cutting through complexity

CONSUMER MARKETS

Turning global risk into opportunity:

Key priorities for consumer company CFOs

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Foreword

KPMG International is pleased to present *Turning Global Risk into Opportunity*, a report based on our recent survey of 350 senior finance executives from consumer markets companies around the world. A series of in-depth interviews with select CFOs was also conducted, to enhance the survey findings and fully explore the current state and future outlook for companies in the retail, food, drink, and consumer goods sectors.

This is a time of considerable volatility and opportunity for these sectors. Globally, the 2008/09 financial crisis had a lasting affect on consumer behavior, and economic uncertainty, globalization, and new technology all continue to drive change in the way consumers spend. Structural changes in the global economy are shifting economic weight from West to East and creating massive new markets for consumer goods and retail companies in emerging economies. At the same time, developed countries are growing slowly, if at all, while competition is increasing from both domestic and overseas players.

To succeed in this highly dynamic, fluid environment, manufacturers and retailers must re-think their business models and be willing to adapt quickly to emerging risks and opportunities. They must strike the careful balance between global scale and local relevance, build strong relationships with stakeholders on the ground and be able to manage a wide variety of risks that can undermine their strategic aims.

At KPMG, we are constantly seeking to understand how the changing external environment is affecting the performance of food, drink and consumer goods manufacturers and retailers. Our research, in which reports like this play an important role, helps us to gain valuable insight into the strategies and tactics that businesses are adopting to succeed in a complex and fast-changing world. This makes us better able to advise our clients which, in turn, helps them to position themselves for sustainable, long-term growth.

We would like to thank the executives who participated in this study and we hope the findings are useful as you address the challenges and opportunities you face. We at KPMG welcome the opportunity to discuss this study and its implications for your business in the years ahead.

Willy Kruh
Global Chair, Consumer Markets
KPMG

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Executive summary

The role of the chief financial officer has never been more critical in the consumer sector. As companies navigate turbulent environments in which prospects for developed and emerging markets continue to diverge, they must make difficult, far-reaching decisions against a backdrop of considerable uncertainty and volatility. By applying the discipline and analytical rigor of financial management to these decisions, finance leaders will be critical to ensuring that their company is on a path to sustainable long-term success.

The choices to be made present companies with challenging dilemmas. Revenues for much of the industry are falling, and yet companies need to invest to keep pace with competition. Huge markets in emerging economies are opening up, but companies must continue to nurture their core business in developed countries. Customers have become more value-conscious and price-sensitive yet companies must still maintain margins against a backdrop of higher input costs.

The consumer sector is also battling against volatility and uncertainty in financial markets. Currency rates, commodity prices and share prices continue to be highly volatile, making it challenging for companies to plan ahead. Credit conditions remain tight, particularly in markets with exposure to European sovereign debt. And consumer demand remains difficult to predict as confidence ebbs and flows.

In both developed and emerging markets, relationships with customers are changing. Technologies, including the internet, social media and mobile communications, provide powerful new opportunities to build client loyalty. But they are also usurping traditional ways of consumer engagement and rendering some established business models obsolete. In emerging markets, the effect may be even more pronounced as these economies "leapfrog" developed markets by adopting cutting-edge technologies.

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Survey demographics

This study is based in part on results from a survey of 350 businesses worldwide, carried out in December 2011. The survey respondents are primarily chief financial officers at food, drink, and consumer goods manufacturing and retail companies. Almost all companies in the survey have global revenues in excess of US$500m annually and nearly two-thirds have revenues in excess of US$1bn. Respondents are spread throughout key regions of the world, including North America, Latin America, Asia-Pacific, Europe, the Middle East and Africa.

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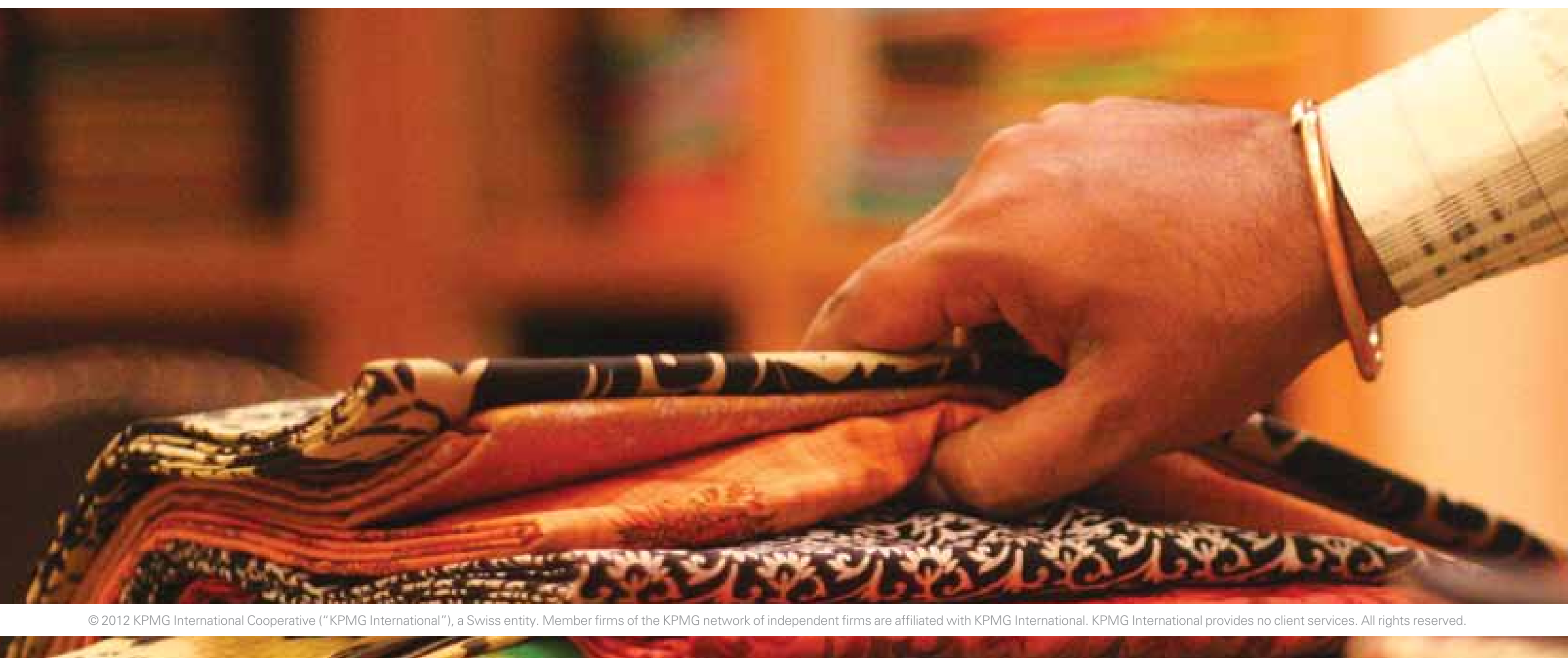
In this report, we examine the impact of these trends on consumer companies through the lens of the chief financial officer. We outline opportunities for market growth, and ways companies are managing across markets with varying development levels and business environments. And we look at how companies are managing risk at a time of considerable turbulence. Our study reveals several interesting findings:

> "Seven in 10 respondents say that tapping new middle-class consumers in emerging markets is key to their growth strategy."

Successful companies will continue to invest despite a worsening outlook and declining revenues. The mood among many consumer companies is downbeat. Around four in 10 respondents to our survey expect their company's revenues to fall over the next year. Retailers are even more likely to be pessimistic about the future, with more than half expecting a decline in revenues compared with fewer than 40 percent of manufacturers. But despite these disappointing performance expectations, companies still have an appetite for investment in market expansion, new product development and digital commerce. To retain market share in developed markets, and gain a hold in emerging economies, companies must continue to invest.

Despite their problems, developed markets remain a core focus. Although developed markets face the prospect of sluggish economic growth, consumer firms still see countries such as the US and Canada as important sources of future business expansion over the next two years. Growth in these markets will be highly challenging over that period, however – and companies that achieve it will require a potent combination of innovation, increased productivity and efficiency, and the capacity to adapt quickly to changing consumer behavior.

But emerging markets will by far represent the biggest opportunity for growth. Seven in 10 respondents say that tapping new middle-class consumers in emerging markets is key to their growth strategy. Companies with higher-than-



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average performance are particularly likely to be focusing on emerging markets. But this poses a dilemma for consumer goods companies – they must simultaneously nurture developed markets and invest for growth in emerging economies. Striking the balance between the two and timing investments appropriately is a critical challenge, and one in which the CFO plays a vital role.

Mobile is now the leading technology used to maximize sales. Within the space of a few years, mobile communications have transformed consumer behavior and business practice. CFOs see mobile as the top technology for maximizing sales. Some retailers are now using mobile devices instead of tills – the first major innovation in point of sale for decades. Mobile is also the key to tapping emerging market growth, since mobile phones are often the primary means to access the internet in these regions.

Risk conversations are becoming more frequent, but an enterprise-wide view of risk is not yet a reality. Formal risk reviews are happening more frequently to help understand a fast-changing environment. The proportion of respondents that conduct formal risk reviews weekly with senior management has risen to 19 percent, up from 7 percent two years ago. Conversations about risk may be more frequent, but few companies have an enterprise-wide view of their risk exposure. Most deal with specific risk categories locally, or within the business unit. This makes it difficult for companies to understand the interdependencies across risk categories, or align specific risk mitigation efforts with overall strategy.

Sustainability has moved from being a 'nice to have' to a core business issue. For CFOs, the potential for using sustainable approaches to reduce costs through energy efficiency, improved logistics and reduced packaging is immediately appealing. According to research previously conducted by KPMG, as many as eight in 10 consumer goods firms have developed a sustainability strategy[1]. Among our respondents, more than half say sustainability positively impacts their operating costs. Finance functions also have a key role to play in sustainability reporting, which is likely to deepen further as new developments such as integrated reporting become established.

1. http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/corporate-sustainability-v2.pdf, p.14.

