AlixPartners

Disruption Insights

Disruption is the new economic driver

When it really matters.

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Simon Freakley
Chief Executive Officer

Letter from our CEO

Commerce has long been powered by the ebb and flow of the credit cycle. In a very short period of time, on the back of significant and rapid technological change, accelerating disruption cycles have emerged as the primary driving force in the economy and the main strategic challenge confronting business leaders.

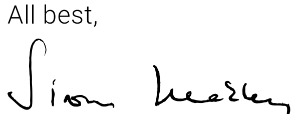
In many ways, AlixPartners has been helping our clients manage disruption over the entire course of our 40-year history. Recently, the pace of this disruptive change has accelerated so significantly that we decided to take a step back and study why this is happening.

Our 2020 Disruption Insights is a result of this analysis, and with it, AlixPartners has embarked on an annual project to study the causes of disruption, to identify what leading organizations are doing to create, mitigate, and, in some cases, harness its effects. In the following, you will find our key findings.

As you will read, strategies and operating models that have served businesses well over many years can become obsolete seemingly overnight in this fast-changing environment. Agility and a willingness to disrupt one's own business become increasingly important leadership behaviors. Equally important is finding the right strategies to get from idea to execution at speed.

We hope that this study, and those in the years to come, will help provide insight into how best to respond to these challenges.

All best,



Simon Freakley

OUR FINDINGS

Disruption is the new economic driver

Our findings in brief

KEY THEMES

Five unique but interrelated themes emerged from our research as the main drivers of disruption across industries.

CONNECTIVITY

Technology connecting people and processes accelerates the pace of disruption.

SELF-CENTRISM

Connective technologies empower individuals, change consumer behaviors, and raise the bar for business.

UNCERTAINTY

Individuals are empowered, but they are also overwhelmed by a deluge of data, opinions, products, and services.

ENVIRONMENTAL AWARENESS

Evidence of environmental pressures mounts, raising concerns among the general population and impacting consumer behavior.

POPULISM

Rising populist politics and policies create an unstable geopolitical and business environment.

NAVIGATING A SEA OF DISRUPTION

Disruption has created a fast-changing and less-predictable environment for most industries, leaving many leaders feeling adrift. New realities require businesses and their leaders to address a different set of priorities and hone new skills.

In this year's study, we examine how disruptive factors are affecting industry and identify successful strategies that companies are employing to respond. Some paths are by their very nature specific to industries or industry subsectors or even geographies.

However, our research identified four broad strategies across industries that successful businesses are pursuing.

PLACE YOUR BETS

A focused approach can meet the expectations of the self-centric consumer, but limited resources preclude being all things to all people.

SECOND-MOVER ADVANTAGE

A considered and well-timed follower can create significant shareholder value.

BRANDS MATTER MORE

In a crowded and confused marketplace, the value of brands increases.

REBEL WITH A CAUSE

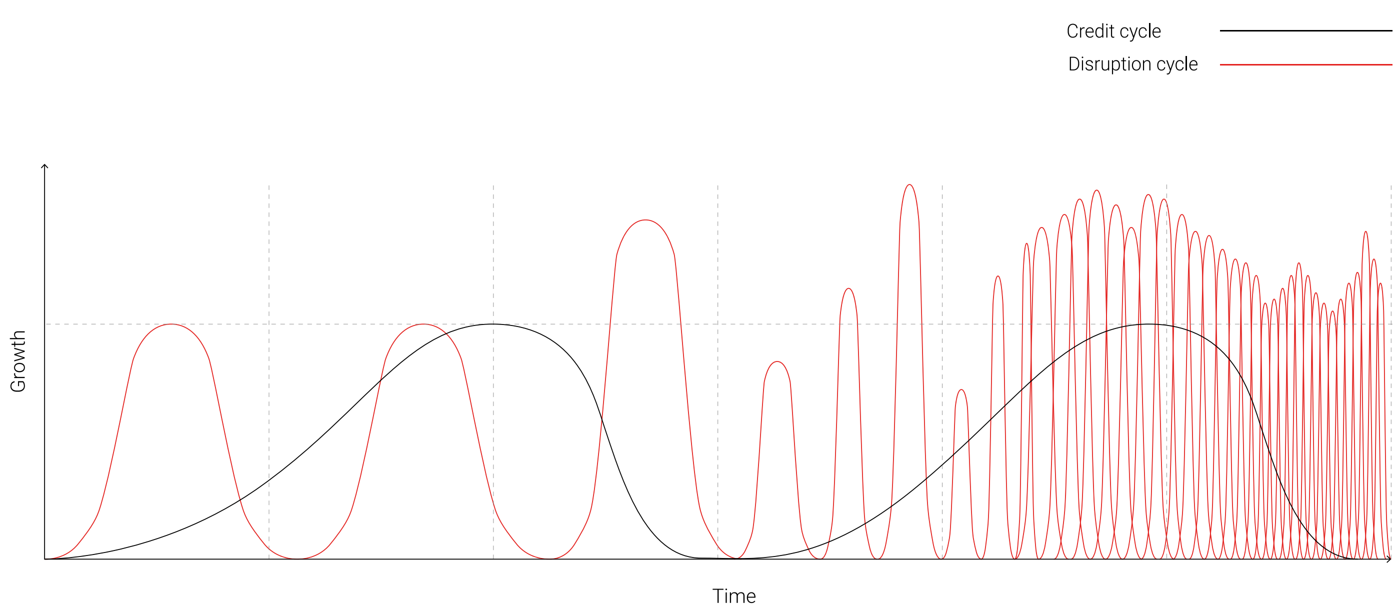
A contrarian position can still be profitable. Cash flow from declining businesses can be reinvested into areas of growth.

Today, disruption, across industries, is happening more frequently and with overlapping and additive impact, causing major dislocations of shareholder value, revenue, profit, and jobs. This study was undertaken to better understand what is driving change within five major industries and identify successful strategies that companies are pursuing to respond to disruption in their industries.

Disruption is the new economic driver

The driving force of the economy is changing. The recognized phenomenon of the economic cycle, with its boom and bust of credit expansion and contraction, has historically driven the fortunes of business and the economy at large. As we saw during the 2008 financial crisis and the recession that followed, these factors remain important. However, the gaps between economic cycles have been lengthening in recent decades, and governments and business alike have become ever more adept at managing their effects. At the same time, the pace of disruption has accelerated dramatically, and its impact has magnified.

TRADITIONAL CREDIT CYCLE VERSUS DISRUPTION CYCLE



Whether we're talking about the fourth industrial revolution, consumer self-centrism, climate change, or the rise of Asia, that accelerating pace and the cumulative impact of disruptive waves are the key driving forces in the economy and therefore represent the primary strategic challenges that both government and business leaders face today. Both the pace and the amplitude of the disruptive waves are increasing in frequency and overlapping to the point where disruption is becoming chronic. Whereas credit cycles will no doubt drive macroeconomic swings, the ability to manage disruption has become the critical commercial capability.

In a globalized economy, disruptions are rarely limited to the markets in which they originate. Disruption in one industry can have wide-ranging and often unpredictable ripple effects in many other industries and geographies, with significant macroeconomic implications. Consider, for example, the massive impact the telecommunications industry has had on media or the impact that connected consumers have had on retail. Disruption is creating dramatic dislocations and redistributions of revenue growth and profit.

When industrial performance correlated tightly with the credit cycle, business planning could be driven by expectations around economic expansion or contraction. We are now in the tenth year of global economic growth, the longest on record. This should be the best of times, and for some, it is. However, businesses across most industries struggle to cope with chronic disruption.

We define disruption as the displacement of businesses, markets, and value networks as the result of economic, societal, environmental, political, regulatory, or technological changes. Technological innovations can, in addition, serve as catalysts to accelerate other disruptive forces.

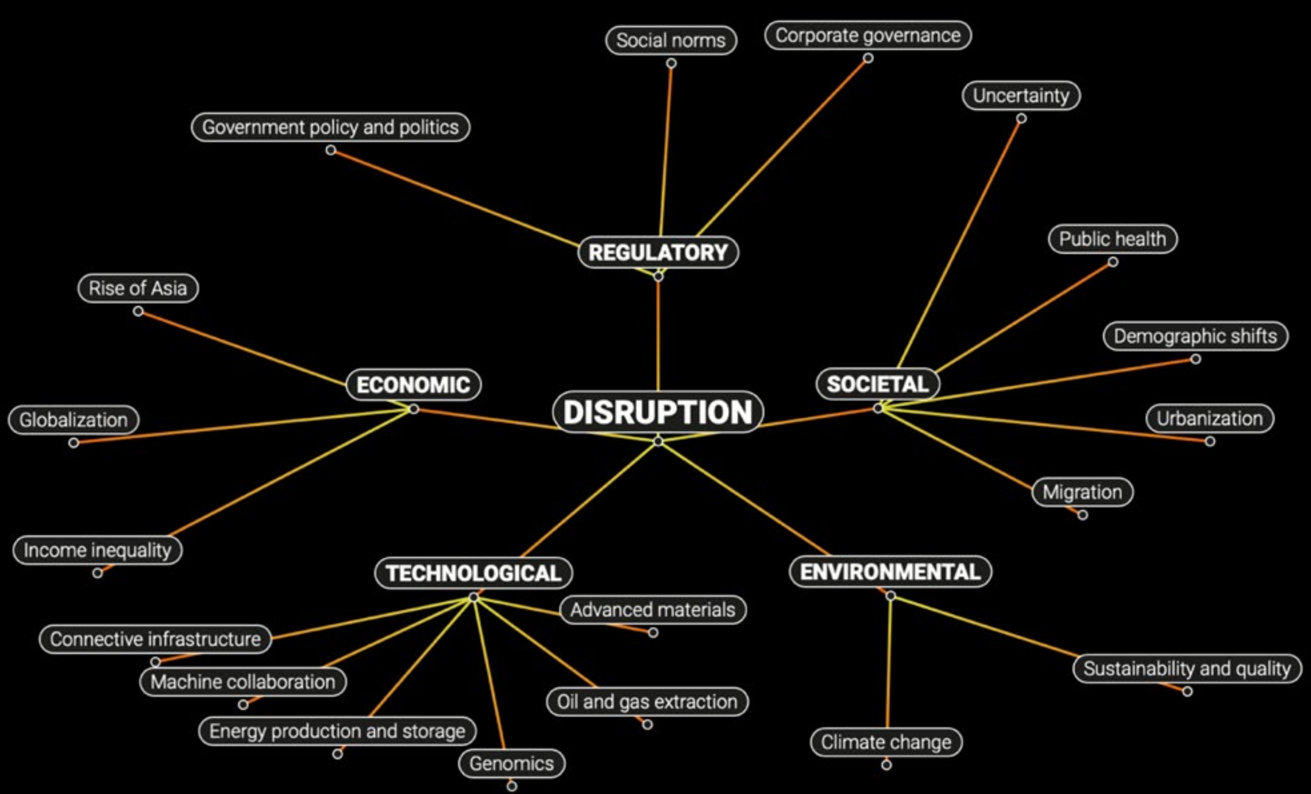
We know, of course, that disruption presents both opportunities and threats. But the now near-constant presence of disruption creates an even more pressing need for both private- and public-sector leaders to find new ways of anticipating, responding to and, where appropriate, creating these forces of change.

To understand this phenomenon in more detail, AlixPartners embarked on a project to study the causes of disruption in five industries–retail, consumer products, automotive, media, and telecommunications–to identify what leading organizations are doing to create, mitigate, and, in some cases, harness its effects.

Forces of disruption

When observed over the course of human history, the accelerating pace of change becomes clearly apparent. Advancing waves of technological progress that once occurred only over hundreds of years now take place over decades or less. Unrelenting and accelerating disruptive change is the lesson of that history, but because of a confluence of many factors, particularly technological innovation, the pace of that change—and the levels of complexity it presents to leaders who must confront it—is truly unprecedented.

DISRUPTION'S UNDERLYING FORCES



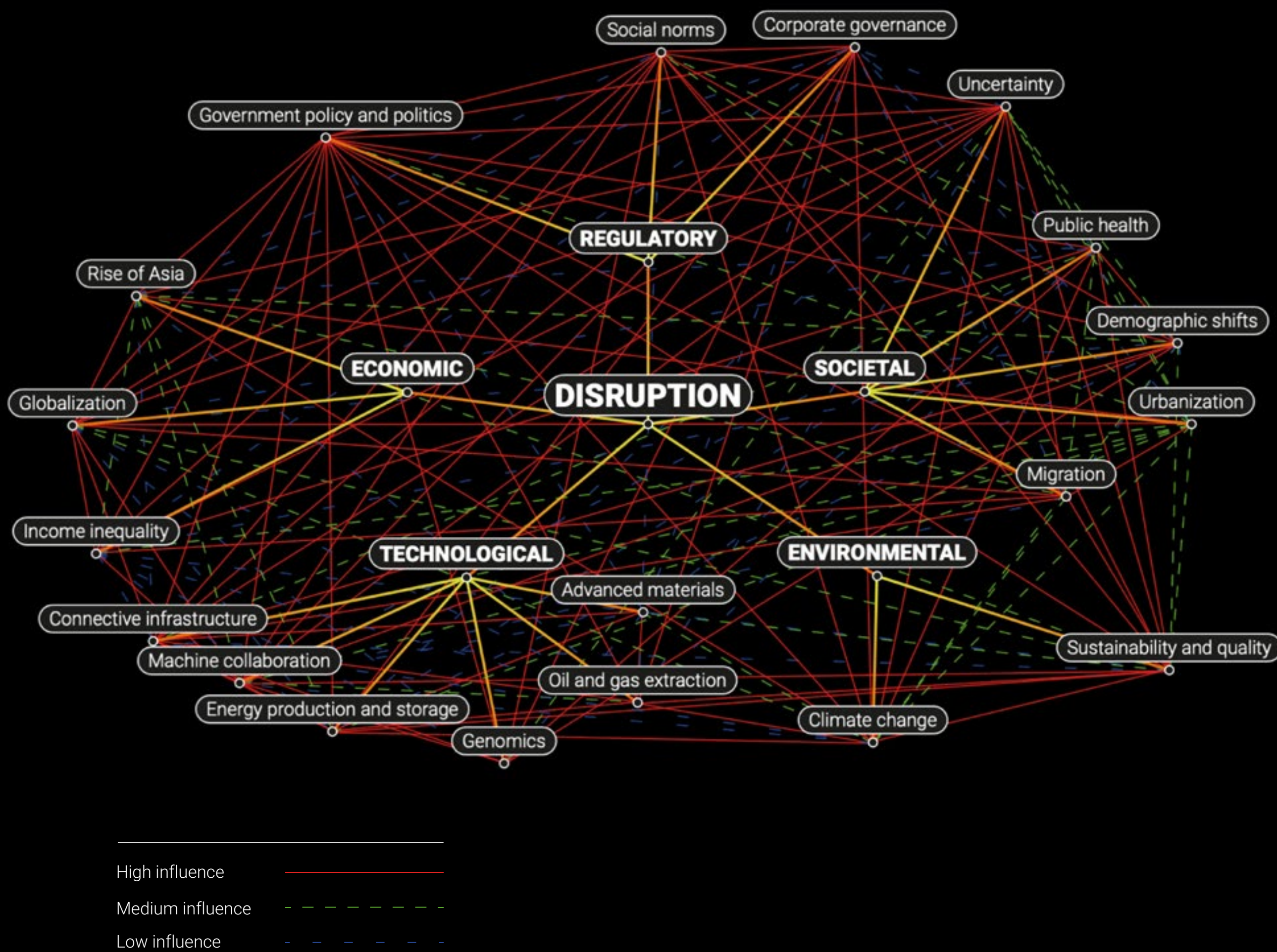
Connective infrastructure:

– Mobile technologies / 5G
– Internet of Things
– Cloud technologies
– Quantum computing

Machine collaboration:

– Artificial intelligence
– Robotics
– Autonomous vehicles
– 3D printing
– Augmented and virtual realities
– Enhanced processing speed and storage

INTERCONNECTEDNESS OF DISRUPTIVE FORCES



Societal, economic, and environmental disruptions

Many disparate yet interrelated forces are at the heart of disruptive change today. Tectonic shifts in the societal, economic, and environmental fabric are influencing broad swaths of humanity. These shifts include the rise of Asia, globalization, demographic changes, urbanization, income inequality, human migration, and climate change.

