 sq ft curated retail alley with shops, eateries and bars.

4 Shinola’s first watch, the Runwell Limited, sold out in two weeks in 2013. Four years later, it launched its first mechanical watch, the Lake Erie Monster.

The next big retail space?

Shinola has yet to announce if and where they will open more hotels. Many top designer brands including Versace, Armani and Missoni have already invested in their own hotels. Cult Spanish shoe company Camper has created two Casa Camper design hotels in Barcelona and Berlin, which mirror its hip and cool image.

Danish kitchen accessories company Vipp offers guests a contemporary loft in Copenhagen or a shelter in the Swedish woods, decked out in Vipp products. Japanese retailer Muji has hotels in Shenzhen, Beijing and Ginza, all featuring the company’s goods.

Extending a luxury brand into the hotel sector is a challenge. There is no shortage of competition although, in the short term, the outlook looks encouraging. CBRE Hotels Americas Research is predicting that, in the US market, the growth in demand will slightly exceed the supply of new rooms in 2019.

Making a brand serve different sectors is far from straightforward. There is a real risk of degrading or diluting the brand proposition. Yet luxury brands such as Shinola may be better placed to succeed because they stand for a kind of lifestyle rather than specific products. [▶](#)

How does your company reinforce its own brand? Learn more about how KPMG’s Customer Advisory team can help your company stand out on page 31.



Watches are hand-assembled in Shinola’s Detroit factory

Counterfeit products

US\$227m

Amount paid in the EU for canned tuna that has been dyed pink to make it look fresh

88%

of lemon sole sampled in New York supermarkets by investigators was not lemon sole

5%

of fish imported into Australia is tested by the authorities

2%

of a typical serving of imitation crab in the US is actually crab

30%

of the world's seafood has been mislabeled in the past decade

Food fraud

Counterfeit products are costing the food industry billions of dollars and hurting consumers. What can be done to stop the fakes?



Cans of counterfeit pâté made from dog food

When you pick up a jar of sweet lime pickle from a supermarket shelf, how do you know what's in it? Many consumers take the ingredients for granted. One survey published in the *Journal of Education and Health Promotion* last year estimated that 48 percent of shoppers didn't read the labels on food and found that 58 percent of those who read them say they don't really understand them¹.

On the pickle jar, the label's list of ingredients would read something like this: lime, vegetable oil, acid regulator, fenugreek seeds, mustard powder, turmeric powder, garlic powder, yellow mustard seeds, black mustard seeds, chilli powder, asafetida powder, paprika powder, dried chilli flakes and paprika extract for coloring.

This all looks very reassuring – especially if

the jar is from a brand you trust – but every day across the world, consumers are not getting what they are paying for. Their food may be counterfeited to resemble a favorite brand, adulterated with cheaper ingredients and marketed as sustainable when it isn't. In extreme cases, the food bears no resemblance to the ingredients on the label – as happened in Israel in 2004 when health ministry officials seized 80,000 cans of dog food that had been relabeled to be sold as liver pâté and pâté foie gras.

Substituting dog food for pâté is an extreme example of the kind of fraud that, **Ian Proudfoot**, Global Head of Agribusiness, KPMG in New Zealand, says is endangering consumers' health, hurting food and drink brands and costing manufacturers billions of dollars a year.

"The world's food system is worth around

50%

of seafood imported
into Canada was
found to be
mislabeled

67%

of sea bass sampled
in a 2019 investigation
in 24 US states
were mislabeled

0.1%

of fish imported into
the US is tested by
the authorities

28,000

seafood products are certified
as sustainable by the Marine
Stewardship Council

US\$700,000

Record price paid for a bluefin tuna

**Bluefin tuna is
very expensive,
which makes it a
tempting target
for food fraud**

US\$8.1trn and, if you are selling into markets with high levels of product counterfeiting, the total cost may be 2-5 percent of revenue. I do not have a figure I can put on the losses but I would be very surprised if the cost to the global food system is less than US\$100 billion."