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Searching for market growth

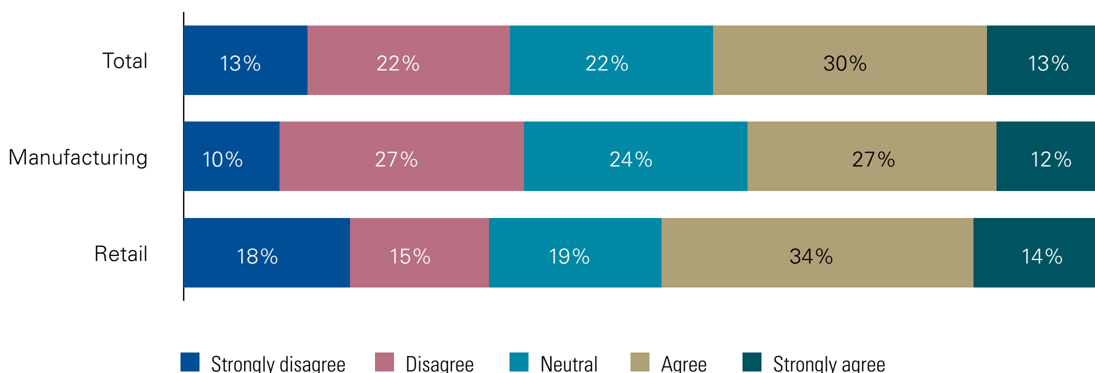
> **"More than four out of 10 respondents expect revenues over the coming year to be lower than last year."**

The search for long-term growth in consumer sectors is becoming increasingly complex. Large established markets in North America, Europe and Japan face significant macroeconomic challenges. Consumer spending is slowing as households struggle to pay down debts and save more to finance future retirement. High unemployment, rising tax burdens, falling real incomes and ageing populations are exacerbating the challenge, making it increasingly difficult for consumer companies to grow in these markets.

The scale of the challenge can be seen from survey respondents' revenue expectations. More than four out of 10 expect revenues over the coming year to be lower than last year (see chart below). Retailers are more likely than manufacturers to be pessimistic, with almost half expecting a decline in revenues. This reflects the sector's structural challenges across much of the developed world.

Despite these challenges, developed economies remain the most important markets for most consumer companies by a considerable margin. They account for a significant proportion of global revenues and profitability. At Procter & Gamble, for example, North America accounted for 41 percent of the company's net sales in 2010, according to its annual report. Retaining and generating market share in these economies, against a highly challenging economic backdrop, is a critical area of focus for executives.

To what extent do you agree that your company's revenues are likely to be lower this year than last year?



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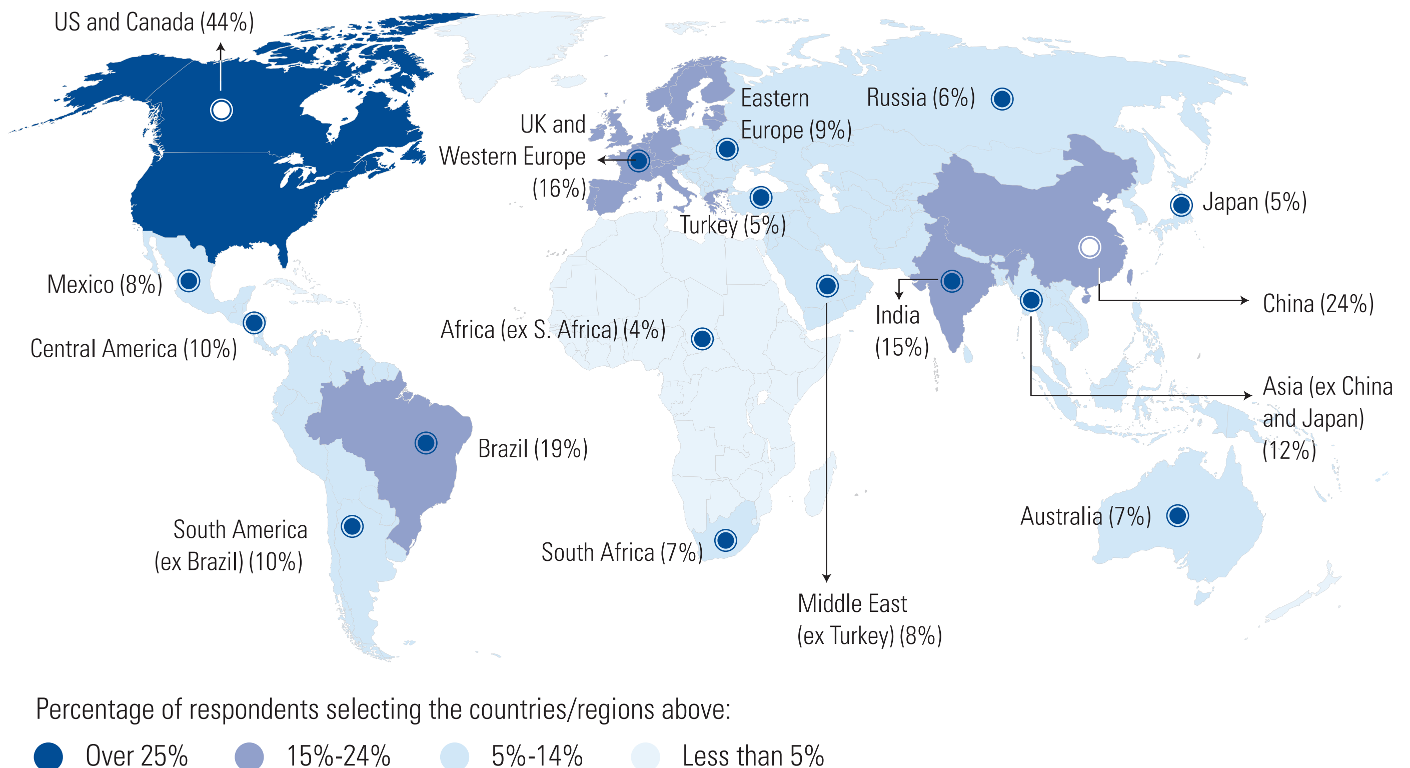
Overall, survey respondents say the US and Canada offer the greatest opportunities for growth over the next two years (see map below), despite their sluggish forecast growth rates: Oxford Economics expects GDP growth of 2.5 percent in 2012 and 2.7 percent in 2013 in the United States, while the corresponding figures for Canada are 2.1 percent and 2.6 percent.

The fact that the US and Canada are established markets continues to make them attractive to consumer companies (see chart on next page). Established markets certainly have their advantages, including consumer familiarity with the products, access to data that can guide the search for growth opportunities, and ready-made distribution channels. They also have customers with money to spend: In the US, annual private consumption per capita currently stands at around US$34,000 and will rise to almost US$45,000 by 2020. In China, by contrast, the corresponding figures are US$2,150 and US$7,140.

Where does your company expect to find the greatest opportunities for growth over the next two years?



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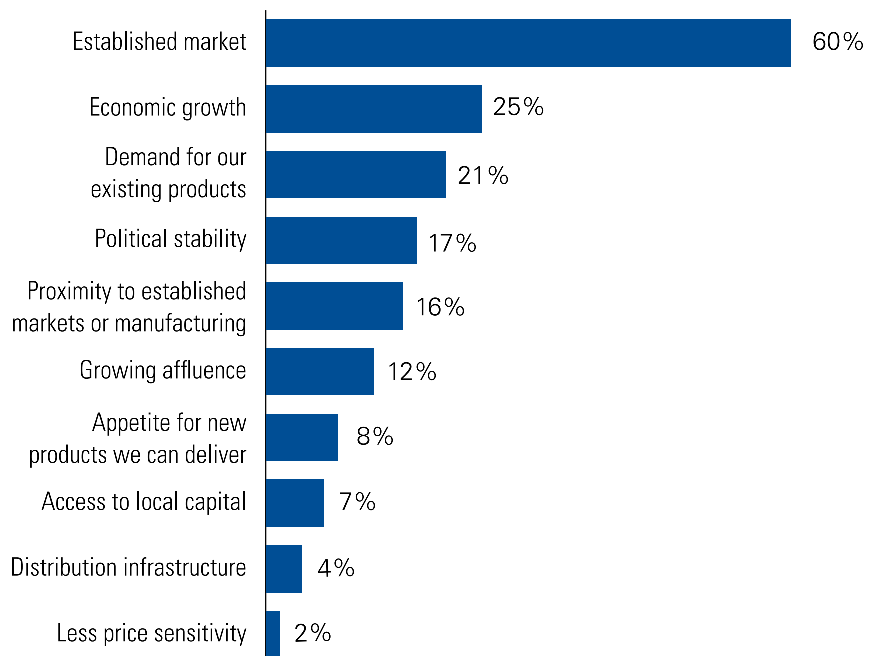
Identifying levers for growth

But established markets can also be highly competitive – and even saturated. At a time when consumer confidence remains fragile, knowledgeable consumers do not always become ready purchasers. Given that developed markets are expected to perform fairly weakly over the next few years, with GDP growth of just 1.9 percent expected in 2012, where do consumer companies expect to achieve growth?

One important area is increased efficiency and productivity, which will lead to bottom-line savings. Companies have spent the past few years refining their cost and operating models, but some CFOs interviewed for this report suggest that more can be done from an execution standpoint to achieve top-line growth. "Better execution can be a key source of growth," says David Tehle, CFO of Dollar General, a US-based discount retailer. "By making sure we do things right, measuring performance, and then taking appropriate action to improve our processes, we can drive additional sales without even opening new outlets."

Innovation is another vital source of growth in developed markets. With input costs rising and consumers seeking greater value, leading retailers and manufacturers must invest in brands or ramp up marketing budgets to increase brand equity. This will help them withstand pressure from lower-cost competitors and retain market share. Innovation is becoming more collaborative and open, with

What characteristics make the US and Canada most attractive to consumer companies?



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businesses working more closely with retailers and other partners to source and implement new ideas.

Of course, investment in innovation comes at a cost. Companies must be prepared to hold steady – or even increase – their allocation to R&D against a backdrop of declining revenues and a weak economic outlook. This takes courage, but it may be the only way in which companies can secure the growth that they think is most likely in developed markets such as the US.

Some companies are experimenting with "premiumization" strategies, which drive affluent consumers to spend on high-end brands that have an aspirational lifestyle component. Alcoholic beverage manufacturer Diageo, for example, has invested heavily in premium brands, which it believes have contributed to around one-third of its growth in the past ten years.[2] Others, such as Waitrose in the UK, are focusing on creating "value brands" to target lower-income or more price-sensitive customers. Between 2005 and 2010, the share of basket accounted for by private "value" brands in US retailers increased from 15.3 percent to 17.4 percent.[3]

Analysts describe this polarization as a "barbelling effect," whereby affluent consumers continue to spend while a growing cohort are forced to trade down to cheaper products. This explains why high-end luxury goods companies and discount brands are currently performing more strongly than their mid-market peers. Sales at discount retailers are also rising: Net earnings at Target, for example, increased by 17.3 percent between 2009 and 2010, according to its 2010 annual report.

The US-based luxury goods company Tiffany provides a good illustration of the top end of this phenomenon. "We think that the global luxury consumer is in a fairly strong position and has recovered well after the initial shock of the financial crisis," says Patrick McGuiness, Tiffany's Senior Vice-President and CFO. "By contrast, the aspirational consumer continues to struggle slightly and is more sensitive to the current economic downturn."