On the demographic front, several changes are occurring. People in much of the world are living longer today and are having fewer children. The International Monetary Fund predicts that in 2020, Asia will surpass the rest of the world combined in economic output for the first time since the nineteenth century. Additionally, the effect of climate change is already being felt in more extreme weather patterns in much of the world, with governments and many industries—including agriculture, insurance, tourism, and utilities—struggling to respond.

Regulatory and political disruptions

The ways governments, civil societies, corporations, and communities regulate themselves through either formal policies and laws or informal norms can cause disruptive change but also, at times, mute its impact.

In highly regulated industries such as financial services, telecommunications, and utilities, the influence of government policy is, unsurprisingly, the strongest. For telco operators, the radically different prospects for companies in the United States versus Europe are demonstrated dramatically in this year's report. Companies in both regions face relatively mature markets that have flat to slow-growing revenues and rising infrastructure costs, but regulators in, for example, Brussels have encouraged a higher degree of competition in Europe, resulting in lower prices for consumers and significant margin compression on the telcos there. Companies in the United States, where there is a larger, unified market and only four principal wireless providers, are under much less pressure.

Even less-regulated industries may see an increase in government oversight. After repeated revelations about the vulnerability of personal information, more people, from regulators to politicians to average consumers, are focusing on the ways their personal data is being used by big business. The technologies for gathering, storing, manipulating, and sharing personal information have moved far ahead of existing rules for what can and should be done with that data.

Technological disruptions

For all of these otherwise disparate forces noted above, technology acts as an accelerant to disruption, turbocharging the impacts of the other disruptors. News events can be communicated instantaneously around the world from multiple perspectives and with varying degrees of accuracy, leading to heightened levels of uncertainty and political instability. Technological advances in healthcare are enabling people to live longer, leading to an aging global population. Interconnected communities, spanning different parts of the world, are helping drive higher levels of immigration into developed countries. The vast amount of data now available to individuals is raising awareness in real time about sustainability issues, climate change, and human rights.

Many of the new technologies are already profoundly affecting the geopolitical environment. New extractive technologies for oil and gas have enabled the United States to emerge as the world's third-largest producer of crude oil, thereby reducing the country's reliance on oil imports to 11%—the lowest level since 1957.[1] The resulting changes in foreign policy priorities are readily apparent.

Genomic sequencing is advancing rapidly, becoming less expensive and more accessible. Scientists are making new discoveries in the ways genes influence specific traits and cause disease. The implications for the study of biology and healthcare could prove immense.

Key disruptive themes emerging from our research

Out of our research this year, five unique but interrelated themes emerged as the main drivers of disruption across the industries we studied: connectivity, self-centrism, uncertainty, environmental awareness, and populism. The mix and effect of those forces may differ from industry to industry, but the themes were consistently present.

CONNECTIVITY

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SELF-CENTRISM

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UNCERTAINTY

Individuals are empowered, but they are also overwhelmed by a deluge of data, opinions, products, and services.

ENVIRONMENTAL AWARENESS

Evidence of environmental pressures mounts, raising concerns among the general population and impacting consumer behavior.

POPULISM

Rising populist politics and policies create an unstable geopolitical and business environment.

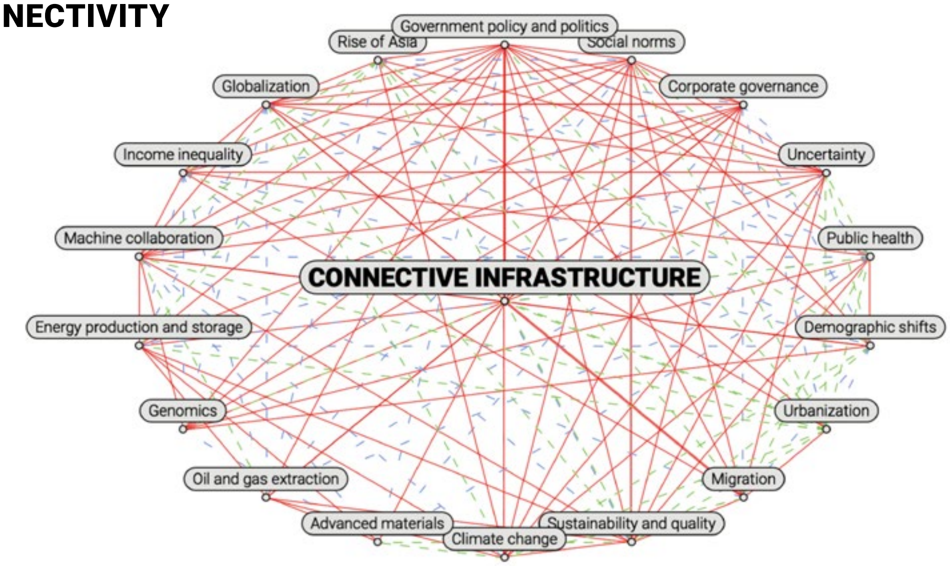
Connectivity

Technology connects people and processes and accelerates the pace of disruption.

The connective infrastructure—from mobile phones to the Internet of Things, to cloud networks—is bringing people and processes online and linking them in unprecedented ways. Of all the forces of disruption, these technologies are the primary accelerants of change in the industries we studied this year.

Innovations in connectivity have reshaped our personal lives and ways of working. It began with the rise of the Internet in the 1990s but has accelerated exponentially in recent years with the advent of new technologies. Cloud computing has already greatly decreased the costs and increased the speed and efficiency of Internet-based services. The Internet of Things is embedding connective technologies into seemingly every device—from microwaves to pacemakers, to assembly lines. These sensor-enabled devices can be controlled and monitored remotely, and they generate valuable insights from the data they provide. And augmented and virtual realities could, over time, replace current mobile devices.

ROLE OF CONNECTIVITY



But no single technology, aside from the Internet, has reshaped connectivity more than mobile phones. It is estimated that 5 billion people around the world have mobile phones, with over half of those being smartphones, keeping them constantly connected. According to the Pew Research Center, the average smartphone user spends almost three hours a day on the device.[2] Why? The sheer quantity and variety of data in the form of news articles, streaming entertainment, social media, online shopping, or the latest meme.

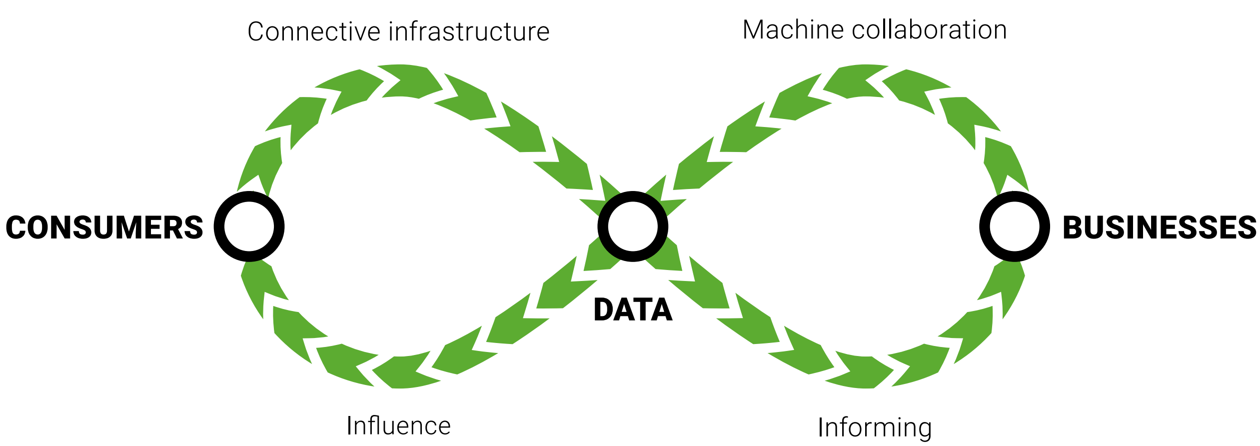
At the same time and unintentionally, individuals are creating a massive amount of data about themselves, which in turn becomes a commodity for companies to monetize. Advertisements can be sold that target specific consumer preferences. Streaming video can be suggested based on past viewing behavior. Dining options can be offered based on proximity, tastes, and availability. Health and wellness apps can track fitness levels and activity and remind people of their goals.

What is true for individuals is also true for business: unprecedented levels of data are now available to companies about their customers, suppliers, and internal operations. Digitization provides critical data throughout the value chain.

All of this data has in turn made possible a revolution in applications and processes for machine collaboration. Artificial intelligence (AI) systems can aggregate the data, filter it, identify patterns, and extract insights at speeds impossible for human beings to replicate. Furthermore, AI systems are "learning organisms" which become more and more effective over time. The opportunities presented by machine learning and other artificial-intelligence-based performance improvements are only now beginning to be used for advantage.

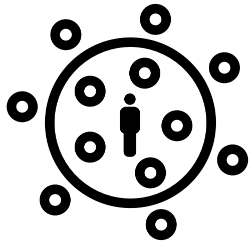
As the types and quantity of data proliferate, demand for greater and improved connectivity also increases. New industrial and business applications for, say, smart factories, mobile health, and autonomous vehicles will rest on faster, deeper, and more-reliable connectivity. Thus, the rollout of 5G technologies, the allocation of additional spectrum to wireless, and other enhancements to mobile technologies become crucial enablers to building the connective tissue this world requires.

INFINITE LOOP OF INTERDEPENDENCE IN A CONNECTED WORLD



Demand for connectivity expanded with the growth of the Internet, which exponentially multiplied the amount of information and data in the world. Consumer demand for access drove innovation and provided new connective technologies, like smartphones, which have accelerated this trend. In turn, these new technologies have multiplied the amount and types of data generated by consumers. This data informs businesses and through collaborative machine processes, like artificial intelligence, provides more insights and, therefore, more data, which both influences consumers and also increases demand for expanded and newer forms of connectivity (like augmented reality).

This creates a self-reinforcing and ever-expanding loop of connectivity, data, and automation.



Self-centrism

Connective technologies empower individuals, change behaviors, and raise the bar for business.

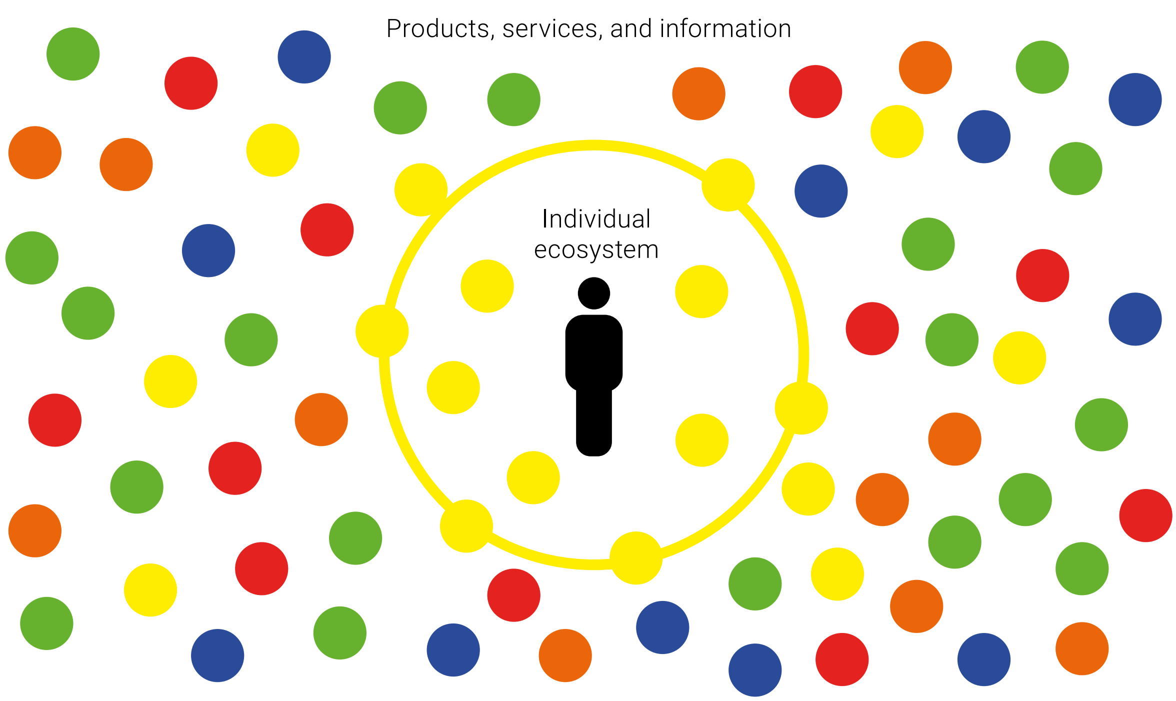
In the same way that data is at the center of self-reinforcing forces that drive technological change, people increasingly place themselves at the center of their own ecosystems, enabled by connectivity. We call this phenomenon the rise of “self-centrism.”

No longer limited by geographic location, individuals can connect with communities, information sources, and brands around their shared values. Similarly, the new technologies lead consumers to expect previously unachievable levels of personalized service and convenience.

Businesses must now meet consumers on consumers’ own terms and in consumers’ own ecosystems. People expect to access products or services where, when, and how they want. In the automotive industry, for example, this expectation has led to the rise of ridesharing platforms and the potential for subscription models that enable consumers to meet their mobility needs by way of newly customized approaches. In retail and consumer products, this has meant rethinking how to reach consumers in a consistent way across many parallel channels anytime, anywhere. For the media and entertainment industry, it has meant developing content that can be consumed across multiple platforms for unique and targeted audiences.

Value chains, which have historically been largely linear and built to maximize operational efficiencies, must become more customer-centric. Critical rethinking is necessary to determine where in a value chain a business’s competitive advantage lies and how and where the business should meet its customers.

RISE OF SELF-CENTRISM



Uncertainty

Connectivity empowers but also overwhelms through a deluge of data, opinions, products, and services.

People, generally, have a sense of unease about the future. A 2019 Gallup poll found that levels of sadness, anger, and fear around the world reached record highs for the second consecutive year.[3] The 2020 Edelman Trust Barometer found that only one in five individuals believes the system is working for them, and less than one in three people in developed markets believes they or their families will be better off in five years' time.[4]

The average person, digitally connected at all times, is constantly bombarded by an overwhelming amount of information, much of it conflicting and seemingly irreconcilable. People want clarity, ease, and certainty in their filtering of such an overload of choice.

Older generations are feeling overwhelmed by fast-moving cultural changes, and younger generations are concerned about declining economic opportunity. The rapid pace of disruptive change has been a key contributor to those societal insecurities. The potential impact of new technologies—particularly in the area of automation—the movement of jobs to lower-cost labor centers, increased levels of immigration, and the consequences of climate change and pollution serve as contributing factors. Heightening political instability and divisiveness in much of the world are both an outcome of and a contributor to the unease as well.