That sounds like a lot of money, but there is a lot of fraud going on. Sometimes, the crime is mislabeling – as in the famous case of a Pennsylvania cheesemaker selling "100 Percent Real Parmesan" cheese that didn't contain any Parmesan at all. Estimates suggest that at least 70 percent of the extra virgin olive oil America imports contain cheaper, lower grade oils². Fraud is even more serious in the seafood industry.

On average, around 30 percent of the world's seafood has been mislabeled in the past decade³. In Canada, a 2018 study of 177 restaurants and retailers found that all 10 samples sold as butterfish were actually escolar, a dark, waxy, oily fish known to cause diarrhea, vomiting and nausea⁴.

Substituting a cheaper fish for a more expensive one is one of the easiest frauds, given the complexity of the supply chain, the limited amount of testing in many countries and the consumer's relative ignorance. Earlier this year, a Virginia fishery owner was jailed after his company mixed up blue crabmeat from Brazil and Indonesia, some of it old or recalled, with local crabmeat, and sold it as "Product of the USA." If you can persuade diners that the Vietnamese catfish they are eating (which costs less than US\$2 a pound) is really red snapper (which costs around US\$9 a pound), your restaurant can make a hefty profit.

Damaging consumers' health

With some food frauds, the consequences are immediately, horrifically apparent. In the most lethal case in recent history, in 1981, rapeseed, from which the toxic compound aniline had been illegally removed, was resold as olive oil to street traders across

Spain. More than 1,000 people are known to have died from an allergic reaction. (Worryingly, scientists still haven't found the precise biological trigger.) In China in 2008, producers anxious to conceal the fact they were watering down baby milk to save money added melamine to ensure their product passed protein tests. This made 300,000 children ill and, tragically, six of them died. The 2013 European horsemeat scandal didn't kill anybody but the revelation that some beef burgers were 29 percent horsemeat – while some beef lasagnes contained no beef at all – shook consumers' faith in the food industry, its supply chain and the regulators.

The growing clamor by consumers across the world for 'authenticity' has, in part, been driven by the cumulative impact of these scandals on the industry's reputation. When a dishwasher breaks down, we may curse, shrug and buy another. Yet food is so important to us – biologically, culturally and emotionally – that when it turns out not to ▶

Counterfeit products

French customs check for counterfeit chocolate



Police in Japan carry out evidence of food fraud by a meatpacker (below)



be what it is supposed to be the sense of betrayal lingers on.

This litany of fraud confirms, Proudfoot says, that no product, sector or country is safe from the counterfeiters. “Consumers in developed economies may not worry about whether their food is genuine or not, but in many parts of the world, it is a real problem.” In 2017, for example, India’s Food Safety and Standards Association found that 8,469 of the 49,290 products it tested were wrongly labeled⁵.

“There is money to be made by rebranding a product to one that sells at a higher price,” says Proudfoot. “Much food fraud is opportunistic and takes place within a country’s borders. The first step in the war against fraud is for countries to strengthen their own capabilities when it comes to law enforcement in this area – and companies should work with governments to help them achieve that.”

Therein lies part of the problem. As Proudfoot says: “Consumers don’t trust governments on food safety and with good reason. Although food fraud is now part of Interpol’s remit, most governments are reactive, rather than proactive. They respond when food safety issues are identified but, particularly in countries that are prone to fraud, do not actively combat the crime or enforce protection on a daily basis. Many

countries do not even have specific counterfeiting nor food safety regulations they prosecute offenders under.”

Even where countries do have regulations, they vary considerably. Escolar, often substituted for butterfish and tuna, is banned in Italy and Japan. Authorities in Hong Kong recommend it is not used in catering, whereas the US Food and Drug Administration unofficially says it “should not be marketed in interstate commerce” and the Australian state of Queensland has issued warnings to reduce the health risk.