On the other side of the barbell, more and more consumers are seeking value for money in a way not evident prior to the financial crisis. "We have seen the emergence of a very cost-conscious consumer who is exerting that approach across the full spectrum of their purchasing intent," says Adrian Gratwicke, CFO of Metcash, a wholesale distribution and marketing company based in Australia. "So whether it's food, shoes, electronics or sunglasses, it's all being forced through the same prism."

One important implication of this trend is that any retailer or manufacturer that occupies the middle ground will find itself squeezed by increased sales at the top and bottom end of the market. These companies will need to decide whether they should hold their ground, and expect consumer behavior to change back in their favor, or introduce premium or value sub-brands in order to capture their share of this trend.

"Companies must be prepared to hold steady — or even increase — their allocation to R&D against a backdrop of declining revenues and a weak economic outlook."

2. http://www.just-drinks.com/interview/just-the-answer-andy-fennell-chief-marketing-officer-diageo_id100588.aspx
3. The rise of the value-conscious shopper, Nielsen.

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The lure of emerging markets

> **"Emerging economies will grow by 6.1 percent in 2012, compared with just 1.9 percent for developed economies."**

While developed markets like the US may remain the most important for the foreseeable future, the biggest growth engines are the emerging markets. According to the International Monetary Fund's latest World Economic Outlook, emerging economies will grow by 6.1 percent in 2012, compared with just 1.9 percent for developed economies.

The long-term opportunity is even more exciting. According to the Organization for Economic Co-operation and Development,[4] the number of people in the global middle class will grow from 1.8 billion to 4.9 billion between now and 2030. Most of these new consumers, who have a daily expenditure of between US$10 and US$100, will live in emerging markets.

For consumer companies based in developed markets, expansion into emerging markets will be key to driving long-term growth. Among the respondents, almost 70 percent say tapping new middle-class consumers in emerging markets is central to their growth strategy. For 58 percent, non-domestic markets are now more a focus for growth than their home market.

These figures are even more striking among those who say their company's financial performance is ahead of the industry average. Among that group, 65 percent say that they are focused more on non-domestic markets, and 80 percent say that tapping new middle class consumers in emerging markets is key to long-term growth strategy. Retailers in the survey tended to be slightly more focused on non-domestic markets than manufacturers.

Despite this, many consumer companies have discovered, to their disappointment, that emerging markets can be challenging business environments. Although risks vary, many developing markets suffer from poor infrastructure, complex regulatory environments and high levels of political risk. These are markets that require patience and a willingness to commit resources for some time before achieving returns. And slowing growth in some emerging economies can dampen expections for these new consumer markets, at least in the short term.

But perhaps the biggest problem facing consumer companies in emerging markets is intensifying competition – particularly from local companies. Ten years ago, consumer companies entering emerging markets would have been most concerned about competition from rival multinationals. Today, local players are just as likely to pose a competitive threat. Companies headquartered in

[4] The emerging middle class in developing countries, Working Paper No. 285

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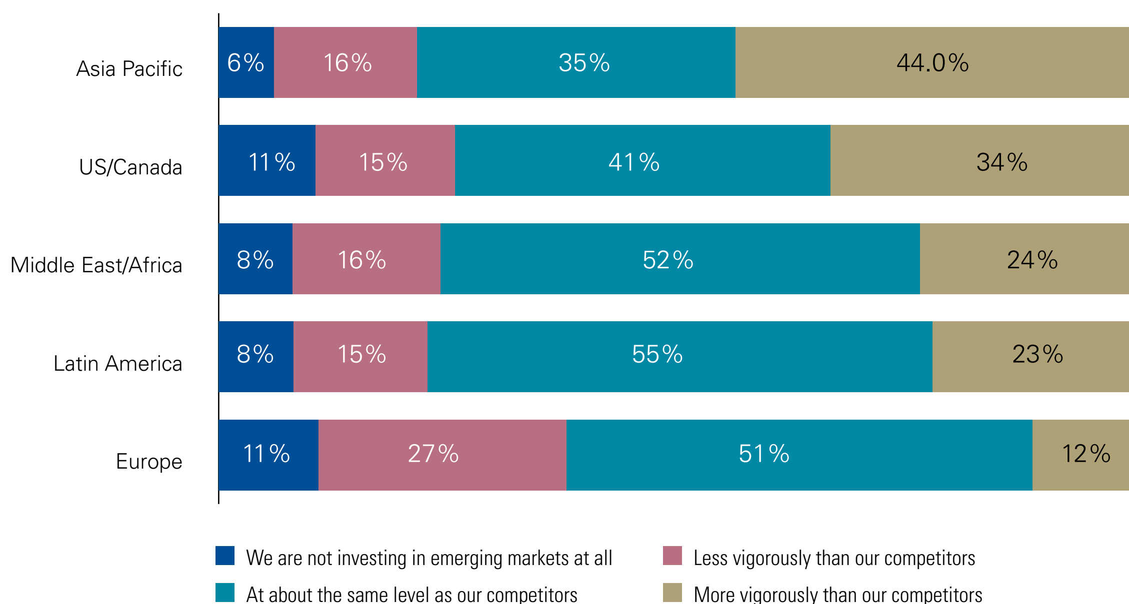
emerging markets typically have the advantages of a deep understanding of local customers, strong balance sheets and good relationships on the ground to navigate a challenging business environment. Any company entering these markets must therefore be confident that it has the assets to compete effectively. It is notable that respondents based in Asia-Pacific, who are geographically closest to some of the largest emerging markets, are more likely to be investing more vigorously in these markets than their competitors (see chart below). These results apply in the case of both retail and manufacturing consumer companies.

The importance of emerging markets to future growth – and the challenges of succeeding in them – present companies in the sector with another important dilemma. They must balance carefully their resource and budget allocation across developed and emerging markets so they continue to nurture core markets while laying the groundwork for expansion in new ones. With resources finite – and increasingly constrained by a weak outlook – they will need to choose wisely. The CFO will play a critical role in this decision, by providing the business both with the analytical rigor and and understanding of both the risks and opportunities

How vigorously, if at all, are you investing in emerging markets (relative to overall revenue)?



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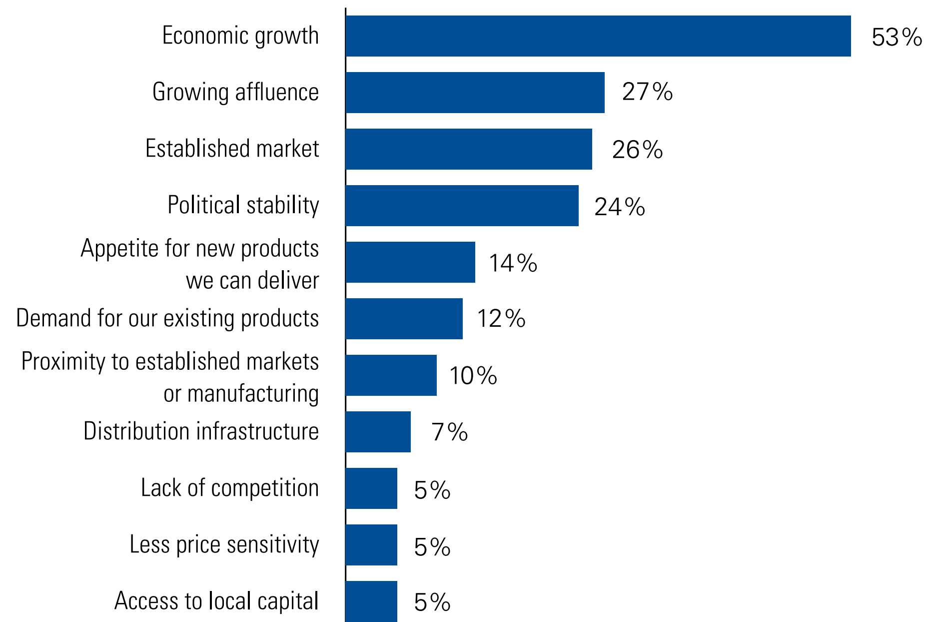
Identifying top markets

After the US and Canada, respondents say China offers the next best prospects for growth, citing its strong economic performance and the growing affluence of its population (see chart below and page 7). "China is a huge piece of the expected growth engine from a global luxury brands standpoint, so we're aligning many of our resources to be able to tap into that opportunity," says Mr McGuiness of Tiffany.

In the past decade, private consumption per capita in China has risen from US$477 to US$1,810. The middle class is spreading across the country into China's fast-growing second and third-tier cities and is now larger than the entire population of the U.S.[5] This huge, fast-growing consumer base presents companies with massive opportunities, but diversified spending power across this vast country also increases operational complexity and the challenges of achieving scale.

Despite the growth rates in emerging markets, some consumer companies remain reluctant to invest there. Ethics and corporate governance remain a key concern, particularly in the light of legislation such as the Foreign Corrupt Practices Act in the US and the Bribery Act in the UK. Although slightly different from each other, these laws both make individual board directors liable for charges of bribery and corruption in overseas markets, even if they were unaware that such actions were taking place.

What characteristics make China most attractive to consumer companies?



Source: KPMG International Survey, November 2011.

5. http://business.financialpost.com/2011/12/24/the-biggest-story-of-our-time-the-rise-of-chinas-middle-class/

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For Mr. Gratwicke of Metcash, the difference in standards of governance between developed and emerging markets has caused the company to look very closely at potential investments in less deveoped economies. "We have found there is a gap between our requirements to observe certain governance requirements as a publicly listed company in Australia and what is acceptable in a developing or less well developed economy," he says. "Where opportunities have presented themselves in developing economies, we've tended to look at them in a little more detail."

The volatility in emerging markets, and the risk of abrupt, adverse regulatory change, can also pose a deterrent to investment. "You can invest an awful lot of time, effort and money in getting a business to a certain point in China, and then all of a sudden, the laws change," adds Mr. Gratwicke. "The reality is that there are very few companies that go into China and make money and even fewer that have been able to extract or repatriate the money they earn."

Dealing with multiple layers of bureaucracy can also cause problems, and underscores the importance of securing local management talent with the necessary contacts and knowledge of how the system works. "You have to understand not just the way the Chinese market operates, but also the interplay between provincial and national governments," says Jonathan Mason, CFO of Fonterra, a multinational dairy company. "In our investments in China, we have secured local consent to operate. But for some overseas multinationals, this can be a new phenomenon to which they are not accustomed."