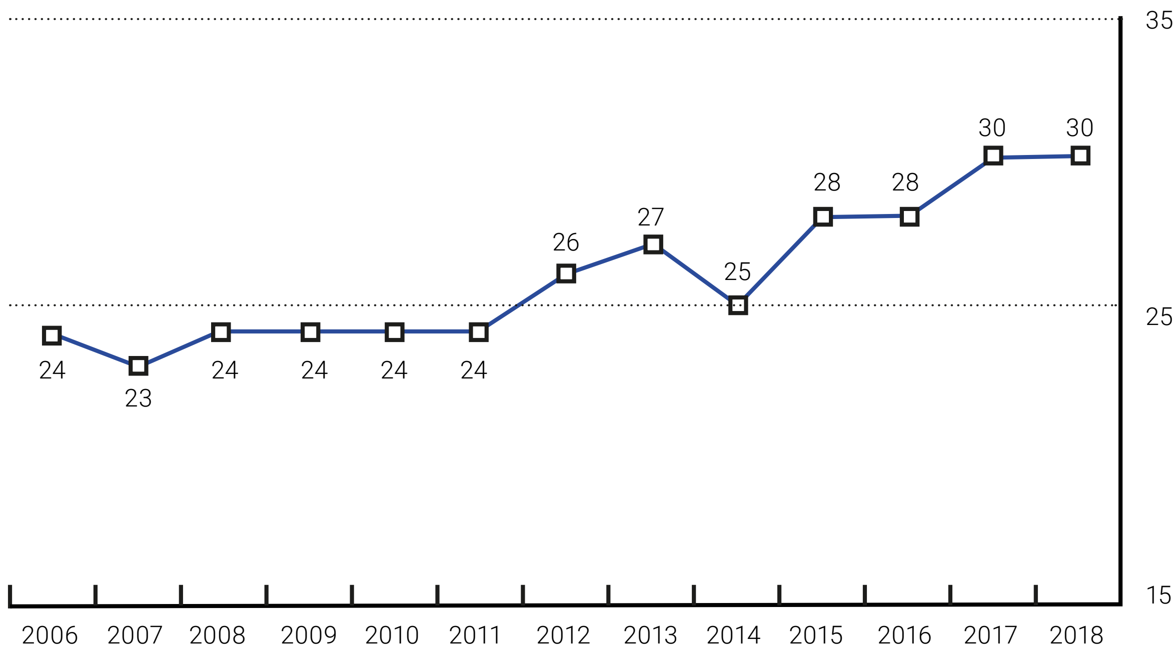
Connectivity lies at the center of all of that uncertainty. The average person, digitally connected at all times, is bombarded by an overwhelming amount of information, much of it conflicting and seemingly irreconcilable. Individuals want clarity, ease, and certainty in their filtering of that overload of choice. Trust, built through perceived shared values, becomes a prerequisite to the clarification of people's options. And, increasingly, algorithms are playing a crucial role in people's identification of those factors of trust and in their filtering out the factors that don't conform to historical patterns of behavior.

This has implications both for society and for business. At a time when everyone watched the evening news with Walter Cronkite or listened to the BBC, people might have disagreed on certain material issues but held a common acceptance of certain base facts. More and more today, though, no common forum exists to establish accepted facts. Information discovery frequently takes place within communities of like-minded individuals (or bots), which can become echo chambers for the same opinions.

To cut through the noise and reduce uncertainty, empowered consumers use shared values–in such areas as wellness, sustainability, lifestyle, and social and political affiliation–in making purchasing decisions, connecting with brands, and conducting their lives. Individuals' expectations around authenticity and purpose are core to those changing behaviors. And though consumers may have long held certain points of view, the combination of unlimited access to information, expanded direct connections to brands, and the multiplication of convenient channels to purchase have empowered those consumers.

As one example of how this plays out in business, individuals increasingly want to live a healthier lifestyle and purchase healthier products. But there is a great deal of information out there, much of which is unclear and often contradictory. Product labels compound this by being unclear. The uncertainty this creates is an impediment to consumers purchasing healthier-for-you products. Companies that want to sell these products need to build trust with consumers, simplify the choices, and connect with people on these values.

NEGATIVE EXPERIENCE INDEX



Gallup's Negative Experience Index is a compilation of responses related to worry, sadness, stress, anger, and physical pain. In 2019, it was based on interviews with 151,000 people in over 140 countries.

Source: Gallup Global Emotions 2019

Environmental awareness

Evidence of mounting environmental pressures raises concerns among the general population and impacts consumer behavior.

Environmental issues such as climate change, environmental quality, and sustainability comprise a core set of values that consumers increasingly demand companies address in their mission and evidence in their day-to-day operations. And consumers are holding companies that fail to live up to those standards accountable through both vocal activism and their purchase decisions.

The global business community is responding. For example, in articulating an expanded standard for a corporation's purpose, the US Business Roundtable stated in 2019, for the first time, that its members must commit to "protect the environment by embracing sustainable practices across our businesses."

In the auto industry, Corporate Average Fuel Economy (CAFE) and tailpipe emissions standards, alongside heightened environmental worries on the parts of consumers and the industry, are driving much of the investment into electric cars in the United States, with similar regulations and trends having even more impactful outcomes in Europe and China.

In what has been dubbed the "Blue Planet" effect, consumer product and retail companies in the United Kingdom have been scrambling to respond to vocal consumer concerns over product packaging since the 2017 broadcast of the BBC's nature documentary Blue Planet II, which detailed the consequences of plastic waste for sea life and the environment.[5]

Many different—and sometimes competing—considerations factor into consumers' buying behaviors. Cost and convenience frequently outweigh other aspects, and the same is true when it comes to environmental issues. However, our analysis shows that consumer expectations and patterns of consumption are changing; albeit faster in some industries than others, including automotive and premium consumer products sectors. Companies that do not proactively decide how to respond to these changing attitudes may find themselves at a competitive disadvantage.

Populism

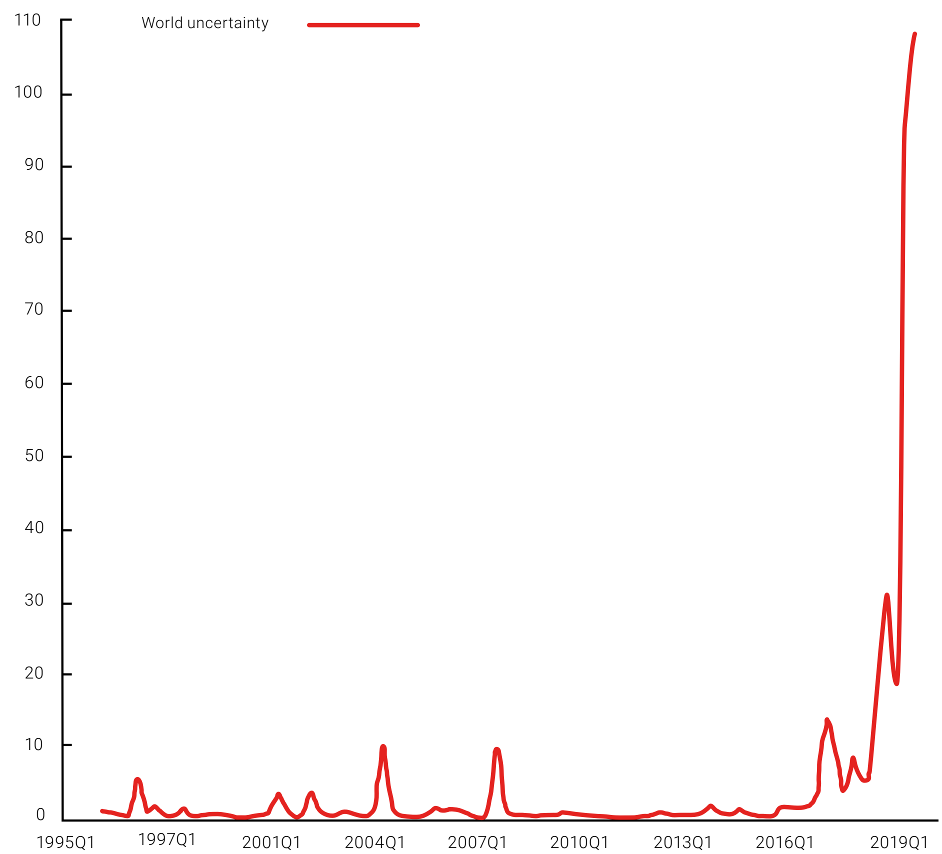
Rising populist politics and policies create an unstable geopolitical and business environment.

Rapidly evolving—and increasingly polarized—political views are causing instability and uncertainty worldwide. Income inequality and stagnating median wages are causing material harm and anxiety among the middle and working classes in the United States and Europe. When combined with rising levels of immigration into these countries, this has led to the rise of populist and nationalist politics. Related trends are occurring in some developing countries as well, including India, Mexico, and the Philippines.

These trends make the business environment more challenging for many companies. For decades, a stable, liberalizing world economic order laid a stable foundation for international commerce, and it facilitated an integrated global economy. Nowadays instability and political fluctuation proliferate.

TRADE UNCERTAINTY SURGES AFTER 20 YEARS OF STABILITY

In the past year, the World Trade Uncertainty Index jumped 10-fold from previously recorded highs as the US-China trade war escalated.
(WTU index, GDP weighted average)



Source: World Trade Uncertainty Index. Ahir, Bloom, Furceri (2018). The source for the data on key dates in the US-China trade negotiations comes from the World Trade Uncertainty Index. (2019).

Higher tariffs and growing uncertainties with regard to ongoing trade disputes have become facts of life for multinational companies, throwing their business planning into a state of upheaval and putting significant margin pressure on many corporations. Similarly, businesses in the United Kingdom have struggled to develop long-term plans in the face of Brexit indecision. Meanwhile, throughout the world, increasing levels of populist nationalism put in doubt the future of the liberal world economic order.

China has emerged, by some measures, as a force for stability in the global economic system. As the world's second-largest economy and largest exporter, China has become a more vocal advocate for international law and lower tariffs, when these align with their broader interests. But the 2019 protests in Hong Kong, driven in part by a lack of democratic accountability and rising economic inequality, are a source of political instability in the region.

Navigating a sea of disruption

Disruption has created a fast-changing and less-predictable environment for most industries, leaving many leaders feeling adrift in uncharted waters. The strategies and operating models that served to generate growth and profitable returns in the past are no longer reliable.

Across industries, new and complex realities require businesses to have different sets of priorities and skills. Historically, the key to success involved executing on a strategy to maximize a set of core competitive advantages that remained fairly static over time. Today, though, those competitive advantages are in flux more often than not. Therefore, agility and the ability to change direction in real time become more important for all organizations.

In particular, **leadership behavior** is a crucial component to responding to disruption. It requires skills like pattern recognition across silos and industries, the ability to deal with ambiguity, and rapid reaction. The pace and magnitude of disruption also require a different composition to management teams and boards of directors. Increased diversity of thought, perspective, age, and background become more critical.

Ultimately, to successfully manage disruption, business leaders must be prepared and willing to disrupt their own businesses and even their own thinking by learning these skills and surrounding themselves with individuals who can think, act, and execute in line with today's disrupted environment. As we continue our research, we will explore these leadership issues in more detail.

In this year's study, we examined in more detail the ways companies respond to the specific, disruptive factors that affect our five focus industries. Our aim is to provide insights into how companies plot their courses through this volatile environment. Some paths are by their very nature specific to industries or industry subsectors or even geographies. That can hardly be surprising. However, our research identified four broad strategies across industries that we believe businesses should bear in mind.

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A focused approach can meet the expectations of the self-centric consumer, but limited resources preclude being all things to all people.

Vertically-integrated operating models increasingly appear anachronistic. By focusing on their key value propositions, companies can retain the parts of the value chain most important to their customers and tailor their business models to meet consumers' self-centric demands.

True personalization, for example, can set some companies apart. Customers of subscription fashion service Rent the Runway have a constantly rotating closet of luxury items at a fraction of the cost of ownership, in effect converting capital costs to operating expenses. The company is growing at 21 times the rate of the retail industry as a whole.

For some companies, value may be an alternative core proposition. Discount retailers like Dollar General, the TJX Companies, and B&M European Value Retail were top-quartile performers in our analysis. By offering lower prices to cost-conscious buyers, discount retailers are bucking trends in the retail industry by expanding their brick-and-mortar locations to meet their core customers' needs, while maintaining only a basic online commerce presence.

Dollar General already has more stores (some 16,000) in the United States than Walmart does globally and is on track to open another 1,000 in 2020.[6] Revenues at the company have grown, on average, 8% per year for the past three years.

In automotive, physical powertrain systems are unlikely to continue as core differentiators for automakers once propulsion systems transition from internal combustion to electric. Meanwhile, performance software and battery management will be critical. Electric motors are likely to become components provided by suppliers. Given this landscape, what is the value proposition for original equipment manufacturers going forward?

Data can be helpful.

Critically, data and artificial-intelligence-enabled analytics now enable companies to capture, analyze, and respond to changing consumer demands faster than before. Designer-clothing retailer Revolve, for example, continuously tests products online, studies customer feedback, and incorporates its findings into products within weeks, using artificial intelligence to model demand. Media companies like Netflix are using data from streaming services to inform and personalize content development and delivery.

The investments needed, however, to respond to those demands and incorporate new technologies require that, in many industries, companies be selective in their approach. For instance, automakers will invest $85 billion in autonomous vehicles by 2025, but the rate of adoption and the best technological applications remain unclear.

In a streaming arms race, media companies are expected to spend $35 billion on content in 2020, but in a more fragmented market, no one company is likely to be a one-stop shop for all consumers' entertainment needs.

Mobile operators are expected to spend $1 trillion, globally, over the next five years to roll out 5G technologies. In an environment of largely flat revenues in Europe and the Americas, telcos are looking for new ways of partnering and sharing costs. In the United States, one of the rationales for the Sprint/T-Mobile merger is that the combined entity can more effectively deliver 5G coverage, particularly in underserved, rural areas.

There may be more innovative ways to share infrastructure, as well, particularly given antitrust concerns over further consolidation in many markets. In the United Kingdom, O2 and Vodafone announced a plan last year to share equipment to do just that.

Second-mover advantage

A considered and well-timed follower can create significant shareholder value.

New entrants are investing enormous sums in order to develop new technologies and operating models and purchase market share. Investors are more and more questioning this model and expecting clear paths to profitability.

Tesla is building a loyal customer base and is innovating by means of new technologies and manufacturing practices, but the firm has yet to demonstrate a business model that will lead to sustained profitability. Similarly, we see a challenging path to profitability—under their current pricing models and expense rates—for many of the ridesharing companies.

Netflix cannot continue to invest 75 cents out of every dollar of revenue into content. It will have to either raise prices or reduce the amount it's spending on content—or both.

One thing businesses can do is pursue a measured approach. This can have significant benefits such as learning from early movers' missteps or developing a market.

Just look at Apple Computer, which built its business not by being first with a product but by designing it better, with the end user in mind. That includes personal computers, music downloads, and mp3 players. Its current success derives from its early recognition of the imminent centrality of mobile connectivity, which led them to design not the first, but nevertheless superior, smartphone product.

Walmart is another example of a second mover. Finding itself impacted by the growth of Amazon, Walmart has taken a deliberate approach to building its online business, leaning into its strength in grocery where it has a significant advantage. Today, it is now the second-largest online retailer in the United States, growing its e-commerce by 41% in the third quarter of 2019.

In the entertainment industry, Disney entered into direct competition with Netflix in November 2019, leveraging the strength of its library of content and strong brands to sign up 10 million customers on the first day of its streaming service. Barclays Bank already estimates the market value of that new business at $100 billion.[7]

Brands matter more

In a crowded and confused marketplace, the value of brands increases.

Barriers to entry have fallen in many industries. Startups can more easily build a brand through social media. New manufacturing and supply chain innovations mean new products can be brought to market faster and more responsively to consumer demands than in the past.

However, there is still strength in brands that are aligned with consumers' values. In an uncertain world, brands that connect directly with consumers through authenticity, purpose, and shared values can build trust and retain customer loyalty.

Wellness, for example, is an area in which many beauty, food, and beverage companies are differentiating themselves, providing clarity for consumers who remain unsure which products really are better for them. Environmental considerations are increasingly informing consumers' purchasing decisions, impacting sourcing, packaging, and transparency for many companies.

Many established consumer products companies have leveraged their size and cash flows from existing businesses to acquire smaller, faster-growing brands to ignite growth and spark innovation. Unilever, for example, has made 29 acquisitions since 2015. Sustainability has been a central focus, with the acquisitions of companies like Seventh Generation and the Laundress, two eco-friendly laundry groups. The company said in 2018 that its sustainable brands grew 46% faster and delivered 70% of sales growth.

News publishing has been massively disrupted first by the rise of the Internet and then by Facebook and Google. There is an ocean of content available, and consumers don't want to pay for it. Premium news organizations like the Economist, the New York Times, and Dow Jones are all growing online subscriptions, partially replacing lost advertising revenue, on the strength of their product quality and value alignment with their customers.

In what has been termed the "Trump Bump," the New York Times has added approximately 200,000 paid subscribers per quarter since Donald Trump's election in 2016. The New York Times now has approximately 4.7 million paid digital subscribers and hopes to have 10 million by 2025. It has grown subscriptions through its news reporting but also through incremental access to its unique cooking and crossword content.