Although there has been some harmonization of global food regulations, Proudfoot says it is in the industry’s enlightened self-interest to drive change, combat fraud – and regain consumer trust. “Companies are aware of the risks and are responding but also, given the competitive pressures many are under – especially on price – they are trying to keep the costs down.” Many potential solutions are technology driven but he says there is an educational component too: “Wherever people are in your supply chain do they understand what they’re being asked to do? And why they are being asked to do it?”

The difficulty is, he says: “Regulators and the industry are no longer setting the rules, the consumer is, and when the consumer sets the rules they’re going to set them higher than any regulator. The industry can complain all it likes but if we don’t meet those expectations, consumers will vote with their feet and buy a product they have confidence in.”

Building customer trust

There are four pathways to resolving this problem, according to **Jerwin Tholen**, Director Supply Chain Transparency, KPMG in the Netherlands. “In high-risk countries, we need to see stronger law enforcement. We could use physical markers and/or laboratory tests with paperwork throughout the supply chain. Companies could invest in supply chain traceability software and/or blockchain solutions. Yet if we think about the future customer journey, a new generation of food verification scanners could build customer trust.”

After some appalling food safety scandals in the past decade, China has tasked local authorities with monitoring food standards. The government has cracked down on websites selling counterfeit food and stopped a company that was faking production dates on its honey. It has also mooted lifetime bans from the industry for offenders.



Chinese police officers check bottles of beer during a raid on an illegal brewery

The use of physical markers – spraying food to identify it, putting invisible barcodes on avocados – could make a difference, especially if backed up with tests and reports throughout the supply chain. Yet many companies are more ambitious, exploring how they build systems to support supply chain traceability and transparency.

“At the moment some companies are reluctant to further invest in large supply chain traceability systems because they believe that blockchain will deliver miracles in the near future,” says Tholen. “In reality, full blockchain solutions are not scalable yet – they are too complex and costly.”

Yet companies that focus on the interoperability of cloud-based traceability systems – and, together with other front-runners, standardize the

way data is handled so that it effectively works like an Applications Programming Interface (API) – could, Tholen suggests, reduce the cost of data collection. They may also want to start experimenting with blockchain now

to guarantee immutability of supply chain data, so that as the technology evolves, it could work in combination with cloud-based traceability systems to provide supply chain data that is completely secure and accurate.

Such solutions would make fraud much harder – and give manufacturers confidence in the integrity of their supply chain – but would it be enough to satisfy consumers who, as Proudfoot says, have been fed a consistent diet of scare stories by the media?

Possibly not. There remains, Tholen says, the matter of the “first mile challenge”. With sophisticated traceability systems and blockchain technology, you may be able to prove that a particular coffee comes from a certain village in Vietnam but, he asks, “How do you know that the coffee entered into the system really originated from that village?”

“There are many apps and scanners on the market that use the barcode/list of ingredients and underlying data to give the consumer insight into the health and/or sustainability profile of a product,” says Tholen. “For these technologies to progress, we still need traceability software, data collection and blockchain to advance. These apps and scanners are effectively an ‘add

on’ to the supply chain traceability systems that create transparency for consumers.”

Yet there is another more innovative approach that could completely resolve the problem. Imagine you are in a restaurant and the waiter has just brought the butterfly fish you ordered. Before you take a bite, you open an app on your smartphone and scan the fish to identify its biological and chemical characteristics. If your scan shows that, for example, 14-25 percent of the fish is oil – and that it contains a lot of wax – you are probably being served escolar.

In principle, this technology could be applied to any food and drink in any retailer or restaurant. It would make fraud exponentially more difficult and act as the ultimate assurance of authenticity for consumers.

As with many such innovations, there are

some significant barriers to overcome. Data will initially be expensive if you want to use the app to test a wide variety of products. To work on an industrial scale and be truly user friendly, it would require a significant capital expenditure investment by FMCG

companies. The industry would also have to spend a lot of time and research effort on the technology to build consumer trust.