Growth ambitions: A regional perspective

At an aggregate level, the established markets of the US and Canada and the high-growth market of China are seen as consumer companies' most likely sources of growth over the next few years. But an analysis by region reveals a more nuanced picture where respondents favor neighboring countries over distant ones as sources of potential growth. This is in line with data on trade, which typically shows that around 60 percent of cross-border trade flows at a global level take place within continents.[6] For finance executives with companies based in the US and Canada, the domestic market far outweighs any other as the source of potential growth. This reflects that market's size and importance and also how companies headquartered there may generally be less inclined than those in smaller, more trade-dependent markets to focus on international expansion.

The situation is very different in Europe, where companies tend to be focused on a broader range of countries as sources of future expansion, spanning every region. This may partly reflect the weak state of domestic economies in Europe, which is forcing companies to look further afield, but it also reflects a longstanding openness among relatively small European economies that must seek out opportunities overseas to pursue a sustainable growth strategy.

Respondents from Asia-Pacific tend to have two main priorities: rapid-growth markets of China and India, which are geographically close, and the huge, although distant, consumer market of North America. This illustrates the extent to which Asian companies now have global ambitions, but also shows that they will be highly selective about where they will invest. Emerging markets outside of those in Asia, for example, are of little interest to Asian companies in our survey.

Respondents based in the Middle East and Africa see South Africa, the region's second largest economy after Saudi Arabia, as their most promising growth opportunity. They are quite international in their outlook, with more than one-quarter saying the US and Canada offer the greatest opportunities for growth, and others having a strong focus on Asia.

Latin American-based companies are the most local in their focus, with Brazil, the region's largest market, seen as the most promising source of opportunity, followed by the US and Canada, and then the other markets across Central and South America. Although not all Latin American companies are as local – the Brazilian meat producer JBS is one notable exception – our survey suggests that relatively few are venturing outside of the Americas in search of growth.

6. DHL Global Connectedness Index 2011

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Evaluating and executing strategies

"Respondents from emerging market regions are more likely to be increasing overall budgets – reflecting the scale of their opportunities and relatively larger need for investment."

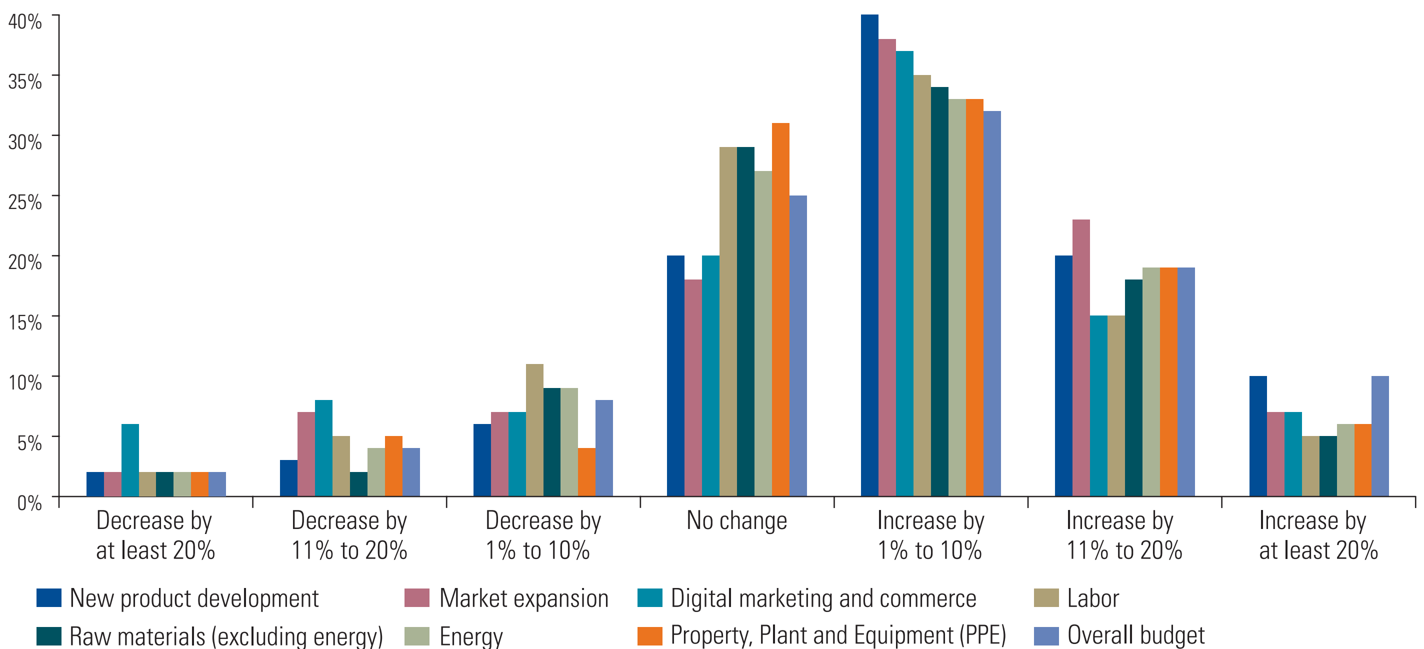
Any growth strategy needs investment, and CFOs play a critical role in evaluating potential options and determining how resources should be allocated. Among those surveyed, almost 70 percent say they are increasing their company's overall operating budget in 2012 (see graphic below). Manufacturers are more likely than retailers to be increasing allocation, with 73 percent of the former and 63 percent of the latter ramping up their budgets for the coming year.

Respondents from emerging market regions are more likely to be increasing overall budgets, reflecting the scale of their opportunities and their relatively larger need for investment. For example, 81 percent of Latin American companies are increasing their budgets, compared with only 51 percent of those from Europe.

More than two-thirds say market expansion is a key area for budget increases over the next year. Most companies are also ramping up investment in new product development, and digital marketing and commerce. Again, respondents from emerging market regions are more likely to be increasing their budgets for these activities.

In some cases, budgets will need to increase to keep pace with inflation. For example, it is unsurprising that companies are increasing budgets for raw materials and energy, as not to do so would mean retrenchment when these costs are rising. That said, the overall goal among respondents is clearly one of growth. To retain market share in developed markets and gain a hold in emerging economies, companies are ready and willing to invest. If they do not, they will be left behind

To what extent will your operating budgets change in 2012?



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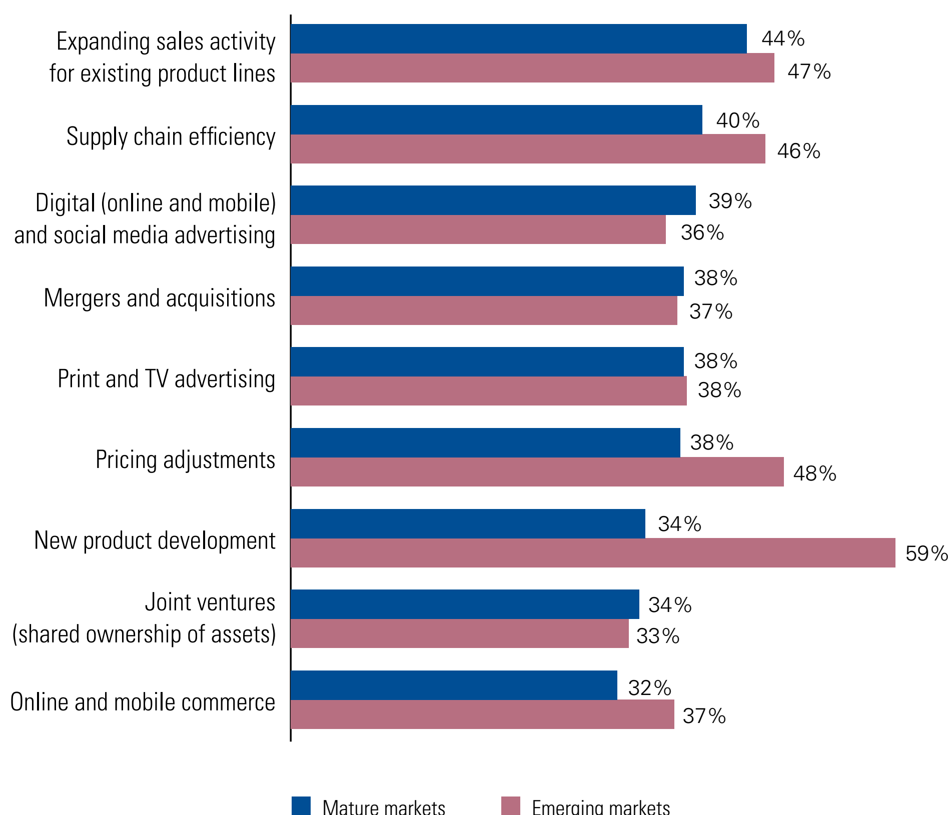
The investment choices that consumer goods companies make have never been more critical. At a time when revenues are declining for many in the sector, the margin for error in making investment choices has narrowed significantly. Although investment is crucial, just to keep pace with stiffening competition, the costs of making the wrong strategic choices are greater than ever.

"The current environment forces us to review our business model and simultaneously redefine our strategy for growth," says Andrea Brioschi, CFO of Italian retailer Coop Lombardia. "We need to invest to regain market share and expand our business, but it must be a profitable expansion. So we need to evaluate our options carefully."

The kind of growth strategies companies pursue varies depending on the stage of development within a market. In emerging markets, new product development is seen as having the most potential as a growth strategy. These markets are often at a much earlier stage of development from a consumer perspective, so it is natural that the focus is more on creating new lines and even categories to suit local tastes. In more mature markets, the focus is on increasing sales activity for existing product lines (see chart below).

Which strategies will have the greatest impact on overall revenue growth at your firm in the next two years?



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Building a rationale for investment

Although CFOs are not always instrumental in setting strategies, they certainly play a crucial role in ensuring investment decisions are grounded in rigor and analysis. Finite resources must be allocated carefully, and trade-offs must be made between different objectives and time horizons. At a time of considerable uncertainty in the global economy, this role is more critical than ever to ensure that the company chooses the right strategy to suit both current and future conditions.

Mr. Gratwicke emphasizes the importance of ensuring any new investment in a particular market is aligned with the company's overall corporate strategy and capabilities. "We have a set of core competencies that could be applied to any opportunity outside of our home market," he says. "So it's important for us to assess whether a particular opportunity aligns with those competencies. If it does, we'll consider it."

When planning a new investment, Dollar General uses a wide variety of data and analytical tools to determine the best new store locations, including analyzing neighborhood profiles, complementary businesses, competitors, demographics, income levels, job types and using a range of financial tests. The company also has detailed profiles of 66 segments of customers that it calls "people types." "We then apply our knowledge of the distribution of these people types in different cities and suburbs to help place, design and stock stores to meet local needs," says Mr. Tehle.