Rebel with a cause

A contrarian position can still be profitable. Cash flow from declining businesses can be reinvested into areas of growth.

While their revenue streams may decline over time, frequently that time horizon may be longer than predicted due to consumers' resistance to change or the cost of newer technologies. Instead of being mere impediments, these legacy businesses can finance investment into new technologies and faster-growing products or services.

For example, even though cord cutting has accelerated, millions of consumers have cable and will continue to have cable. In North America, pay TV subscribers were expected to fall by some 3 million in 2019 to 88 million, but the rate of decline is diminishing.[8] Distribution to this channel will remain an important source of revenue for many traditional media and entertainment companies and will help finance their moves into streaming.

General Motors is expanding its offerings of large trucks and sport utility vehicles (SUVs), in part to help finance investment into electric and autonomous vehicles. Margins on SUVs can be as high as 30%, and continued, strong demand has led GM to invest $1.4 billion in expanding its manufacturing capabilities for these vehicles.

A run-off business plan can also be a successful strategy for some. Because of the long tail on many declining businesses and the lack of a need to invest in the latest technologies, declining businesses may provide profits to investors for many years to come. The internal combustion engine will not disappear in most of our lifetimes, and suppliers of its components can continue to generate significant profits for some time.

Finally, disruptive trends matter only if they matter. Health and wellness may be an area of growth, but alcohol, tobacco, and junk food still do well. Some of the top-performing companies in this year's analysis were companies such as Anheuser-Busch InBev, Hershey, Japan Tobacco, and Monster Beverage. They produce products that many consumers still demand.

Examining disruption across industries uncovers learnings from which all businesses can benefit. In a world where the pace of disruption continues to accelerate, leaders must take note.

Methodology

5

Industries

– Automotive
– Consumer products
– Media and entertainment
– Retail
– Telecommunications

65

Global exchanges

635

Public companies

Weighted business performance metrics including:

– Profit margins
– Net income to revenue
– Return on capital employed
– Multi-year revenue and profit growth
– Valuation metrics

QUALITATIVE QUESTIONS ANALYZED

– What are top-performing companies doing to cause disruption or mitigate its impact?

– What factors affect companies in the lowest segment?

– Do these forces disrupt all companies equally?

– What do anomalies tell us about the industry?

Insights from the data

AUTOMOTIVE

– 25 of the top 32 companies in our analysis were automotive suppliers, which historically have higher profitability than automakers.

– Those automakers in the top quartile were driven by strong revenue growth.

CONSUMER PRODUCTS

– Luxury fashion and beauty brands were 36% of top quartile performers.

– Alcohol and tobacco companies constituted another 26% of the top quartile.

– Bottom-performing companies tended to offer products that have fallen out of favor with consumers, particularly in food.

MEDIA AND ENTERTAINMENT

– Social media, gaming, and top-branded entertainment companies constituted 65% of top-performing companies in this industry.

– Advertising, print publishers, and television and radio broadcasters were in the bottom quartile.

RETAIL

– 18% of top-performing companies in our study were primarily, or exclusively, online retailers.

– 16% of the top group were discount retailers, with little or no online presence.

– Bottom performers tended to be multiline, brick-and-mortar retailers and grocery chains.

TELECOMMUNICATIONS

– US and Canadian telcos constituted the majority of top-quartile performers, as did certain Chinese operators.

– European telco operators struggle, in particular, with limited growth potential or pricing flexibility.

View each industry-specific report at alixpartners.com/disruption.

Notes

1. US Energy Information Administration.

2. Pew Research Center, “Global Attitudes Survey,” Spring 2018.

3. https://www.gallup.com/analytics/248906/gallup-global-emotions-report-2019.aspx.

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RETAILERS VYING FOR RELEVANCY

Disruption in the retail industry

In brief

DISRUPTION THEMES

– Self-centric consumers continue to move purchases online and expect a seamless experience across shopping channels. As a result, retailers are increasing investments in technology, and margins across the industry are being compressed.

– Amazon more and more defines customer expectations about pricing, convenience, and accessibility at levels that few retailers have the resources to match.

– Consumers want an increasingly customized yet consistent and convenient experience.

– Brands are cultivating an enhanced direct-to-consumer value proposition that competes directly with retailers for consumers' hearts and pocketbooks.

IMPLICATIONS

Successful retailers are embracing self-centric consumers but understand that self-centric doesn't mean being all things to all consumers.

– Retailers must think outside of old operating models and in new and integrated ways, with speed and agility being critical.

– Faster and more flexible systems can integrate customer data and embed test-and-learn capabilities throughout an organization to take advantage of new insights and respond in real time to changing consumer preferences.

Retailers vying for control

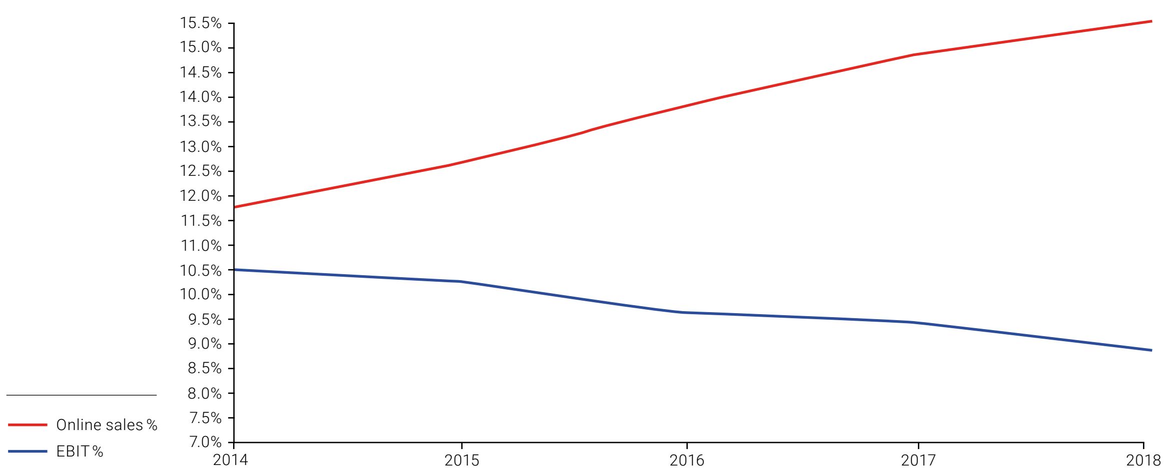
Rumors of retail's death have been greatly exaggerated. Retail sales continue to rise—at a compound annual growth rate of 4% globally for the past five years.[1] However, channel share is shifting away dramatically from physical stores to online, driven by changing consumer behaviors, new entrants, and new technologies.

In 2019, despite record revenues, more than 8,500 store closures occurred in the United States alone, as did 23 retail bankruptcies; and about $40 billion in equity value was destroyed for listed retail companies. Since January 2017, the US retail sector has lost almost 200,000 jobs.[2]

In February 2019, one of the original retail disruptors, Sears, Roebuck and Co., which developed the mail-order-catalog business model in the late-nineteenth century, emerged from Chapter 11 bankruptcy. However, the company continues to struggle with anemic sales and has announced hundreds of additional store closures. Its last profitable year was 2010, when it reported $133 million of income on $43 billion of sales. Revenues had fallen 68% from their peak to just $17 billion in 2017, its last full year of reported earnings before filing for bankruptcy.

In 2019, Debenhams, one of the largest and best-known brands on the UK high street, went into administration, affecting its 165 departments stores, more than 25,000 employees, and thousands of concession staff. German retailer Galeria Kaufhof announced it was cutting 2,600 jobs. And fashion house Gerry Weber, which operates 1,200 stores in 60 countries, entered into administration under German insolvency laws.

AS ONLINE SALES START TO CLIMB, EBIT% DROPS YEAR ON YEAR

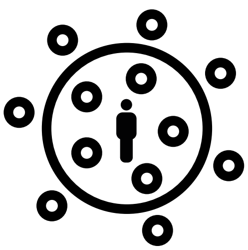


Findings from our analysis of financial performance indicate that retailers with strategically developed online approaches are more successful than those playing catch-up. The dichotomy is most pronounced in a comparison of such companies as Amazon and Alibaba with almost any of the struggling brick-and-mortar department stores, like Sears or Debenhams.

As retailers shift more and more of their sales online, profitability is eroding—partly because of the investments in technology and infrastructure necessary to make the shift but also because of a lag in retailers' ability to manage the costs of running both online and brick-and-mortar channels.

Costs are going up. Wages are rising. Advertising investments are on the increase in order to win customer acquisition in an increasingly noisy space. And global trade wars are adding to margin pressures and uncertainty with regard to global supply chains.

In addition, an influx of private capital is funding new, digitally native competitors in retail, which are being rewarded by their investors for growth over profit. Private investments in retail have accelerated, with $73 billion invested globally over the past five years.[3] The new companies offer customers unprofitable incentives in order to gain market share, which in turn changes customer expectations across the industry and which affects profitability.



Self-centric consumer

A confluence of fast and ubiquitous connectivity, demographic shifts, and attitudes toward the environment and sustainability is causing dramatic changes in today's consumers' expectations. Those consumers we term self-centric.[4] Consumers have placed themselves squarely in the center of their own ecosystem, and they expect retailers to meet them there—on their terms. Plus, self-centric consumers are not shy about shunning retailers that fail to meet their expectations, which are higher than ever.

SELF-CENTRIC CONSUMER

Our studies from 2007 to 2018 show today's self-centric consumer has higher demands of retailers than ever before.

SERVICE	PRODUCT	EXPERIENCE	PRICE	ACCESS
85%	81%	89%	92%	84%
72%	69%	81%	86%	70%
of customers expect one-to-one, personalized exchanges	of customers want product that represents values	of customers want a seamless experience across channels	of customers want price that provides value	of customers want to shop any platform any time and place

Consumers have come to expect a seamless experience across all purchase channels as well as the ability to shop a full and fresh product assortment by using any device of their choosing, at any time of their choosing. In some channels, such as apparel and footwear, consumers also increasingly want to be involved in personalizing products, including by making contributions to the design process and determining colors and styles. Greater transparency, sustainability, and environmental consciousness are also being demanded from retailers, and consumers are punishing those that don't meet their standards via social media, boycotts, and other means.

"The self-centric consumer wants personalized and convenient service at every step of the way."

When seamless access to products becomes commonplace, consumers also expect to be able to easily check and compare prices and know why they're paying what they're paying. The self-centric consumer wants personalized and convenient service at every step of the way—from receiving marketing messages to undergoing the customer service experience.

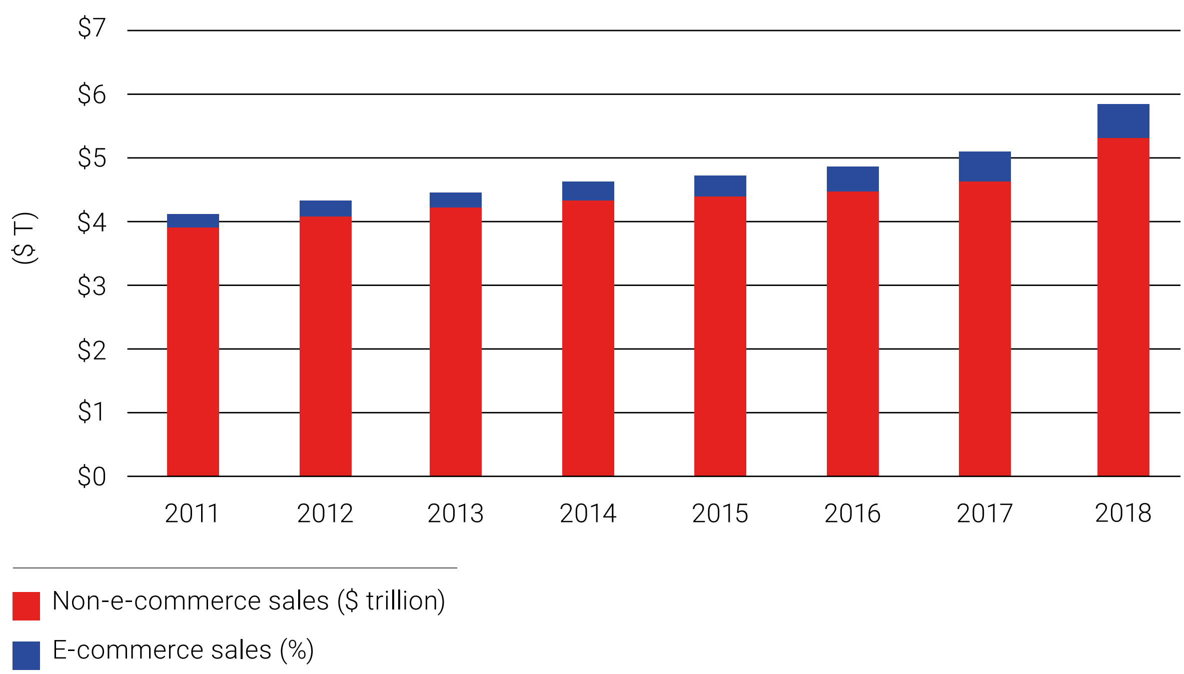
The boundaries between experiential and transactional are more nebulous than ever before. Consumers demand an experience that transitions effortlessly from off-line to online channels and serves all their needs.

Channel shifting

As consumer behaviors change and digital commerce grows, brands must now focus on how to apply a mix of delivery channels in order to connect with customers and communicate the right messages at the right times.

E-COMMERCE IS TAKING SHARE WITHIN RETAIL

2011 to 2018 US retail sales: total industry sales and e-commerce share (%)



Source: US Census Bureau Annual Retail Trade Report

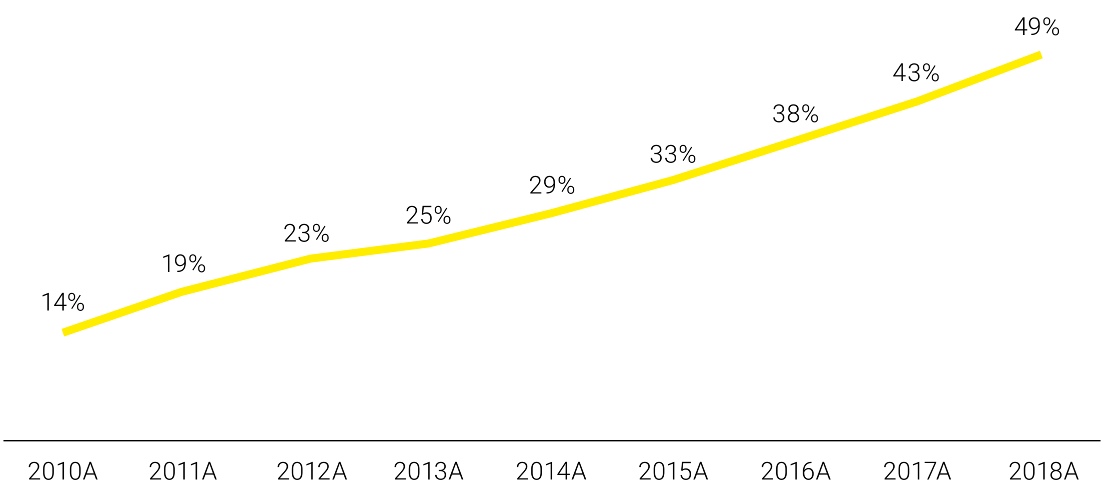
Increasingly, the powers that are driving digital sales and customer expectations are pure-play behemoths like Amazon and Alibaba. In China, online retailers Alibaba and JD.com dominate the market, with 56% and 17% market shares, respectively.[5]

In the United States, consumers more and more consider Amazon their one-stop shop, and the company is predicted to become the largest online retailer in Europe in 2021.[6] Amazon's US e-commerce share reached 50% in 2018, and one by one, brick-and-mortar competitors in the areas of books, toys, clothing, and sporting goods have disappeared because Amazon has offered cheaper online alternatives. And Amazon is still expanding into other retail segments. In the past three years, Amazon acquired online pharmacy PillPack, supermarket Whole Foods Market, and home security firm Blink.