The US\$100bn question is: how long will it take the industry to create such apps and design them to be as easy to use as Facebook, Twitter and Instagram? The rewards could be immense. Yet Proudfoot says the business of fighting food fraud and regaining consumer confidence cannot wait that long: “This is an issue that is costing farmers, growers, distributors, supply chain partners and retailers real money every day.”

KPMG’s Agribusiness team helps clients manage the risks related to fraud and supply chain transparency. See page 31 for more information.

“Consumers don’t trust governments on food safety, as most are reactive, rather than proactive”

Actionable insights



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1 Managing the risk of fraud should be integrated into the day-to-day activities of each and every person in the industry.

2 Consumers’ curiosity about the origins of their food has increased exponentially. Transparent labeling is a good start but ultimately technologies such as blockchain will ensure data visibility to customers.

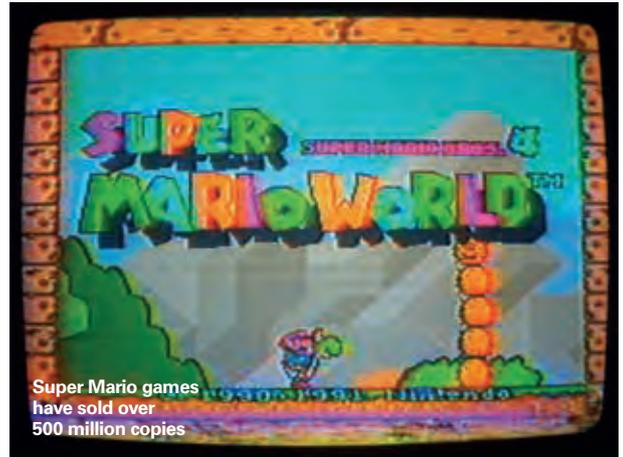
3 The agriculture and food industry has lost consumer trust due to various counterfeit food scandals. Collaboration, education and technology are needed to create a new, trusted food system.

4 No country or company is safe. The UK’s relatively high standards of food safety did not prevent the horsemeat scandal. Companies need to constantly scrutinize their suppliers and distributors.

5 Many countries do not have specific counterfeit food regulations. This should be a key focus for governments – and the industry – moving forward.

Let the user guide you

The video game industry puts player behavior at the center of product development



Actionable insights

1 Everyone is responsible for the user experience.

Every input – no matter how minor – can change the way the customer experiences the product or service.

2 Develop a culture of informed iteration.

Designs should be implemented, given to users to test and their behavior – rather than their opinions – used to create data, which can help shape future development.

3 Progress is only progress if you're moving in the right direction, so

user experience needs to be top of mind at every stage of development.

4 Don't forget innovation.

Product extensions can deliver revenues, but breakthrough innovations can be transformative.

5 Remember you are not the customer.

Your gut instinct should not be given more weight than objective data on the consumer's experience.

If you want to put customers at the center of your business, talk to a video game developer. Creating games to meet the expectations of an informed, passionate and vocal customer base, they have embedded user experience (UX) into every aspect of their business, and used the discipline to cut through the confusion that can mar product development.

As Sebastian Long, a user experience expert at American consultancy Player Research, notes: "It is extremely difficult to remain objective about things we've crafted ourselves, or things we're extremely familiar with. We can easily become oblivious to causes of disparities between the design of our game and real players' actual experience of our game." When developing a game, it is very hard to gauge how even small choices will shape the player's experience for good or ill, especially if – as is often the case – the game is intended for a player who is unlike anyone in the development team.

Recognizing these challenges, most major video game publishers and developers have invested in UX in the past five years. Typically, Long notes, they use player psychology to support game design, test games with real players, use data science to analyze player behavior and have a leader whose job it is to represent the player on the project and within the company. Yet UX is too crucial to be entrusted to any particular group, no matter how able, in video gaming, it is everybody's responsibility.

In essence, game development is a four-stage iterative cycle: a design is created, that design is implemented, its effectiveness is measured with users, the results are assessed and then fed back into the design. In most cases, players are not asked for their opinion, or split into focus groups because their actions speak louder than words.