For companies that operate in emerging markets, building an investment rationale is even more complex. One key challenge is a lack of historical data on consumer preferences. "When seeking to support an investment

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hypothesis in a market like China, you have to look at the broad demographic data, the creation of wealth inside the country and other macroeconomic data points," says Mr. McGuiness of Tiffany. "You can't always look at the history of consumer behavior for this segment because that data may not exist."

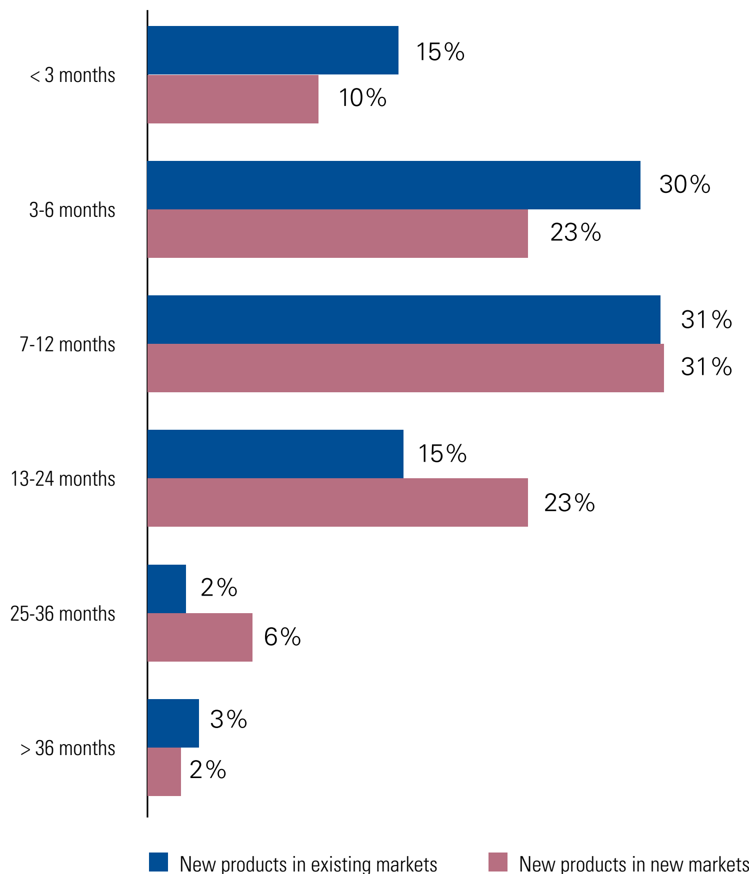
Finance leaders must also manage the trade-offs between allocating resources to profitable, but low-growth developed markets, or shifting them to high-growth markets that may require investment over a period of years before turning a profit. Investments in new markets, particularly emerging ones, typically take longer to achieve returns because the company needs to build awareness of its brands, and develop an infrastructure that will enable its products to reach the market.

Twenty percent of those surveyed expect it will take longer than a year for their new products in an existing market to achieve expected return on investment, but in new markets that figure increases to over 30 percent (see chart below).

In some cases, CFOs may be willing to accept a longer ROI and higher risk in the short term, where the decision is in the context of the overall portfolio. "In a market like China, we are willing to take less of a return in the near term to establish a foothold in a market that we believe on a longer term has an incremental return possibility," says Mr. McGuiness. "Our assessment of the market investment considers the broader business impact and related return beyond the borders of a particular country."

> **"One challenge of building a rationale for investment in emerging markets is a lack of historical data on consumer preferences."**

How long do you expect new product introductions to take to deliver expected ROI?



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> "Rather than investing heavily in fixed assets, consumer goods companies are building partnerships and outsourcing arrangements that can easily be scaled up or down."

Getting execution right

In slower-growth, developed economies, the focus continues to be on efficiency, productivity and cost reduction. By contrast, fast-growth emerging markets unsurprisingly require a more entrepreneurial mindset. The pace of change in those business environments can require constant experimentation, quick decision-making, and speedy scaling up of successful ideas.

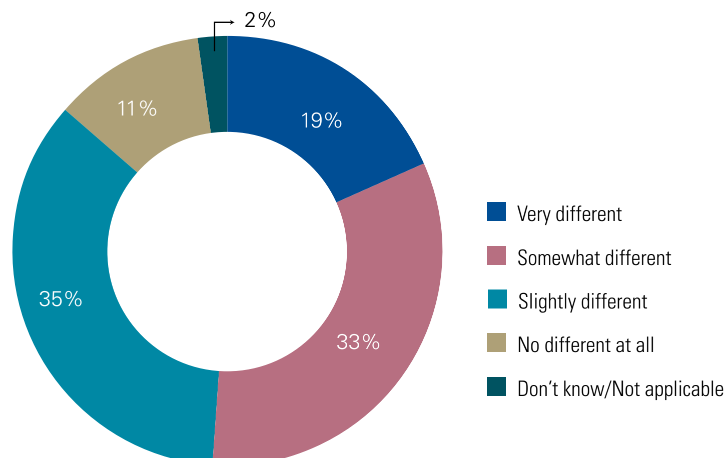
Rather than investing heavily in fixed assets, consumer companies are building partnerships and outsourcing arrangements that can easily be scaled up or down. This gives them the ability to respond quickly to changing external conditions, from a deteriorating environment in some developed markets to rapid growth in emerging ones.

Mr. Tehle explains how Dollar General adopted this approach when building a presence in California, which was an untapped market for his company at the time: "Instead of building and owning a distribution center in California, we signed a short-term lease on a center operated by a third party, which will give us the flexibility to either scale up or wind down the investment if it doesn't work out."

The same principle applies in emerging markets. Consumer companies understand they must scale up their investments quickly to capture a huge market at speed. Often, the only way to do this is through partnerships with local companies that have easier and quicker access to distribution channels or manufacturing assets or resources.

For profitable growth in both developed and emerging markets, consumer companies must strike a careful balance between global and local. They must ensure they derive economies of scale through shared services and integration of key activities, such as manufacturing

How different are consumer preferences in markets where your company plans to expand versus your current markets?



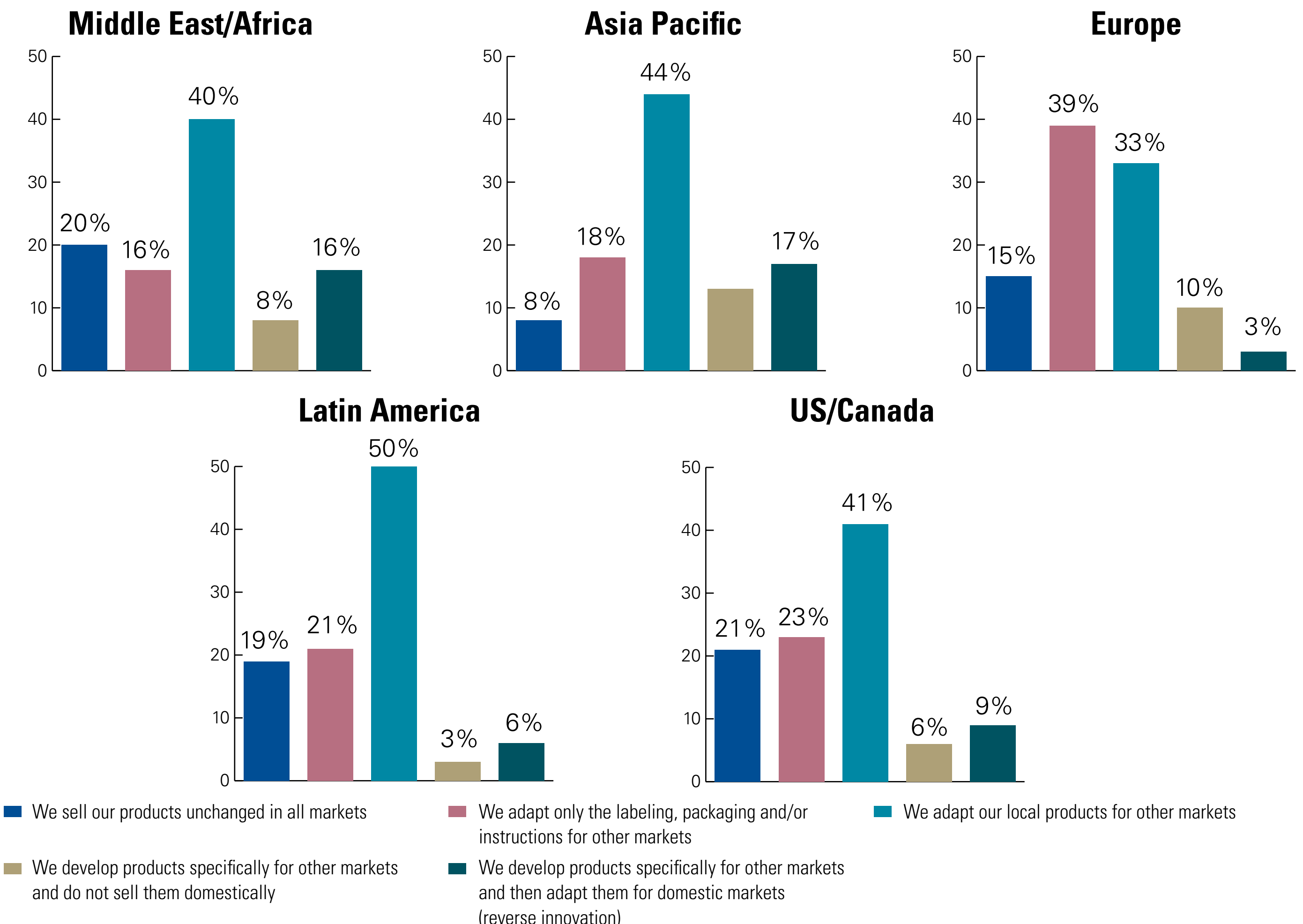
Source: KPMG International Survey, November 2011.

and procurement. They must also take into account the preferences of local consumers so that their products are relevant in each market.

Differences in local consumer preferences and tastes mean companies need to adapt their products. More than half of our survey respondents say that the consumer preferences in markets where they plan to expand are somewhat or very different from their current markets. Among those who say they are investing more vigorously in emerging markets than their competitors, this figure rises to 60 percent (see chart on previous page).

Most companies recognize the need to adapt most products to suit different markets. Just one-fifth of the surveyed companies based in the US and Canada, for example, say that they sell all their products unchanged in every market. Among respondents based in Asia-Pacific, this figure is even lower (see graphic below).

How is your company developing products to meet consumer needs in other markets?



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The most common approach is to adapt products developed for domestic markets to meet the needs of other markets. More than four out of ten respondents from the US and Canada, Latin America, Asia-Pacific and the Middle East/Africa adopt this approach. Very few companies, especially outside of Asia-Pacific and the Middle East and Africa, say they develop products specifically for other markets or take those products and adapt them for their domestic markets (a concept known as reverse innovation).