Competitors are scrambling because Amazon grew to $233 billion in revenues in 2018, with record profits, and is affecting the way retailers do business across the value chain—from product development to manufacturing, to marketing, to logistics.

AMAZON IS WINNING MARKET SHARE, WITH NEARLY 50% OF ALL US E-COMMERCE SALES

2010 to 2018 Amazon US GMV[1] as percentage of US e-commerce sales



[1]GMV = gross merchandise value
Sources: US Department of Commerce, company filings, Bloomreach survey

The shift to a multichannel world is leading to a downward spiral for many brick-and-mortar retailers. As customers shift more and more to spending online and out of physical stores, retailers are investing less and less in brick-and-mortar, which is resulting in fewer sales as the experience deteriorates for consumers. Retailers must evaluate where to put their investment dollars: in "new retail" customer demands like free and fast shipping or in physical stores. In addition, dead malls are becoming a bigger factor, and bankruptcies are accelerating.

Companies are struggling to find the right balance, rapidly scaling their e-commerce businesses but keeping enough brick-and-mortar stores for products and consumers that still require the in-person experience.

How companies are responding

EMBRACING THE SELF-CENTRIC CONSUMER

It is impossible to excel in every category of expectations being set by consumers. By carefully considering their key value propositions, though, successful retailers are distinguishing themselves with their customers and driving growth and value for their organizations.

On product, true personalization can set a retailer apart. Rental brands like Rent the Runway, which offers customers a constantly rotating closet for self-expression at a fraction of the cost of actual purchase, are growing at 21 times the rate of the retail industry as a whole.

Value may be an alternative core proposition for some companies. Discount retailers like Dollar General were top-quartile performers in our analysis. By offering lower prices to cost-conscious buyers, discount retailers are bucking trends by expanding brick-and-mortar locations in order to cater to their core customers' needs at the same time as they maintain a basic online-commerce presence.

Retailers are also responding to demands that products reflect customers' values. CVS discontinued selling tobacco products in store, and Walmart announced it plans to reduce its gun and ammunition inventories in the wake of 2019's mass shootings. Similarly, UK supermarket-chain Iceland discontinued making private-label products with palm oil due to concerns over the impact palm oil production is having on rain forests in Asia.

KNOW YOUR CUSTOMER

Digital commerce is the fastest-growing channel for most retailers, but for companies courting value-conscious consumers, brick-and-mortar is where it's at. These companies do not invest in any material way in an online experience but, rather, focus on opening stores and maintaining low prices for their customers.

In the United States, Dollar General opened almost 1,000 stores in 2019 and expects to open another 1,000 in 2020.[7] Its competitor Dollar Tree closed some underperforming locations, renovated others, and expected to open 550 stores in 2019.[8] Each of those companies, which operate in the United States and Canada, has more physical stores than Walmart does with its global footprint. B&M European Value Retail, which operates under a similar business model in the United Kingdom, grew from 20 to more than 600 stores in the past 10 years, serving 4 million customers per year.[9]

TJX Companies, which operates under the T.J. Maxx, Marshalls, HomeGoods, Homesense, and Sierra brands, plans to open 230 stores in 2020, including new stores in Canada, Europe, and Australia. Discount apparel retailers Burlington and Ross Stores similarly expect to continue their expansions.[10]

Discount retailers stood out in our analysis this year for their clarity of focus on providing value products and access in order to meet the self-centric needs of their customers, and, by largely sidestepping online sales, they're both avoiding channel conflicts and keeping costs down.

"...responding to demands that products reflect customers' values."

"...seamless access on any platform at any time..."

On price, customers want to validate and compare prices. Amazon has introduced dynamic pricing based on customers' price appetites. And other retailers are offering more perceived value to customers through, for instance, free and fast delivery.

To provide seamless access on any platform at any time, retailers are making a number of adjustments. Retailers such as Target and Argos have turned their brick-and-mortar infrastructure into an asset, using stores as fulfillment centers to get products to customers more quickly by way of services like "buy online, pick up in parking lot." Sephora customers can use their smartphone cameras to "try on" makeup, thereby eliminating a barrier to purchase. Such customized marketing and product assortment are becoming increasingly possible at every step by retailers' leveraging of customer data insights and building trust. And retailers are relying on advanced analytics to drive personalized marketing and product experience.

Many retailers are also improving their experience across channels. H&M is appealing to customers' preferences toward sustainability and transparency by launching off-line-to-online product transparency for all garments on its website. In-store shoppers can scan all items on the H&M app and access product-sustainability details.

INTEGRATING THE LEFT AND RIGHT BRAINS OF LEGACY OPERATING MODELS

Legacy operating models with linear value chains, historical functionality, and separations between digital and physical businesses can no longer compete in responding to the needs of today's self-centric consumers. To succeed, retailers must think in new and integrated ways, with speed and agility becoming increasingly critical in this environment and with consumers at the center of a concentric circle of touch points. Companies must infuse those qualities throughout their organizations.

TURNING A LIABILITY INTO AN ASSET

Managing the omnichannel experience and rationalizing physical footprints in an online age are stubborn challenges for retailers.

Target Corporation, the world's ninth-largest retailer by revenue, is taking advantage of its brick-and-mortar assets in order to accelerate its digital transformation journey. Target uses its stores as fulfillment centers for online orders, and it bolstered its next-day-delivery service by acquiring Shipt, a mobile delivery service application, in 2017. Target's network of stores and Shipt's technology platform and community of shoppers enabled the company to add same-day delivery to its capabilities.[11]

According to the company, those innovations have dramatically driven down the expenses associated with digital commerce. When Target fulfills an online order from the back of one of its stores versus shipping from a distribution center, costs fall by about 40%, and when customers order online and pick up at a store, or use curbside pickup, or select shipping via Shipt, "about 90% of the cost goes away."[12]

And these investments are paying off. Research firm eMarketer predicts that Target will break into the top 10 e-commerce retailers in the United States in 2020.

"Companies must also break down silos across functions and geographies."

Companies must also break down silos across functions and geographies. Collaborative decision making can begin to bring an organization together to move at speed. Cross-functional teams with aligned incentives and integrated plans can drive successful results, which in turn creates an atmosphere of trust and shared vision. Keeping consumers and their demands at the center of those work streams is critical. The success of cross-functional teams can serve as case studies within an organization to achieve good teamwork and closer alignment of operating models.

Stitch Fix has its data scientists sit next to merchants and designers, and it discusses customer data trends with design teams to incorporate new style development.

New benchmarks for speed are reducing the time from concept to store and are upending traditional processes. Retailers are shortening time to market by implementing new processes and by reshaping decision making. Partnerships and digital tools, too, can deliver greater speed.

Adidas is using digital tools for 3D templates and graphics in order to make fast design decisions. The company has also established a partnership with Foot Locker to sell products made in its SpeedFactory, which has an accelerated digital production process that can create limited runs with designs sourced from creators in local communities up to 36 times faster than industry standard production times.

Accelerating data-driven insights

One of the benefits of meeting self-centric consumers in their ecosystems and on their terms is the creation of a wealth of customer data from which retailers can gain valuable insights. Newer, faster, and more-flexible operating models that embed test-and-learn capabilities throughout an organization can take advantage of the gained insights so as to continuously iterate and improve product offerings.

Clothing retailer Revolve continuously tests products online, gathers customer feedback, and incorporates the results into products within weeks. Attribution and predictive analytics model the demand, which the company includes into items that will become hot sellers.

Digital tools and dashboards, which have become common in the retail world, help rationalize and visualize all customer data. But it's even more critical to look at the right metrics and ask the right questions. The quality and scope of available metrics are advancing, but many retailers have not yet changed the way they evaluate performance. Retailers have to invest in advanced analytics applications across all of their operating areas, with the goal that employees make decisions based on predictive modeling and automated learnings rather than spend time extracting learnings. And those investments must be understood and championed by the leadership of the organization.

GETTING YOUR FINGER ON THE PULSE

Evaluating and connecting the right metrics is essential.

YEASTERDAY → TODAY

METRICS TO MONITOR PERFORMANCE

- Sales and margin
- Assortment and inventory productivity
- Traffic, transactions, and conversion

CONNECTED INSIGHTS TO DRIVE DECISIONS

- Average unit retail impact on sales and margin
- Account and channel profitability
- Assortment and attribute performance by segment
- Connected, cross-channel customer buying habits

PREDICTIVE MODELING AND AUTOMATION

- Personalized and dynamic pricing
- Predictive margin lift models
- Artificial intelligence inventory and reorder optimization
- Consumer-insight-driven design and buying

Nike acquired Celect and its world-class data scientists to better understand and model customer preferences. Celect's cloud-based analytics platform provides proprietary insights that enable retailers to optimize inventory across an omnichannel environment through hyperlocal demand predictions. As Nike Chief Operating Officer Eric Sprunk said: "As demand for our product grows, we must be insight driven, data optimized, and hyperfocused on consumer behavior. This is how we serve consumers more personally at scale."

What's next for retail?

Contrary to popular mythology, the retail industry is broadly healthy, yet many retailers stand at a precipice, with the winners and losers getting separated from one another faster than ever before. Many organizations are facing stacked disruptions that threaten their very existence. Retailers must invert a decades-old dynamic and address today's top challenges: putting customers at the center of everything, discarding old operating models, and accelerating data-driven insights that reflect the right metrics for today. Taking those steps will help retailers regain control of the retail experience.

Some retailers have successfully enhanced how consumer-centric they are, have sped up their decision making and execution, and have changed their approach to data. Individually, each of those ideas helps make incremental improvements. But embraced together, the three principles become game changers.

Growth and success are ahead for those that break today's retail rules and are willing to make consumers the centers of their universes, to develop an agile operating model, and to apply data-driven insights to drive decisions.

Notes

1. statista.com/statistics/311325/cagr-of-retail-sales-channels-worldwide/.
2. AlixPartners research, as of October 29, 2019.
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GROWTH IS PERSONAL IN A DIGITAL WORLD

Disruption in the consumer products industry

In brief

DISRUPTION THEMES

– Long reliant on strong brands and relationships with retailers, consumer products (CP) companies are looking for ways to reignite growth.

– Trust in specific brands that demonstrate authenticity, purpose, and shared values is replacing blind faith in the general goodness of brands.

– Health and wellness considerations represent an increasingly important shift in consumer preferences.

– Many of the trends are more strongly expressed by younger generations—especially in Europe and the United States. Wage stagnation among the middle class and rising inequality also increase demand for more value-conscious products.

– Digital connectivity and commerce are redefining how consumers buy and from whom they buy, with profound implications for operating models and marketing strategies.

IMPLICATIONS

Successful consumer products companies are taking a multifaceted approach to the management of disruption:

– Proactively and clearly identify the values their companies and their products will represent to the end consumer.

– Evaluate and optimize their product portfolios to support the identified values.

– Acquire smaller, consumer-engaged brands—which remains a smart strategy for larger companies—but over-integration of such brands may cause companies to lose their authenticity and their edge.

– Reduce operational complexity and realign structures to allow faster market responses and support strategies.

– Turbocharge innovation processes to adapt to new market requirements.

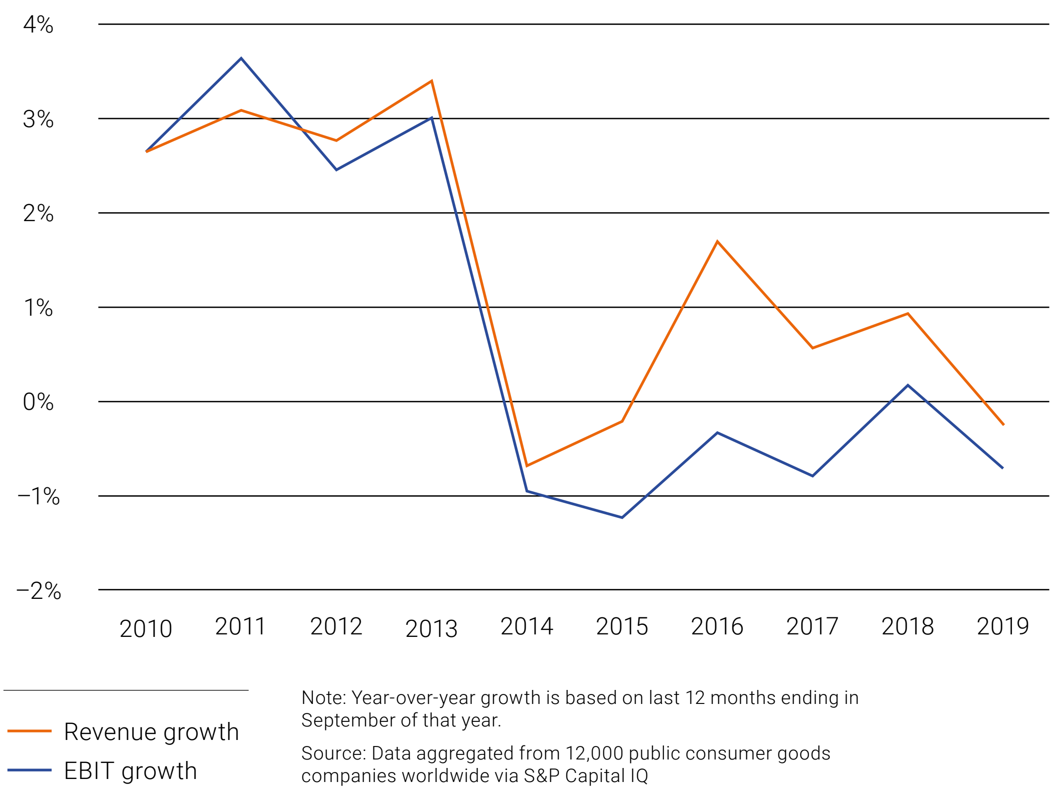
– Accelerate digital transformation in order to position themselves for growth in e-commerce and digital marketing.

Disruption in the consumer products industry

In recent years, consumer products companies have struggled to continue delivering the growth in both revenues and earnings they have historically enjoyed. Those companies have traditionally relied on a combination of strong brands, retail relationships, and investment in developing economies to power their financial performance. But that formula no longer results in the reliable growth it once did.

During the past 10 years, despite record economic expansion around the world, earnings growth at CP companies slowed to 1.7% per year compared with 3.4% for the global economy. Efforts to improve returns through cost management are not only useful but necessary and can be significant sources of funding for investments in growth. However, on their own, cost reductions are not sufficient to drive growth and value over the long term.

PUBLIC CONSUMER PRODUCTS COMPANY GROWTH OVER TIME: REVENUE AND EBIT



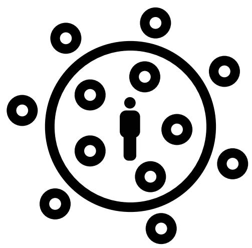
Note: Year-over-year growth is based on last 12 months ending in September of that year.

Source: Data aggregated from 12,000 public consumer goods companies worldwide via S&P Capital IQ

What is it that is affecting growth in this industry—particularly at the largest, most-established companies? And how can those companies best respond?

Four disruptive factors

To guide companies during this time of tremendous industry change, we identified four macro themes that are driving disruption in the consumer products industry.



1. RISE OF THE SELF-CENTRIC CONSUMER

Now more than ever, consumers are demanding what they want, when they want it, and how they want it. Near-constant connectivity is driving awareness and the availability of an infinite shelf of options, while accelerating logistics models satisfy needs with ever-increasing convenience and speed. All of that has served to promote the rise of the self-centric consumer, who is able to buy products that more perfectly meet needs in each moment.

For CP companies, these developments make for both an opportunity and a challenge. New technologies and new behaviors enable the companies to develop direct and dynamic relationships with their customers in unprecedented ways.

But consumer expectations, too, are unprecedented. Untethered from geography, today's empowered and networked consumers are increasingly demanding customized yet seamless and convenient experiences that cater to their evolving expectations. They want pricing transparency across all potential channels, and they're increasingly expecting more and more personalized and intimate engagement with the brands they purchase.

This digital connectivity between consumers and between consumers and companies has (1) facilitated the conversion of traditional patterns of interaction into digital form, whose patterns are reconstructing at accelerating rates, and (2) redefined how parties interact and transact. Social marketing, for example, has changed how consumers discover and learn about products and services and is forcing companies to radically rethink how they interact with consumers and the role of the brand.