Without this discipline, the pressure to just 'get on with it' might encourage developers to convince themselves that users will react as they do. As they are so close to the project, this can be disastrous. The usability issues that hamper some launches are surprisingly predictable – players are confused by the way the game is set up, have trouble learning it, find it too cluttered with tasks or, conversely, that it lacks depth. Yet the plethora of options facing any game designer – thatgamecompany's *Journey* is an adventure without dialogue, *The Walking Dead* is driven by character development, while *Tetris* is a classic puzzle game – make it easy for them to lose sight of how their creation will look and feel for players. That's why putting UX at the center of development is essential.

Video game developers and publishers can make money by replicating, imitating and enhancing previous successes, but the greatest rewards are accrued by the innovators. In 1985, the nascent industry was in crisis, as players grew disillusioned with game quality. Overturning such perceptions, *Super Mario Bros* launched an enduring franchise and helped revive the entire business. *The World of Warcraft*, which attracted millions to play online games, has generated almost \$10bn in revenue since its 2004 launch.

Close attention to the player experience has helped video gaming transform the quality of its products and the quantity of revenue it generates. Last year, market intelligence firm Newzoo estimated that worldwide sales of games topped US\$138bn, 13.3 percent up on 2017. The fact that games like the first *Super Mario Bros* now look archaic shows how far the industry has come. User experience has been at the very heart of that success. ▮

Insights

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Other publications



Consumer & Retail M&A trends 2019

This report from KPMG International's Deal Advisory practice reveals how industry players are responding more proactively to the fast-evolving behavior and expectations of today's global consumers.

www.kpmg.com/dealadvisory



Consumer loss barometer

The report is focused on understanding the cybersecurity gap that exists between consumers and organizations. Focusing on where the priorities differ and how leading organizations integrate cybersecurity into their business transformation agendas.

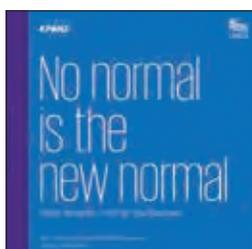
www.kpmg.com/consumerlossbarometer



Me, my life, my wallet

KPMG International's groundbreaking Customer Insights program identifies the complex drivers of choice that open and close the customer wallet.

www.kpmg.com/knowyourcustomer



No normal is the new normal: Make disruption work for your business

This survey of 530 senior consumer goods and retail executives looks at how companies are adapting to pursue growth in a disruptive marketplace.

www.kpmg.com/TopOfMind

Service areas

Customer Advisory

Today's customers are better informed, better connected and more demanding than ever before. To succeed in today's markets, businesses must reimagine the products, services and experiences they provide to consumers and migrate to truly customer-centric business processes enabled by digital transformation.

KPMG teams offer a suite of solutions that can help you achieve profitable, sustainable growth through customer-centric thinking. We can help your business engage customers, increase customer loyalty and achieve profitable growth in the age of digital disruption.

Agribusiness

KPMG's Agribusiness group offers audit, tax and advisory services geared to the unique needs of the agribusiness sector. We help our clients manage a range of important matters, including:

- regulatory obligations
- exploring market opportunities
- operating models
- handling and storage efficiency
- tax reform
- climate change implications

Clients draw on our deep industry experience and extensive technical resources to augment their internal capabilities and to obtain a fresh, independent perspective on important strategic and operational issues.

Tax

Organizations of all sizes are ever more exposed to new trends in tax regulation around the world. As a leading tax network, we believe that we – as individual tax professionals and as member firms – have a duty to engage in and advance the discussion and debate surrounding responsible tax, increased calls for transparency and the future of taxation in an increasingly globalized, digitized world. As tax leaders strive to evolve their departments for the new complexities they face, we work with them to define and build their ideal target operating model, enabling their departments to adapt to regulatory change, improve compliance processes and add more value to the business and beyond.

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

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