From the CFO's perspective, the trade-off is between local relevance and cost. A consumer company could ensure its products are tailored to each market by decentralizing entirely the product development process, but this would in most cases be prohibitively expensive. The goal is therefore to create shared capabilities and platforms for products at a regional level, and then apply a local overlay to ensure the product suits local tastes and customs.

Aurora Fashions, a UK-based international fashion retailer that owns the Coast, Warehouse and Oasis brands, has developed shared services that provide its country operations with central resources and functions that do not require localization. Over time, says Richard Glanville, Aurora Fashions' CFO, the scope of these shared services has expanded beyond functions such as finance and human resources to encompass a wide variety of activities.

"Shared services started off being those parts of the operation that didn't touch the customer and where we thought we could derive economies of scale," he explains. "But more recently we've expanded that quite a lot and now have a lot of central expertise in e-commerce, photography and video that we can supply to country markets for them to apply their own local adaptations."

A shift in focus for R&D

In the longer term, it seems clear that success across markets with very different cultural and economic environments will require a more localized approach to product development that takes into account the needs and expectations of an

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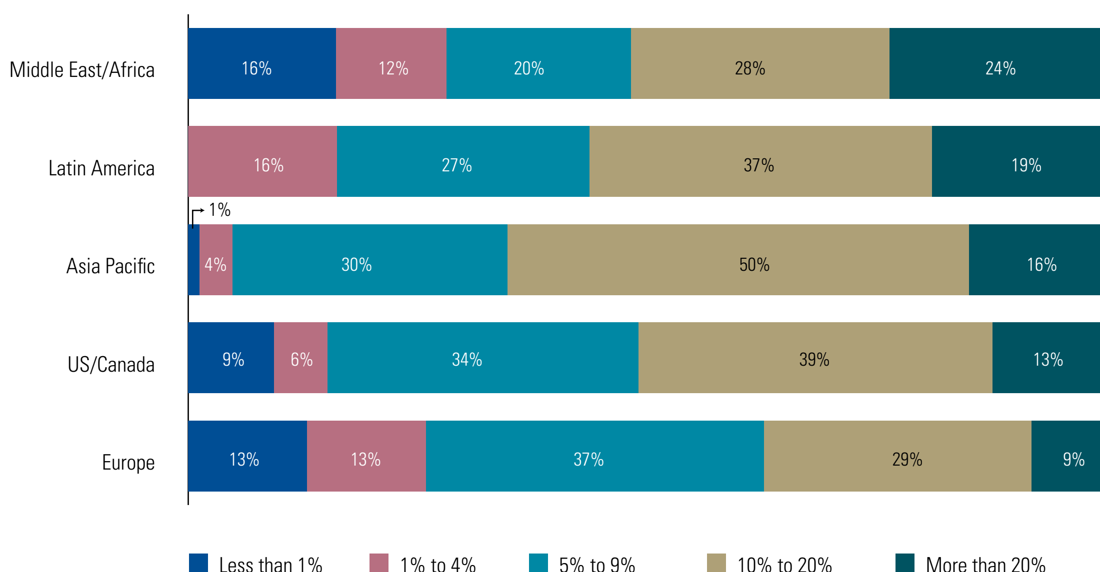
increasingly discerning customer base. Rather than have a centralized R&D function that creates global products that can be adapted for different markets, companies will increasingly need to carry out R&D locally in emerging markets to ensure products are relevant for the local environment and conditions.

There are signs that this shift in the focus of R&D is now underway. Respondents in Asia-Pacific are most likely to allocate at least 10 percent of their R&D budget to emerging markets, as one might expect given their proximity to China and India. But even companies in developed markets are earmarking substantial amounts of their R&D budget to emerging economies (see chart below).

Manufacturers are more likely to be increasing R&D budgets in emerging economies than retailers. In part, this reflects the regulatory landscape. Some emerging markets remain difficult for retailers to enter without forming a joint venture or partnership. But this is changing: In January 2012, the Indian government paved the way for global retailers to enter the country by changing the previously restrictive laws governing overseas investment in the sector. According to the new rules, non-domestic companies can now own 100 percent of retail stores selling one brand.

It is also striking that high-performing companies tend to be most enthusiastic about shifting R&D to emerging markets. Among those respondents who say their financial performance is ahead of the industry average, 22 percent are investing more than one-fifth of their R&D budget in emerging markets. By contrast, just 8 percent of those whose performance is on par with the industry average are making a similar allocation.

How much of your 2012 budget for research and development is earmarked for emerging markets?



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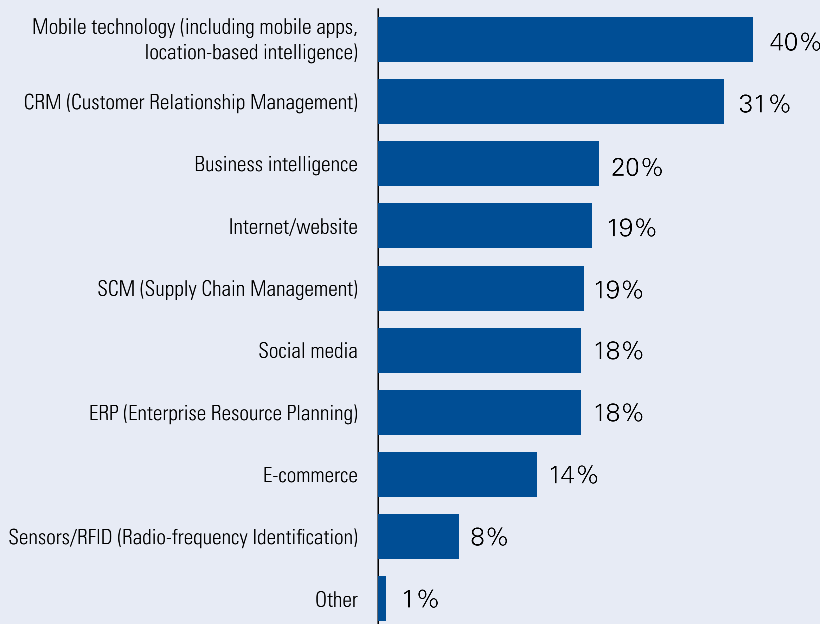
Case study: Technology in a multi-channel world

The extraordinary pace of technological development is transforming both customer behavior and business practice in the consumer sectors. In an interesting finding from our survey, respondents cite mobile as the technology that is most important in terms of its ability to maximize sales. It ranks higher than both the internet and e-commerce, providing a clear illustration of both the speed of transformation in the communications industry and its impact on business.

Over the next two years, which of the following technologies will be most important to help you maximize sales?



Source: KPMG International Survey, November 2011.

Mobile technology is dramatically altering the retail experience. Richard Glanville, CFO of Aurora Fashions, says the company's new stores are now equipped with Apple's iPads™, which can be used as portable tills to complete transactions and help customers find sizes in other outlets or online if they are not available in-store. "This is the first real change in point of sale technology for almost 20 years," he explains. "Mobile enables our staff to deal with customers in a more efficient and interactive way and means they now have access to the same information as our customers."

This trend is fundamentally changing the relationship between retailer and customer, raising important questions about the role of retail premises in a multi-channel world when consumers have constant access to mobile stores, price comparison tools and product reviews. From the CFO's perspective, a multi-channel approach where customers can order online for next-day delivery as easily as they can make purchases in-store is a key goal. This model has the potential cost-saving benefits of more efficient use of retail space and a more centralized approach to distribution. "The multi-channel

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approach is generating huge amounts of incremental sales and margin for us," adds Mr. Glanville.

In emerging markets, the speed with which mobile has become the key communications and commercial device is even more extraordinary. In Africa, for example, there are now 500 million mobile phones on the continent; in 1998, there were fewer than 4 million.[7] Over the past few years, Africa has become the world's leading center for mobile payment transfers. The consultancy Juniper Research predicts that by 2015 mobile banking will grow into a US$22bn industry in Africa.[8]

Success in both developed and emerging markets will therefore depend on the swift adoption of mobile as a device for communicating with customers and for facilitating transactions. Consumer goods and retail companies that are slow to embrace mobile will find themselves struggling to keep up at a time when competition for market share is becoming increasingly fierce.

New technologies, such as mobile and social media, can also be important sources of information and data about customer behavior and preferences. Collecting this data is not easy, because it is often in an unstructured format, but companies that do this well will be in a strong position to conduct analysis on new investments and manage the performance of existing assets. "It all comes back to the data," says Mr. Glanville. "The finance function needs to work closely with the teams in shared services and in the brands to try and derive unique insights into how our customers are behaving. Once we are able to collect those unique insights, we are then in a position to ask ourselves whether we are doing the right things and if we need to do anything differently."

But while the opportunities are considerable, so are the speed with which companies must move and the risks of getting it wrong. "In the old days, you'd have an idea for a new system, you'd specify and code it, then pilot it over a period of about a year before implementing it," says Mr. Glanville. "In a multi-channel world, you just can't wait that long."

7. http://www.guardian.co.uk/technology/2011/jul/24/mobile-phones-africa-microfinance-farming
8. http://www.reuters.com/article/2011/01/26/africa-mobilebanking-idUSLDE70L02N20110126

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Risk management

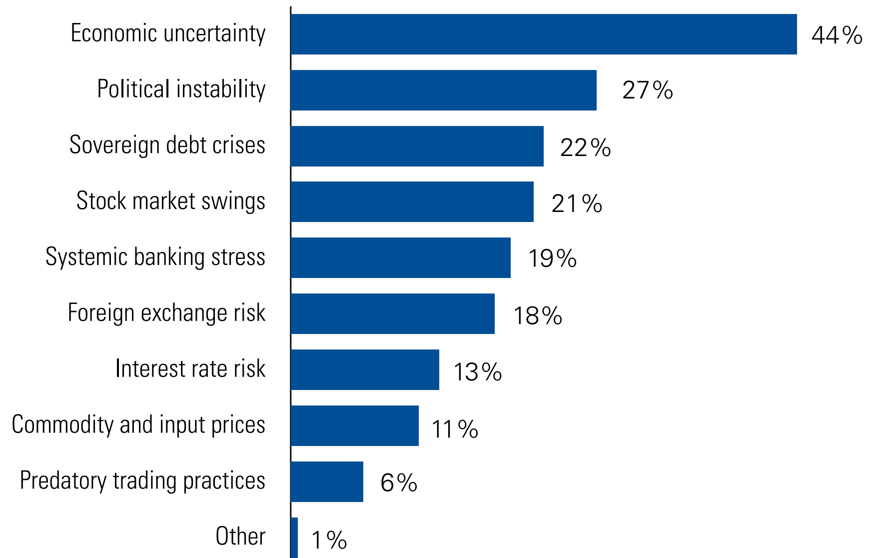
Risks facing consumer companies are diverse and widely distributed. Multinationals in the sector typically have highly complex supply chains, spanning multiple countries and business partners. This means they are exposed to a wide range of threats, including supply chain disruption, reputational damage from the activities of partners, regulatory uncertainty, fraud and intellectual property theft, and product safety.