E-commerce has changed how consumers buy. The first e-commerce waves appeared years ago, when retailers took their offerings online; and new digital retail business models such as Amazon, Boxed, and Alibaba emerged that are central parts of today's CP landscape.

Nowadays, digital commerce is actually transforming whom consumers are buying from. That transformation is occurring across multiple channels—including direct-to-consumer business models—and is both affecting established CP companies and enabling new entrants.

The new patterns of engagement are also giving rise to new digital routes to market. Companies are being forced to rethink the assets they own, the infrastructure required, and who owns the consumer relationship.

Take, for example, Schick razors and its new-entrant competitor Harry's. Harry's launched as a low-cost, direct-to-consumer shaving brand in 2013, taking advantage of its rapid online growth to expand into traditional retail by offering its products at Target and Walmart. The company was expected to earn $200 million in revenue in 2019.[1] Edgewell Personal Care, the maker of Schick razors, had agreed to an acquisition of Harry's in 2019 but was blocked in these efforts by the Federal Trade Commission (FTC) on anti-competition grounds. In its lawsuit, the FTC stated, "The loss of Harry's as an independent competitor would remove a critical disruptive rival that has driven down prices and spurred innovation in an industry that was previously dominated by two main suppliers, one of whom is the acquirer."

Digital and physical commerce are converging, and based on our analysis, companies that are furthest advanced on the digital journey see the convergence largely as already having happened.[2]

However, despite that fact, many companies still lack focus on digital as a key component of their strategy. We analyzed the earnings calls of the 125 largest public CP companies globally for the four months leading up to May 17, 2019, and found that 33% had made no reference to digital commerce or strategy in their calls with investors.[3]

2. GROWING IMPORTANCE OF AUTHENTICITY, PURPOSE, AND SHARED VALUES

In an era offering seemingly infinite choices, powered by near-constant connectivity and information availability, choice can become overwhelming. The question, Which products and brands can I trust? is a powerful lens through which consumers bring clarity to a universe of options. Consumers are more and more placing their trust in brands that demonstrate authenticity, purpose, and shared values that align with their own.

Saying the right things is not enough. To today's discerning consumers, authenticity is demonstrated not just through what is said but also through the actions behind the words. Consumers are increasingly evaluating not just a product but also how the product is being marketed, produced, and sourced and whether those activities align with the company's stated values and their own.

Several new entrants have been successfully engaging with consumers when it comes to values. For example, Goop, Lush, and Tata Harper in the beauty and personal care space and Honest Company in the baby products space have grown quickly through a singular focus on natural and organic products that resonate with their target consumers.

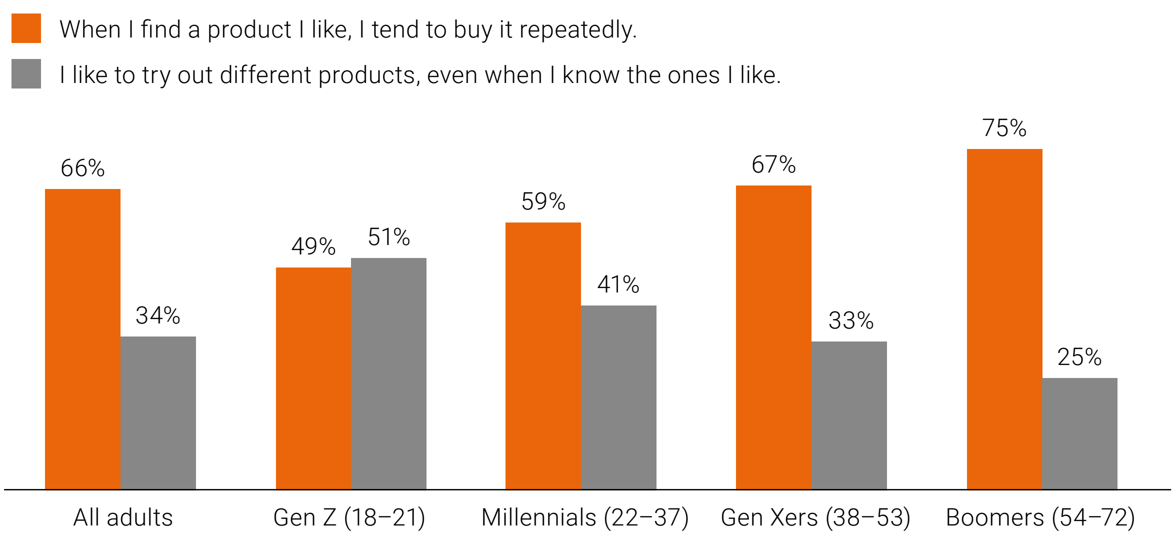
Across the market at large, there has been tremendous growth in products making values-based claims such as sustainability and traceability. According to NYU Stern's Center for Sustainable Business, 50% of growth in consumer-packaged goods in the United States from 2013 to 2018 came from sustainability-marketed products.[4] Anglo-Dutch conglomerate Unilever announced in 2018 that its most-sustainable brands grew 46% faster than the rest of the business and delivered 70% of the company's sales growth.[5]

Correspondingly, companies that find themselves wrong-footed in those matters can find themselves facing serious public relations crises that directly affect revenues—negatively. In what's been dubbed the "Blue Planet" effect, many consumer products companies and retail companies in the United Kingdom began struggling to respond to vocal consumer concerns over product packaging after BBC's 2017 broadcast of nature documentary Blue Planet II, which detailed the consequences of plastic waste for sea life and the environment.

As early adopters of new technology, these points of view are expressed most strongly by younger generations of consumers, who are causing demographic differences in consumption patterns. Millennials, for example, are radically reshaping the beauty and personal care industry and demanding authenticity by shunning traditional labels in favor of independent brands, thereby driving the brands' rapid growth.

PRODUCT LOYALTY, BY GENERATION

"Which of the following statements comes closest to your view, even if neither is exactly right?"



Based on a survey of 2,202 US adults. Published on MarketingCharts.com in October 2018.
Data source: Morning Consult

Those premium products, of which consumers have expectations when it comes to authenticity, purpose, and shared values, are also becoming increasingly bifurcated from more-commoditized products and services, where there is a push toward value. For cost-conscious consumers, brands become less important, and nonbranded or private-label goods are gaining in prominence.

3. EXPANDING BOUNDARIES OF THE WELLNESS LIFESTYLE

Among all of those values, healthier lifestyles have become increasingly important parts of consumer preferences. Dietary habits are changing. Eating well is becoming seen as living well. And the boundaries of wellness are expanding. Consumers are placing more importance on exercise, mindfulness, sleep quality, stress management, and other dimensions of wellness—and a multitude of apps, wearables, and other enablers are helping consumers make those choices parts of their daily life.

There is still a gap between aspirations for wellness and actual purchasing behavior, but the gap appears to be narrowing. In our 2018 Global Health and Wellness Survey, more than half of respondents said that living a healthy lifestyle had become more important to them during the previous year, with healthy eating reported as the most important aspect of that lifestyle. Fully 76% of respondents reported consistently purchasing healthy food and beverages for themselves or their household in the past year.

And in certain sectors, companies are finding themselves displaced by competitors offering so-called better-for-you products. In our analysis of companies this year, manufacturers of processed meats, dairy products, and frozen foods were among the worst performers.

EVOLVING CONSUMER PREFERENCES

A fourth-quartile performer in our analysis this year, Dean Foods, America's largest milk producer, filed on November 12, 2019, for bankruptcy protection. Financial performance at the company had struggled in recent years because milk consumption in the United States is falling, whereas demand for organic-milk and alternative-milk options is on the rise. Sales of nondairy milks grew 23% in the past four years.[6] Dean was unable to take advantage of the trend after the 2012 divestiture of its Silk and Horizon Organic brands.

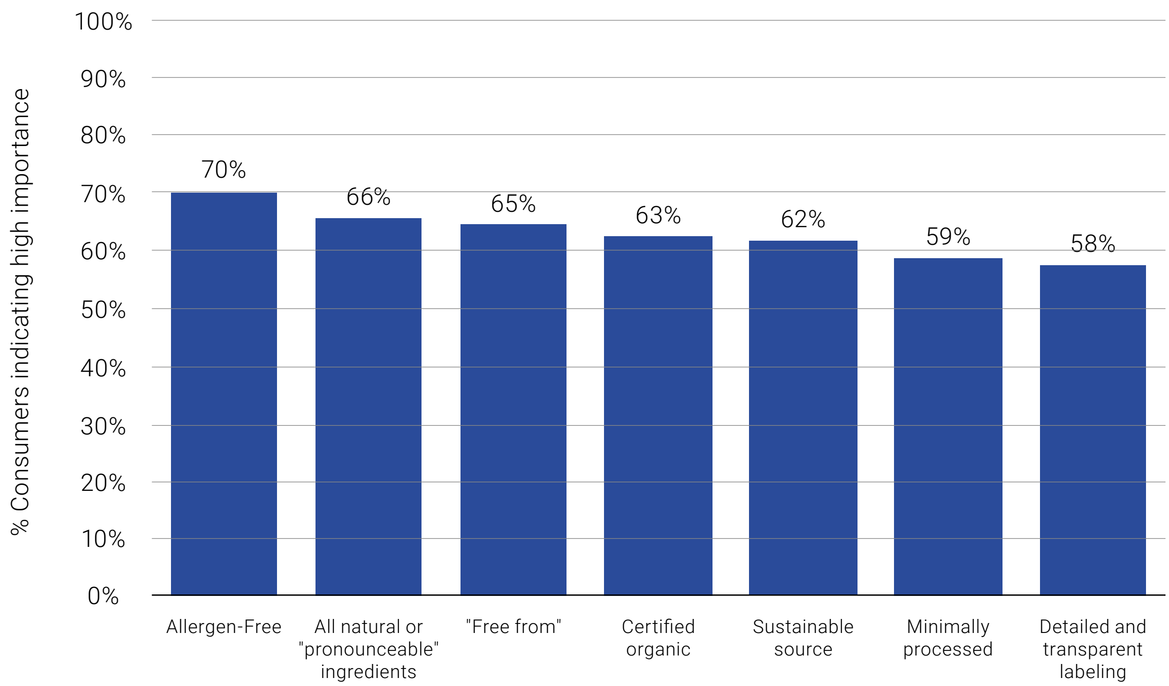
The emergence of private-label offerings that cater to price-conscious consumers was another factor affecting the company's performance. Walmart accounted for 17.5% of Dean's revenue in 2016, according to the company's annual report. The figure fell to 15.3% in 2018 after Walmart's opening of its own milk-processing plant.

In a struggling industry, some innovations are defying the odds. Fairlife, a brand of ultrafiltered, higher-protein, and lower-lactose milk, is distributed in the United States and Canada by the Coca-Cola Company. The brand grew its sales 42% in the first quarter of 2019 compared with the previous year, according to Food Navigator.

Even in this mature market, responding effectively to changing consumer demands can help establish a strong growth trajectory.

TOP AREAS OF IMPORTANCE TO 19- TO 34-YEAR-OLDS WHEN PURCHASING HEALTHY

% Consumers indicating product attribute is highly important when purchasing healthy



Source: AlixPartners Health and Wellness Study, 2018

Implications for companies

Disruption has affected all aspects of the consumer products sector. CP companies' brands and their relationships with retail stores have been fundamentally altered by the advent of new technologies, new brands, and new consumer preferences and behaviors. Consumers—especially younger generations of consumers—are searching for authenticity and values they share with companies in order to filter the overload of choice and as a means of self-expression.

In response, consumer products companies should focus on four areas of development during this period of unprecedented change.

1. CLEARLY DEFINE THE VALUES YOUR BRAND AND COMPANY REPRESENT

The rise of the self-centric consumer makes it increasingly difficult for brands to be all things to all people. For many types of products, targeted segments are getting smaller and smaller, giving rise to smaller and more-focused brands that resonate with target consumers.

Moreover, the growing importance of authenticity, purpose, and shared values has raised the bar when it comes to how companies and brands connect with their target markets. Targeting the right market and building a product with competitive functionality and a strong value proposition are tenets that remain foundational to success. The biggest winners, however, will be those that do so while also connecting with their targets in authentic ways and through shared values.

Companies should be deliberate in deciding where they stand and how they want to be positioned. And they should be committed to acting consistently with those values in order to demonstrate authenticity. Values should not be generic or universal, such as "motherhood and apple pie." Instead, they should be specific and sources of differentiation that can serve to help the company position itself for participation in market growth trends.

For example, health and wellness is an area of accelerating growth across many subsectors of consumer products. In addition, wage stagnation among the middle class in much of the developed world is causing many consumers to try to find ways of making their paychecks stretch further. Products that respond to the needs of those cost-conscious buyers also show promising growth prospects. Data analytics can provide new insights into which categories of products offer the most promise and which may be most vulnerable to new technologies and consumer trends. Those trends and many others can usually be integrated into an authentic set of values that both enable the company to connect with its target consumers in authentic ways and position the company favorably so as to attract sources of market growth.

2. MARKETING BECOMES EVEN MORE IMPORTANT, BUT INVESTMENTS MUST BE TARGETED AND MEASURABLE

Large, well-funded brands used to be uniquely positioned to access marketwide media channels to transmit their messages. But as niche brands proliferate and digital communication becomes democratized, companies must engage with consumers more intentionally. In addition, the value of mass messages resonates less in an era in which consumers are in search of products and experiences that uniquely reflect themselves.

In the new environment, the use of digital channels and social media to stay on message and connect in authentic ways with consumers around core shared values is critical to success. Social media channels are increasingly becoming means for two-way dialogues. And for certain types of brands, consumers see that as a crucial element of the brand experience.

Beauty and personal care products are at the leading edge in using celebrity and social media to build new brands and connect with consumers. Rihanna's Fenty Beauty brand, which she launched in 2017, sold almost $600 million of products in its first 15 months. Kylie Cosmetics, a start-up founded by Kylie Jenner, was valued at $1.2 billion when cosmetics giant Coty purchased a controlling stake in 2019.

Apparel companies, too, are proving adept at using social media to build authenticity and consumer connections. Nike launched its Breaking2 project in 2016 to break the two-hour barrier for the marathon and used Facebook and Twitter to engage in real time with running fans around the world. The company's Zoom Superfly Elite shoes helped Eliud Kipchoge beat the two-hour barrier in 2019, though the results were not recognized as a record based on World Athletics standards.

To be profitable, marketing must be targeted, tailored, and measured to the needs of self-centric consumers. Indeed, while digital channels are growing and currently getting much of the focus, depending on the nature of the brand and the customer, traditional marketing remains an important medium; and linear television continues to have the widest audience—particularly among older consumers, who have the most disposable income.

BUILDING AUTHENTIC AND DIRECT RELATIONSHIPS

In 2017, Nike launched a new strategy called Consumer Direct Offense, which focused on direct-to-consumer sales to drive growth in the upcoming decade.[8] The strategy signaled a significant step toward building more-meaningful and more-direct relationships with consumers in a highly fragmented market.

Having ended its retail partnership with Amazon, Nike is opening more brick-and-mortar outlets and is investing in its online presence to expand its direct-to-consumer business. That helps control customer experiences, tailor them to individual needs, and create brand loyalty in a market that has seen increasing competition.

Nike has also invested in technology and analytics through acquisitions of smaller firms that excel in predictive analytics to create new products, forecast demand, and identify the best marketing techniques to reach their targeted consumers. Nike's analytics start-up acquisitions in this space include Celect, a predictive-analytics firm, and Zodiac, a consumer data analytics company. The company's stock has risen more than 73% since announcement of the strategy on the back of impressive earnings, and the company's revenues rose to $10.7 billion in the first quarter of 2019, with digital sales up some 42%.[9]

But much of all marketing dollars is wasted. We estimate that about half, or $50 billion, of digital marketing and trade spend by CP companies globally is ineffective.[7] Despite the promise of greater measurability and engagement, many companies continue to be frustrated by their inability to track and measure outcomes given more-complicated marketing models and distribution channels. Penetrating so-called dark social applications, like WhatsApp, remains a major hurdle for digital marketers. And new privacy regulations and consumer expectations increasingly challenge companies to extract value from personal data for digital marketing purposes.