These risks should never be downplayed, but according to survey respondents, they pale in insignificance when compared with the current economic environment. Asked about the sources of volatility that pose the most serious risks to their company's growth in the next two years, respondents point to economic uncertainty as the leading concern by some margin (see chart below).

There are few differences between the concerns of the manufacturers and the retailers surveyed. However, one difference is political instability, which is more likely to keep manufacturers up at night than retailers. In recent months, there has been a series of protests in China as workers become more concerned about the government's plans to move the economy away from low-end manufacturing to more value-added and innovative industries. In November 2011, more than 10,000 workers in Shenzhen and Dongguan went on strike to protest cuts in overtime. There have also been clashes between workers and police in Shanghai over plans to relocate a Singaporean consumer electronics supplier, which will lead to large-scale job cuts.[9]

To succeed in this environment, companies must rethink their business models and turn received wisdom on its head. "All previous paradigms and points of reference have become invalid," says Mr. Brioschi of Coop Lombardia. "As CFOs, we need to learn how to handle

Which sources of volatility pose the most serious risks to your company's growth in the next two years?



Source: KPMG International Survey, November 2011.

9. http://www.ft.com/cms/s/0/61673902-1e6e-11e1-bae4-00144feabdc0.html#axzz1ixnHfMIe

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and adapt to a very unstable market. This requires stronger forecasting skills and, above all, constant comparison and reference to others in our sector."

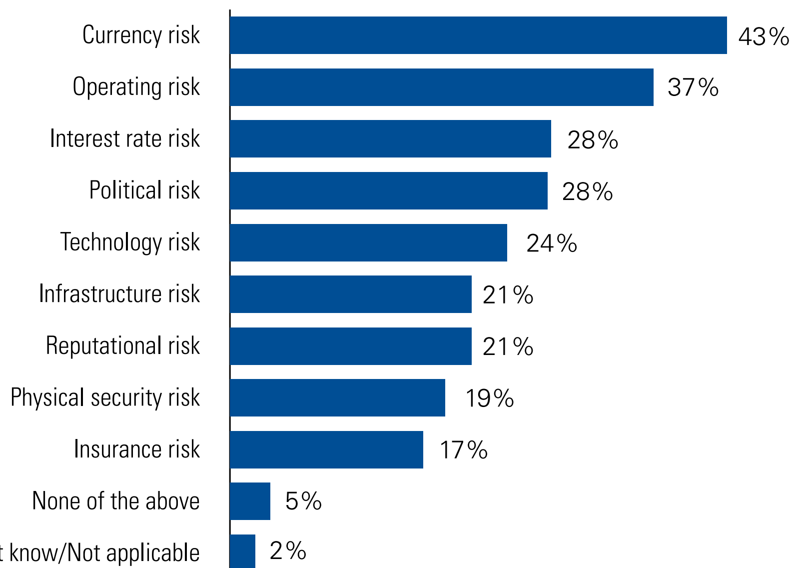
In such an environment, risk management becomes less about dealing with tactical exposures associated with the supply chain, business continuity and health and safety, and more about assessing how the company's strategy will hold up against considerable economic and market uncertainty. Although some consumer companies will have a dedicated risk function, it often falls to the CFO to bring management of these risks together at an enterprise level and provide a bird's-eye view of overall strategic and tactical risk exposures.

"Risk management for the CFO is a multi-faceted role," says Mr. Gratwicke. "There are the traditional risk activities, around treasury, finance and capital, but I also have a risk management function that reports into me so I have a broader mandate, covering everything from physical assets to product safety and brand protection. There is also a fairly in-depth risk management process that sits behind our corporate governance process to ensure the audit committee, CEO and CFO are able to sign off on our accounts."

Yet bringing risks together under an enterprise-wide umbrella is not common among consumer companies. The majority of respondents do not manage any category of risk at the enterprise level. Currency risk is most likely to be managed centrally, as cited by 43 percent of the CFOs surveyed. But other risk categories, including technology, reputation and infrastructure, are formally reviewed at an enterprise level by fewer than one-quarter of respondents (see chart below).

"Currency risk is the risk most likely to be managed centrally, as cited by 43 percent of the CFOs surveyed."

What types of risk does your company formally review at the enterprise level rather than by region or business unit?



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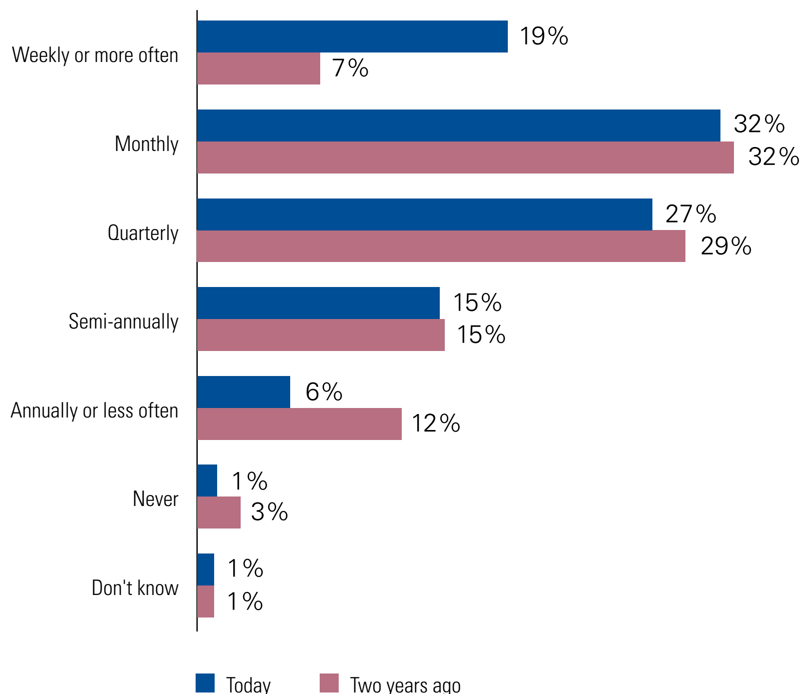
> **"The fluid, fast-changing nature of the risk environment means finance leaders are engaged in more frequent dialogues with senior management about potential exposures."**

But even if companies do not have a full enterprise-level approach to risk management, careful layering of risk management at the local, regional and global levels can help provide the visibility CFOs need. For Mr. McGuiness, the key is to have global policies and procedures that can be cascaded down to the local level. "We strongly believe that culture is created at the top and cascades down through the organization, so the further away you are from the corporate headquarters in New York, the more important it is to have strong leadership on the ground to embody the business ethics and approach that we support on a global basis," he says.

The structure of the finance function strengthens this approach. In each country, the local teams report to one of three regional centers in Europe, Asia-Pacific and the Americas. These provide necessary oversight within a similar time zone, and perform business and risk analysis at a regional level to identify trends and emerging threats or opportunities. "While the regulatory or compliance work happens more at a country level, our regional finance teams are more focused on strategic business analysis, with additional support coming from the corporate office."

The fluid, fast-changing nature of the risk environment means finance leaders are engaged in more frequent dialogues with senior management about potential exposures. The proportion that has formal risk reviews weekly with senior management has risen from seven percent two years ago to 19 percent today, while the proportion holding formal reviews annually or less often has also fallen (see chart below). This has increased dramatically the workload for CFOs but provides comfort that the company is managing its exposures appropriately in an uncertain world.

How frequently does your company hold formal risk reviews with senior management?



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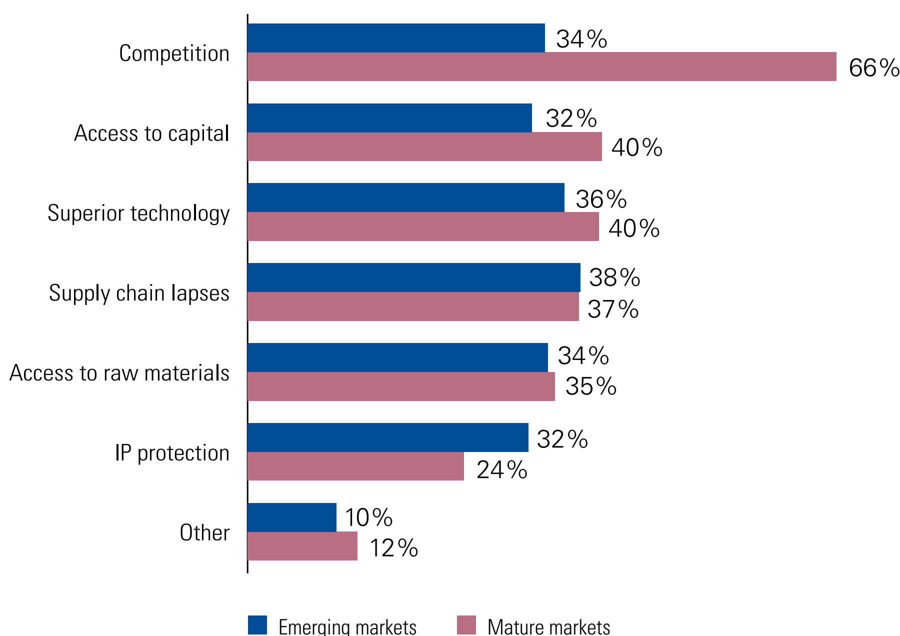
Emerging markets risk

New opportunities in emerging markets, while providing the possibility of significant long-term revenue growth, also expose consumer companies to new, unfamiliar risks. Companies may have to contend with poor infrastructure, weak institutions, political instability and regulatory uncertainty to name but a few. In many emerging markets, consumer companies must partner with local companies to gain access to the market. This itself creates significant risks in terms of product safety, ethical treatment of workers and environmental impact. Should a problem occur in a distant corner of the supply chain, it is the brand owner who will he held responsible for the event, not the supplier.

For Mr. Glanville, this highlights the importance of stable, long-term supplier relationships. "The most effective way of managing risk in the supply chain is through trust, mutual understanding and knowledge of each other's business," he explains. "We know our suppliers well, we visit their factories and know their owners. We don't hop from one supplier to the next."