As paths to purchase become increasingly fragmented and nonlinear, it is now more critical to focus efforts on digital marketing. Our research shows that as the proportion of a firm's marketing dollars spent on digital increases, the efficacy of the marketing increases. There is a learning curve involved, though, and it takes time to get a return on the investment.

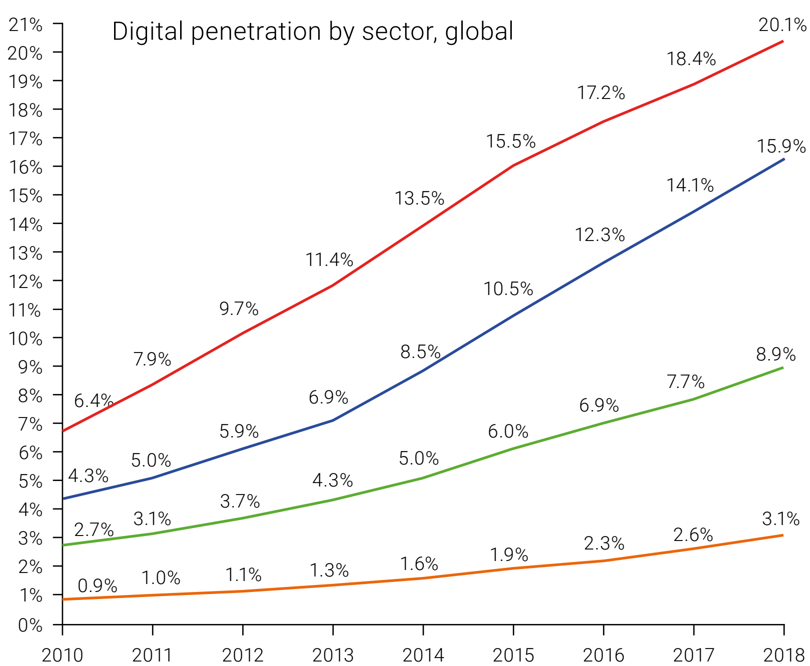
3. OPTIMIZE YOUR PORTFOLIO TO SUPPORT YOUR CHOSEN DIRECTION

Companies must adjust lines of business and brands to optimize their portfolios. New tactics must be enlisted as markets shift. And companies should explicitly (1) consider bold moves like acquisitions or joint ventures to accelerate and de-risk moves or (2) devise new revenue models like services and subscriptions.

Similarly, the divestiture of underperforming businesses—even of once-cherished brands—that no longer offer sufficient value potential can generate meaningful value and provide strategic focus. For example, in 2018, Nestlé sold its US confectionery business, which included such iconic brands as Butterfinger and SweeTARTS, to Ferraro for $2.8 billion. Nestlé followed that in 2019 with the sale of its US ice cream business, including the Häagen-Dazs brand, to Froneri in a deal valued at $4 billion.

INCREASING DIGITAL PENETRATION

Increases across all CP sectors illuminate success in innovative go-to-market strategies



Product type	$ Sales that have migrated online since 2010
Household Durables	$378.4 BN
Apparel and Accessories	$310.2 BN
Health, Homecare, and Beauty	$71.7 BN
Food, Beverage, and Tabacco	$79.1 BN

Sources: Euromonitor international, AlixPartners analysis

Royal Phillips, founded in 1891 as a maker of lightbulbs, divested itself of that business, together with its television and entertainment businesses, in recent years and has announced its intention to sell its consumer electronics brands in order to focus on products for the healthcare sector.

Knowing which category and channel shifts are happening, acting honestly and realistically about those facts, and then shifting meaningfully in response are crucial for success.

For those areas that are growing fastest, it's increasingly important that companies pivot their strategies to take advantage of that growth, which sometimes means abandoning traditional approaches and redefining the roles that the various brands or businesses play in the company portfolio. For some categories and products, decline is inevitable. The answer is not, necessarily, to exit those businesses, because in many cases, the free cash flow from them can fund investment in new growth areas.

A CONSOLIDATION STRATEGY FOR SUCCESS

L'Oréal has used acquisitions of multiple small brands with loyal customer bases to sustain its leadership in the highly competitive beauty and personal care industry.[10] In the past five years, the company has acquired younger brands such as Urban Decay, NYX, and IT Cosmetics[11] and has grown revenue during the same period by 8% to $31 billion.[12]

Lower barriers to entry have facilitated the proliferation of start-ups in the beauty and personal care space. There are 2,722 beauty start-ups on angel-funded websites; the firms have an average valuation of $3.8 million.[13] L'Oréal has many options, as a result, from which to identify well-built brands with a loyal customer base that it can add to its portfolio.

L'Oréal's acquisitions span the globe; the firm has acquired brands in Asia and is building a broader portfolio to cater to a wider set of consumers.[14] The company has been vocal about buying smaller brands and taking advantage of its global reach and economies of scale to build those brands. But brand identity and the consumer experience are kept independent. Acquired by L'Oréal in 2000, Kiehl's is a good example of that by having maintained its authentic and independent edge despite tremendous growth.

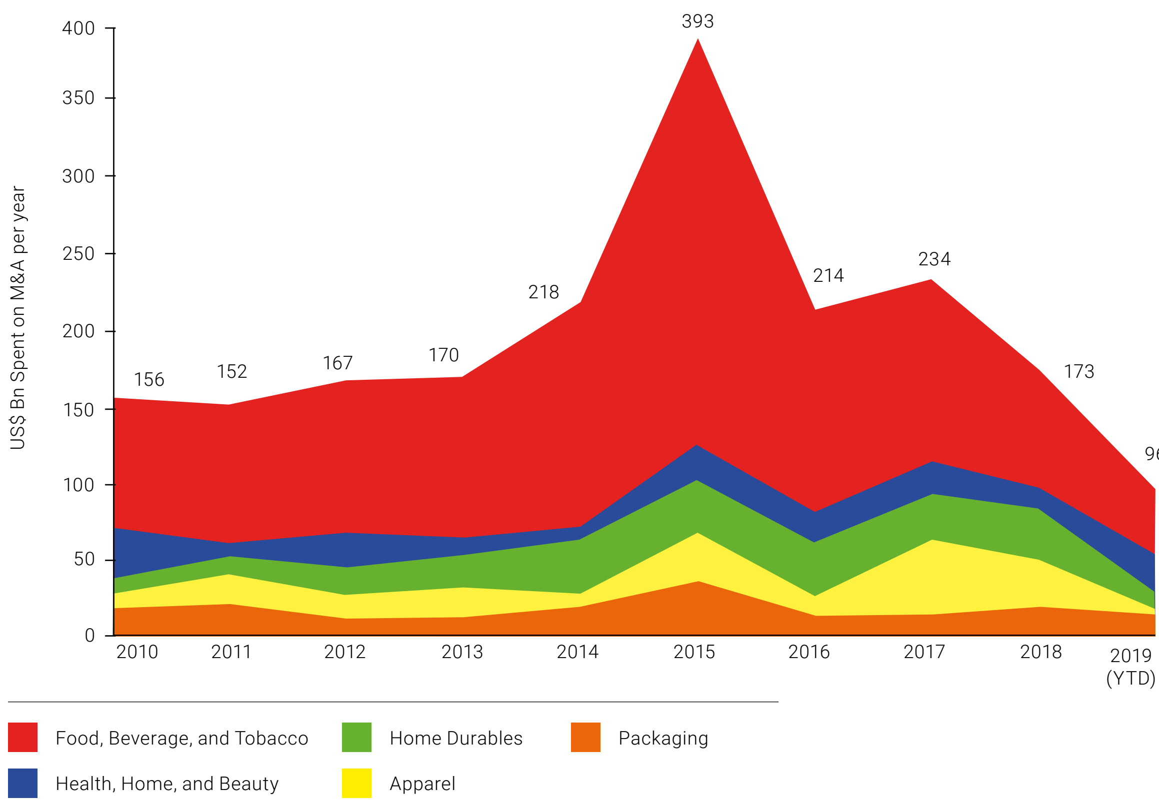
By its acquisition of ModiFace, an artificial intelligence start-up used by companies such as Sephora to provide customers a virtual trial room, L'Oréal is also using technology to offer more-customized shopping experiences.[15] This has helped the company provide a seamless online experience for any brand it owns, thereby creating a new, direct-to-consumer channel of sales.[16]

L'Oréal is an example of an established leader that is using technology and building a portfolio of brands to maintain growth and profits.

And as more and more sales move online, companies must make difficult decisions about sacrificing margins for growth, but given overall trends for most product categories, the choice may prove ephemeral. Ultimately, consumers are moving more and more of their purchasing to digital channels, and therefore, choosing not to meet them there may prove short-sighted.

Established companies continue taking advantage of M&A to secure growth at escalating multiples. Although deal volumes are down from a peak in 2014, acquisition strategy remains a critical path for many of the CP companies navigating through this disruptive environment.

CUMULATIVE M&A TRANSACTION VALUE BY SECTOR, GLOBAL



For both acquired and new start-up products, companies must maintain a balance between synergies and the need to sustain the consumer-facing identity of the target. General Mills, for example, has made great efforts to maintain the brand identity of Annie's Homegrown—which manufactures natural and organic packaged food—following the acquisition of Annie's in 2014. Campbell's has done the same with its acquisition of Late July Organic Snacks. Allowing the acquired brands and companies to continue acting consistently with their stated values is important for maintaining connection and trust with their target markets.

4. START NOW AND ADAPT ALONG THE WAY

The sheer scale of business transformation can be daunting. Companies should not overjudge their capacities to change. They should pick key deliverables that can be implemented within six months. They should consider incubating new businesses that could be disruptive without having to disrupt their core businesses. And they should be willing to learn as they go rather than wait for the perfect answer.

The positive momentum resulting from early wins can lead to further progress, including cultural acceptance of variously dramatic strategic and operational shifts. Approaching a necessary transformation with an agile mind-set is also critical because the initial strategy and implementation road map may change over time.

New technologies, which, too, are elements driving disruption, can offer answers to the problem of transformation at speed by facilitating greater agility, leading to higher connectivity, and by generating deeper insights by means of data and analytics. Accelerating digital transformation efforts, therefore, drives business transformation.

Whatever the strategic direction, maintaining cost discipline is critical for all companies, which must get themselves fighting fit in their otherwise disrupted businesses in order to fund the future.

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THE CASE FOR SELECTIVITY

Disruption in the automotive industry

In brief

DISRUPTION THEMES

– Environmental awareness and tightening government regulations in major global markets will force an incremental transition from internal combustion engines (ICE) to more CO_2-neutral electric propulsion systems.

– The complete elimination of ICE globally is unlikely, but the costs associated with these systems in many markets are increasing due to regulatory requirements and compliance penalties at a time that the costs of electric vehicles are falling dramatically.

– Shared mobility, especially in urban areas, is transforming how people move, evolving from vehicle ownership to mobility as a service, which causes purchase delays or avoidance for some types of consumers.

– The promise of electric autonomous mobility—for both people and goods—is attracting massive investment on the parts of new entrants and existing industry players that want to capture new profit pools. Commercial vehicles will lead the way toward full autonomy. In passenger vehicles, driver-assistance features pave the way to full autonomy and are set to become a battleground.

IMPLICATIONS

Vehicle electrification, autonomy, and evolution to CO_2 neutrality will become mainstream. However, the speed of implementation, issues involving cost curves, and the effects of regulation make timing uncertain. Therefore, the road to success is not yet paved; some of the pioneers are not yet profitable; and it remains to be seen which companies will lead in the new mobility world.

But trends are emerging as follows:

– Few companies, if any, can afford the massive investment required to lead on all fronts, and we're well below the inflection points of either electrification or autonomy, so volumes remain muted: make/buy/partner decisions associated with disruptive technologies are required in order to share the costs and leverage strengths.

– The definition of automakers' core system technologies shifts in a CASE (connected, autonomous, shared, and electrified) environment; winning automakers and suppliers—new and existing—can proactively define the shifts in offerings and business models.

– Change requires a controlled migration from the historical automaker-led linear value chain to a more CASE-centered value chain.

– ICE-related businesses are in decline but generate significant cash flow and will be increasingly managed and funded separately from the CASE businesses.

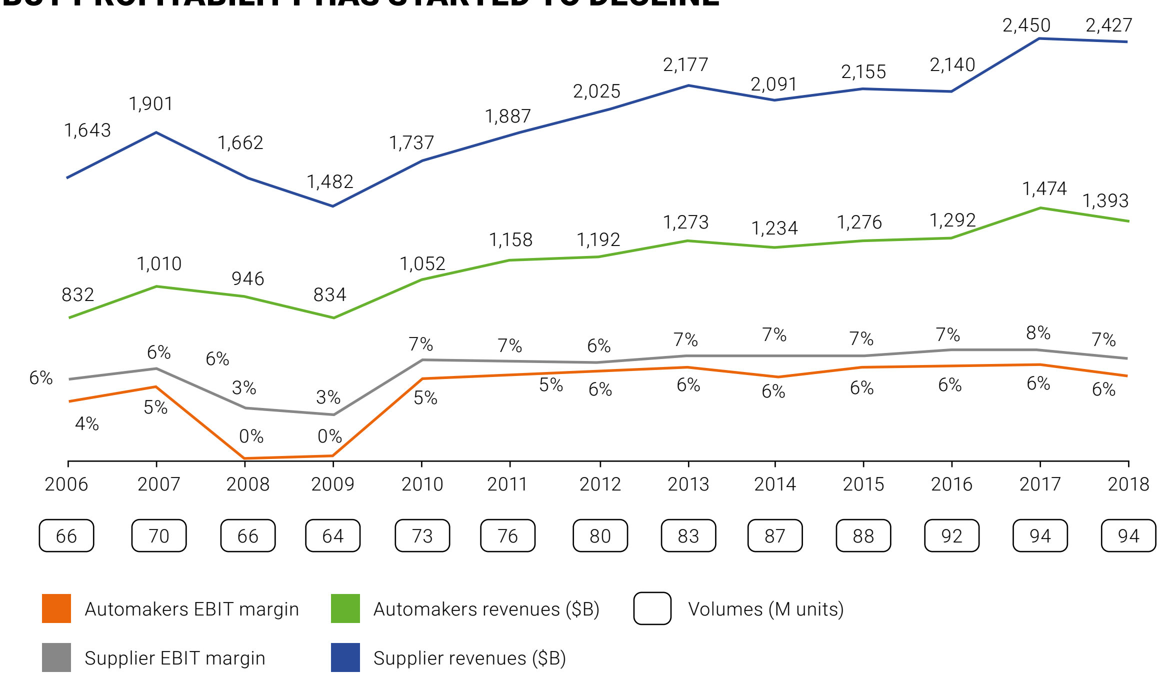
The CASE for selectivity in the automotive industry

Compared with other industries we examined this year, automobile manufacturers and suppliers are the least decoupled from the credit cycle, with auto purchases closely tied to the ups and downs of the global economy because a vehicle typically represents the second-largest purchase in a consumer's life and can usually be delayed or substituted with a used vehicle or other forms of mobility. This makes harnessing and driving these disruptive forces difficult. In fact, automobile manufacturers and suppliers are on the brink of unprecedented transformation caused by (1) new options for ways that consumers want to travel, (2) regulatory pressures, and (3) technological advances; and so, companies in the automotive industry must build up their resiliency to downturns in economic cycles at the same time as they make fundamental changes in their businesses.

Financial performance and near-term forecast

The past nine years have seen record profit levels at both automakers and suppliers, propelled by a strong macroeconomic environment that followed the Great Recession as well as robust sales in the United States and Asia in particular. However, profitability is falling. In 2018, EBIT margins at automakers fell to their lowest levels since 2009, and even though suppliers have fared better by growing sales at a faster pace overall through content-per-vehicle increases, their profitability also decreased in 2018. While full 2019 financials were not

SUPPLIERS AND AUTOMAKERS HAVE GROWN SLOWLY IN THE PAST DECADE, BUT PROFITABILITY HAS STARTED TO DECLINE



available at time of print, global sales volume decreased by 4%, which we anticipate will have negative impact on profitability for automakers and suppliers.