Sometimes, however, supply chain disruption can be caused by circumstances that are entirely out of a company's control. Among survey respondents, supply chain lapses are seen as the most serious operating threats associated with emerging markets (see chart below). In 2011, the explosion of the Fukushima nuclear plant in Japan affected consumer companies from around the world, not just in Asia. Companies also had to contend with the political upheaval of the Arab Spring, floods in Thailand and an earthquake in New Zealand. According to an April 2011 report from KPMG, most companies reported resilience to the earthquake in Japan and the political upheaval in the Middle East, although 61 percent of respondents saw increases in energy, input, and merchandise prices as the most significant short-term impact.

What are the most serious operating threats in emerging markets vs. mature markets in the next two years?



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Case study: Sustainability reaches the finance function

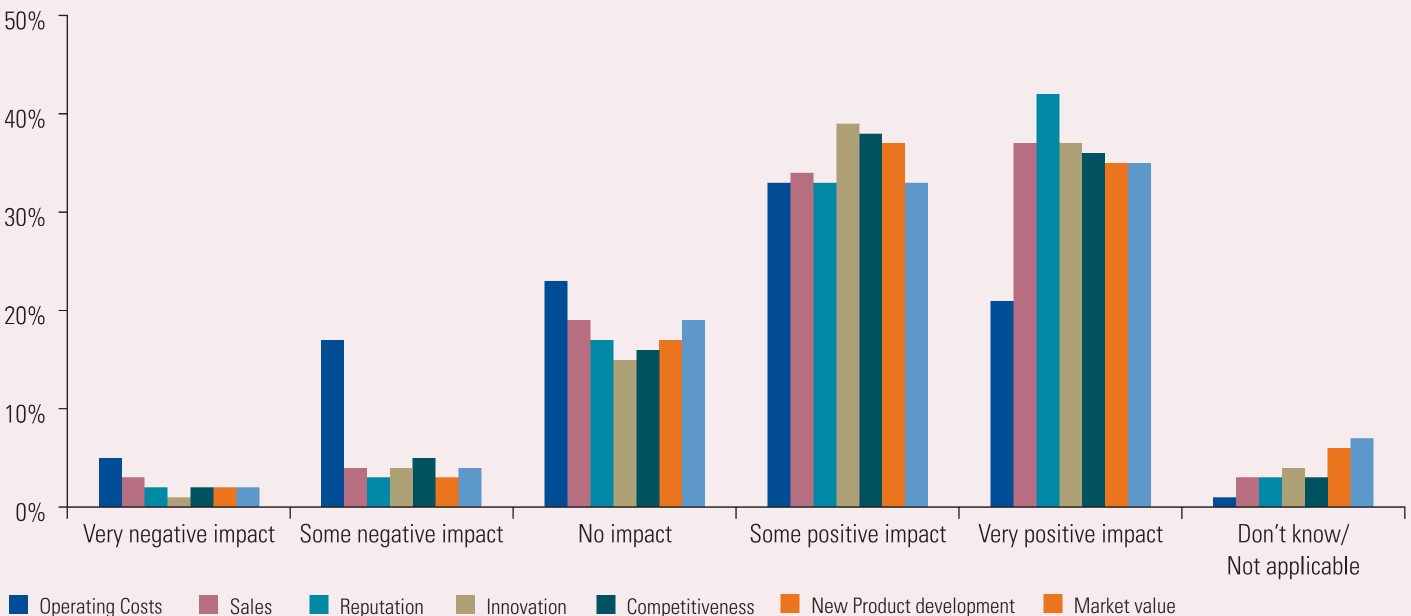
Over the past few years, sustainability has moved to the center of the corporate agenda. Once seen largely as a "nice to have" add-on to business practices, often housed in a satellite corporate social responsibility function, it is now a key topic for boardroom discussion. In a recent KPMG survey of companies, 62 percent said they have a strategy for corporate sustainability in place.

A growing number of companies in the consumer sector are turning sustainability into a core driver of their competitive positioning. The consumer goods giant Unilever, for example, has pledged to halve the environmental footprint of its products, help more than 1bn people take action to improve their health and well-being and source 100% of its agricultural raw materials sustainably.

For finance functions focused on cost reduction programs over the past few years, the potential for sustainability to strengthen the bottom line is an attractive feature that has helped drive its adoption. More than half of the respondents say sustainability has had a positive impact on their operating costs and almost three-quarters think it has made them more competitive (see chart below).

Ensuring sustainability initiatives have real business benefits is a key responsibility for the CFO, according to Mr. Gratwicke of Metcash—which has undertaken a number of such initiatives including fitting premises with photovoltaic cells, consolidating logistics to reduce fossil fuel consumption and integrating sustainable practices into new buildings. "We always try to marry up the economics of taking a certain action from a sustainability perspective with ensuring it makes good business sense as well," he says. "For the most part, you can achieve both aims and that's what we strive to do."

What impact do your company's sustainability initiatives have on key aspects of your business?



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The company also has a sustainability committee comprising the CEO, the chief of logistics, the merchandise director and Mr. Gratwicke, which meets regularly to assess opportunities and trends.

Finance functions are also becoming more involved in analyzing the company's sustainability performance and making it part of overall stakeholder communications. This set of responsibilities may include measuring carbon emissions, setting and monitoring performance targets, and integrating sustainability into corporate reporting.

In the longer term, this trend may evolve into a broader integrated reporting framework, which will bring together financial reporting, management commentary and sustainability into a single coherent package. Although this may be some years off as a universal requirement, a number of consumer goods companies, including Puma, the sportswear manufacturer, are taking steps towards this destination through its environmental profit and loss (EP&L) calculations.

Some CFOs worry, however, that the burden of bureaucracy and reporting may get in the way of the benefits that sustainability can achieve. "My biggest concern is the regulatory burden on business and the danger that policy-makers will get it wrong," says Mr. Gratwicke. "I understand the need for compliance but I think there is still a very fragmented approach to policy and regulation. Anything that can be done to reduce the compliance burden and bureaucracy would certainly be welcome."

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Conclusion

Consumer companies face a highly divergent growth picture across developed and emerging markets. In mature economies, consumer confidence remains low and unemployment stubbornly high. Retailers are struggling with disruptive change in their sector caused by new technologies and changing customer habits. Manufacturers face their own challenges, including building brand awareness at a time when media and communications channels are fragmenting and an increasingly value-conscious and fickle customer base.

In emerging markets, the picture is very different. Although growth has slowed slightly in recent months, from 7.3 percent in 2010 to 6.4 percent in 2011, most leading emerging markets continue to enjoy robust economic growth. Per capita incomes are rising, as is demand for consumer products and the sophistication of retail networks. But as many companies have found, these are difficult markets in which to succeed.

Faced with this highly divergent, multi-faceted business and operating environment, there are a number of key action points that CFOs should consider in order to position their company for sustainable, long-term growth.

Seek out ways to hold on to market share in developed markets. Although mature markets, such as Europe and the US, are set to grow slowly over the next few years, they are still home to the world's richest consumer base, and so will remain critical as a key source of cash flow and profitability for the foreseeable future. Companies should seek to maintain market share through new innovation and through strategies to increase efficiency and productivity across the business.

Make difficult trade-offs between developed and emerging markets. Companies surveyed are, in general, increasing their budgets to keep pace in developed markets and capture share in emerging ones. But in an environment where capital is tight, the funds available for investment are limited. The CFO must play a critical role in evaluating potential investments and subjecting them to rigorous analysis. This is likely to involve difficult trade-offs, particularly as investment increasingly migrates to the high-growth emerging markets. Yet at the same time, CFOs must temper over-enthusiasm for emerging markets – such is their allure that many companies are likely to invest too much and leave themselves exposed to declining market share in their core markets.

Adapt to changing consumer behavior. The global financial crisis has had a major impact on consumer behavior. Customers are now more price-sensitive than ever, but also willing to spend on quality if they think they are getting value from their purchases. Tracking consumer behavior and changing product strategy in-line with its evolution will be critical to success. But companies must be careful not to dilute their brands, or lose coherence through overly frequent changes to their products and pricing.

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Balance global scale with local relevance. As consumer companies diversify their international footprint, they must decide the extent to which they will localize their product or service offerings. Localization is crucial to ensure relevance with customers, particularly at a time when domestic competitors are gaining in confidence. This will increase sales, but it will also ramp up costs. CFOs must therefore work closely with the business to see where economies of scale can be achieved without sacrificing local content.

Harness mobile as a key communications and commercial device. In the space of just a few years, mobile has transformed the landscape for the retail and consumer sectors. CFOs and other senior executives now recognize it as a key tool for driving sales and awareness, both in developed and emerging markets. Location-based services can help to drive traffic to stores, and be used to reach out to customers on a real-time basis about offers and promotions. But mobile also shifts the balance of power between customer and company. With constant access to price information, consumer reviews and competitor information, customers are more knowledgeable than ever. Building strong, lasting relationships with these customers will be a key challenge in the coming years.

Gain an enterprise-wide view of risk. Today's fast-changing, dynamic risk environment requires constant monitoring. As consumer and retail companies diversify their international footprint, the scale and scope of risks facing the business becomes even broader. This highlights the need for an enterprise-wide view of risk that will enable companies to gain insight into exposures right across the supply chain, and be able to assess their severity and interdependency with other parts of the business. CFOs should explore ways of achieving a more consistent, holistic view of their risks that will provide senior management with greater insight into the potential threats that could undermine their strategic choices.

Further integrate sustainability with the finance function. Sustainability is becoming core to business practice. For CFOs, there are quick wins to be gained from energy efficiency and other cost-saving measures, which have a dual benefit of improving the bottom line and reducing environmental impact. But as sustainability becomes more embedded in customer expectations, it will also become an increasingly important driver of sales and improvements to corporate reputation. CFOs should work closely with the business to assess the benefits and monitor performance of different sustainability initiatives, and engage with external stakeholders to better understand what they are seeking from sustainability reporting.

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About KPMG's Global Consumer Markets practice

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We have 145,000 outstanding professionals working together to deliver value in 152 countries worldwide.

KPMG is organized by industry sectors across our member firms. The Consumer Markets practice, which encompasses the Food, Drink and Consumer Goods and Retail sectors, comprises an international network of professionals with deep industry experience.

This industry-focused network enables KPMG member firm professionals to provide consistent services and thought leadership to our clients globally, while maintaining a strong knowledge of local issues and markets.

Acknowledgements

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David Tehle, CFO of Dollar General, the largest discount retailer in the United States by number of stores.

Patrick McGuiness, Senior Vice-President and CFO at Tiffany & Co, a US-headquartered jewellery company.

Adrian Gratwicke, CFO of Metcash, a wholesale distribution and marketing company based in Australia.

Jonathan Mason, CFO of Fonterra, a multinational dairy company headquartered in New Zealand.

Andrea Brioschi, CFO of Italian retailer Coop Lombardia.

Richard Glanville, CFO of Aurora Fashions, a UK-based international fashion retailer that owns the Coast, Warehouse and Oasis brands.

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