Suppliers known for innovation within the industry have demonstrated higher relative performance levels than their peers and customers. For example, Aptiv and Delphi Technologies (formerly together under the Delphi Corporation moniker) are interesting case studies in strategic positioning in the new, CASE environment: Aptiv focuses on mobility solutions, smart-vehicle architecture, and connected cars for connected cities; Delphi Technologies focused on powertrain, advanced propulsion, and aftermarket solutions before being acquired by competitor BorgWarner in early 2020.

THE MARCH TOWARD MOBILITY AS A SERVICE

1890+
Cash Purchase

1920+
Loan

1980+
Lease

2000+
Car Sharing and Subscriptions

2010+
Ride Hailing and Micromobility

2025+
AV-Shared and Integrated Multimodel

We expect this trend toward lower revenues and profits to accelerate as the Chinese, US, and European economies slow. Global industry unit sales are forecast to be flat in the near term before regaining some tepid growth mid-decade.[1] As this article goes to press, the industry is being hit by a new threat as the coronavirus causes the closure of auto part suppliers in China, with a rippling effect across the global supply chain. China is a leading supplier of parts to auto plants around the world, shipping about $35 billion of parts in 2018, according to United Nations data.

The slowdown occurs precisely at a time that automakers must invest heavily to prepare for the long-term and existentially disruptive impacts of new technologies and new modes of mobility. How to cross that imminent profit desert of increasing investment without near-term return is the key challenge the auto industry faces today. Automakers, especially those without strong cash engines to count on, may struggle to mount coherent responses to the disruptive forces of the CASE-vehicle environment.

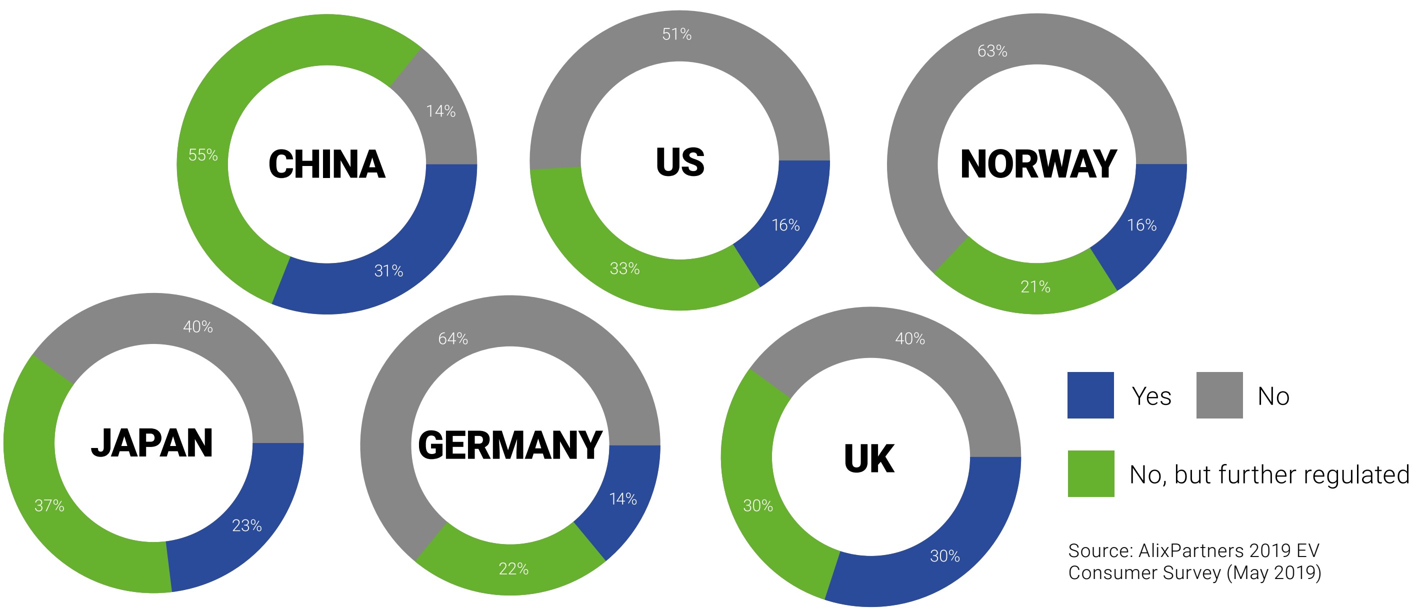
Evolving consumer preferences on mobility

For more than a century, beyond filling basic mobility needs, the automobile has stood as a symbol of consumer success and personal freedom. People in the developed world, especially those coming of driving age, longed for the ability to go where they wanted when they wanted, and a personal vehicle was usually the best way to do that. And even though the dream of free movement hasn’t changed, the ways freedom gets achieved—particularly in advanced markets—are changing via influence by a combination of urbanization, demographics, environmental awareness, and connectivity.

Indeed, one of those fundamental disruptors—in the form of ubiquitous, faster, and improved connectivity—is facilitating dramatic changes in consumer access to mobility—same as it’s changing other sectors of our lives. New entrants, like Uber and Lime, are empowering consumers’ desires to get where they want to go, when and how they want, decoupled from ownership or pooled transportation. And though these entrants may be relatively new, the progress toward mobility as a service is actually a century-plus journey to pay-by-use and multimodal options for consumers. And they are by no means the end of the journey.

The general public is becoming increasingly concerned about the environmental impact of the internal combustion engine, which powers most of the vehicles on the road today. Regulators have long focused on tightening emissions and increasing fuel economy standards to improve air quality and to slow climate change, and consumer sentiment is rapidly catching up. In our 2019 Electric-Vehicle Survey, we found that consumers support further regulation of ICE vehicles, with many supporting their outright ban. Those concerns, together with other factors, are increasing interest in electric vehicles and mobility sharing on the part of consumers.

SHOULD INTERNAL COMBUSTION ENGINES BE BANNED IN THE FUTURE?



Source: AlixPartners 2019 EV Consumer Survey (May 2019)

CASE

Connected, Autonomous, Shared, Electrified.

Disruptive technologies: CASE

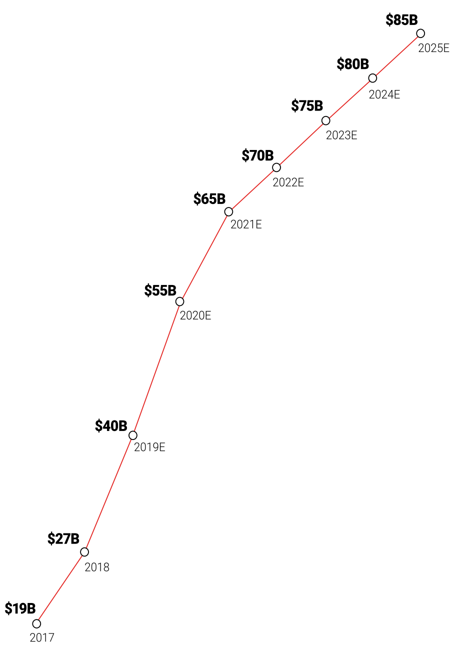
Changing consumer attitudes would be a mere pipe dream were it not for a set of trends that in 2014 we coined CASE: connected, autonomous, shared, and electrified. These trends make possible the realization of evolving consumer expectations and are on a converging path. The compounding and interaction of these disruptive trends have the potential to facilitate, accelerate, and amplify the impact of change across the automotive industry.

CONNECTED

Connectivity is a necessary, evolving, yet largely invisible enabler for many technological advances—including ride hailing and autonomy. Great strides have been made in the leveraging of connectivity to enhance the occupant experience in a vehicle—in essence, porting the connected mobile phone experience into the vehicle and bringing the possibility of an always-on Internet connection to the driving experience. Within such a networked vehicle, technologies enable new and faster services; software can be updated without a dealership visit; and the vehicle itself can become a Wi-Fi hot spot that channels content on demand to its occupants. While opportunities to provide additional value for consumers inside the vehicle seem limitless, a key challenge remains how to monetize them.

Future waves of innovation may focus on a vehicle's connectivity with the surrounding environment to create true vehicle networks for mass vehicle autonomy. That connectivity has significant infrastructural implications that will require government regulation and collaboration, as well as the time it will take to develop, test, and install costly infrastructure. Benefits derived by adding vehicles to the Internet of Things are numerous but not without risks. Connectivity introduces cybersecurity risks as more and more systems go online, as more and more control systems rely on infrastructure, and as more and more customer data gets generated and transmitted.

AUTONOMOUS VEHICLES SPENDING THROUGH 2025



Note: Includes automaker and tech company investments, acquisitions, investments, and partnerships. R&D only includes where disclosed as part of AV budget.

Sources: Brookings Institiution, Google search, AlixPartners analysis, Goldman Sachs

AUTONOMOUS

Investments in autonomous-vehicle development with a view to moving both people and goods have been massive: an estimated $40 billion in just the three years from 2017 through year-end 2019, with a further, $75 billion expected from 2019 to 2023.[2] The market is rewarding some of the companies that bet on autonomy, and even though the timetable for widespread adoption of fully autonomous vehicles is still unclear for the near term, a material impact on revenue is unlikely. For example—and despite an approximately 40% reduction in the third quarter of 2019—Waymo had an equity valuation about twice that of General Motors: $105 billion versus $51 billion.[3]

More than 50 companies worldwide are developing full stacks for autonomous vehicles, and many others are developing aspects of the software and sensors. These companies include traditional automakers and suppliers as well as new entrants, such as Alphabet's Waymo and Intel's Mobileye. Most autonomy-related investment—by our estimate, approximately 71%—focuses on alliances. Examples are investments by Honda and SoftBank in GM's Cruise Automation: $800 million and $2.5 billion, respectively.

The economic benefits of autonomous mobility are positioned as long-term improvements to productivity and cost efficiency. The societal implications are equally significant—for example, providing increased mobility for an aging population and enhancements to traffic safety overall. But the technology and its cost are not yet mature. At the consumer level, we anticipate slow adoption based on two factors: incremental vehicle cost and consumer discomfort. Consumers are simply not ready to flip the switch from driving to being transported by a self-driving car. In 2019, our international survey of consumers showed limited willingness to pay a premium for hands-off-the-wheel autonomy but an eagerness, especially in China, to exchange private ownership for ridehailing robotaxis. Outside China, concerns about the safety of autonomous vehicles with the highest levels of autonomy are significant.[4]

In the meantime, the industry is taking initial steps by introducing driver-assistance systems—such as braking assist or parallel-parking assist—to consumers as available and increasingly standard options on new vehicles.

The pace of adoption will also be constrained by regulation, particularly in the European Union where concerns about infrastructure, safety, and the potential impact on employment predominate.

Autonomy will drive disruption in the automotive industry for decades to come; however, its full impact won't be realized until regulations no longer require a human driver in the vehicle to serve as a backup system. Once this constraint is removed, we will see a multitude of diverse autonomous applications, including implementations in luxury vehicles, in mobility as a service, and in commercial transportation applications.

SHARED

Shared mobility is changing quickly, particularly in urban environments, and is affecting automakers' future plans. For both automakers and suppliers, that means fewer units on the road over the long run, as the impact of utilization improvement overcomes the increase in miles per year of each vehicle. According to a 2017 AlixPartners study of top US cities (defined as markets in which services are at scale and conditions support multimodal mobility), an estimated 19 vehicle purchases—new or used—are avoided or delayed for each car-sharing vehicle on the road and 4 purchases for each ride-sharing vehicle (avoided purchases were non-primary household vehicles or vehicles averaging fewer than an estimated 2,500 miles annually). These values are specific to the markets analyzed and should not be extrapolated to the greater car parc.

The emergence of autonomous robotaxis at scale could have an exponential impact on shared mobility and may reduce vehicle lifetimes by increased deadhead trips.

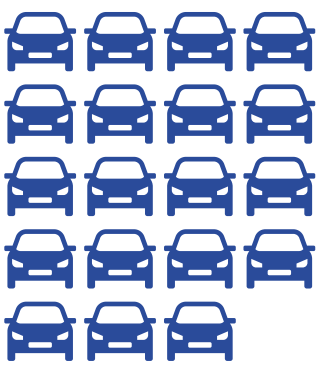
The big question isn't whether car sharing or ride sharing will affect how value gets created. Both definitely will and already have. Rather, the true question is, Who will capture the value? Many of the current sharing platforms are not profitable, and they face real challenges. Automakers have not historically been successful at managing shared fleets and individual customer interactions, as their experiences in owning rental companies, dealerships, and car-sharing services have shown. Potential new entrants, such as companies with experience in managing transportation fleets, lack direct consumer knowledge. There is no obvious winner in the shared-mobility race, and thus new start-ups are the front-runners early on.

VEHICLES NOT PURCHASED BECAUSE OF CAR SHARING IN TOP US CITIES

(among 21% users of market population)

1 Car-sharing vehicle =

19 Cars not purchased



VEHICLES NOT PURCHASED BECAUSE OF RIDE SHARING IN TOP US CITIES

(among 41% users of market population)

1 Ride-sharing vehicle =

4 Cars not purchased

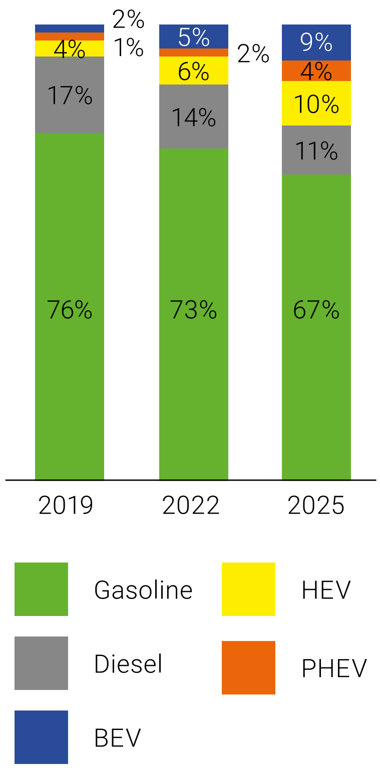
Sources: Zipcar and Avis investor relations, BMW website, car2go website, Austin Business Journal, Boston Herald, Miami Herald, New York Times, Seattle Times, CBS San Francisco, US Census, AlixPartners Car-Sharing & Ride-Hailing Survey

ELECTRIFIED

The most significant single disruptor in today's automotive industry is electrification. Environmental awareness among consumers and tightening government regulations in major global markets seeking CO_2-neutral transportation along with decreasing electric-vehicle costs are driving a transition from ICE to electric propulsion systems. Sales of battery-electric and hybrid vehicles increased 85% in the two years from 2017 to 2019.[5]

In our 2019 International Electric-Vehicle Consumer Study, more than half of consumers surveyed in six countries expressed interest in owning an electric-vehicle, and more than one-quarter indicated intent to purchase one as their next vehicle. But the gap between consumer interest and actual sales remains, with electric-vehicle composite global market share at about 2%. That should not be a surprise given the current higher purchase price of electric vehicles relative to similar vehicles powered by ICE, as well as limited availability across many desired segments and brands. In our survey, consumers also cited concerns about cost, battery range, and charging infrastructure as impediments to purchase.

PROPULSION SYSTEM GLOBAL SHARE



BEV = Battery electric vehicles
PHEV = Plug-in hybrid electric vehicles
HEV = Full-hybrid or mild-hybrid electric vehicles

Note: Totals may not equal 100% because of rounding.

Source: AlixPartners powertrain forecast

By 2025, driven in part by legislation, we predict that global plug-in electric vehicle sales will grow to a 13% global share, with China and Europe leading the way. Electric vehicles are therefore where automakers have plans to invest the heaviest in the near term. The industry has announced plans for $295 billion in investments in the design and manufacture of electric vehicles from 2019 to 2023. That's roughly the same amount of money the global industry spends annually on capital expenditures and capitalized research and development combined.

Automakers and suppliers aren't the only organizations to face heavy investment burdens in support of vehicle electrification. To achieve CO_2 neutrality by 2050, utilities will have to upgrade and expand their networks if they're to meet increased electricity demand for plug-in vehicles and net metering. Hydrogen may also replace some battery usage as the main power storage technique for electrified vehicles but will also require massive infrastructure that does not currently exist.

The shift to electric vehicles will also have a profound impact on the automotive workforce. Hybrid vehicles take more labor hours to assemble, but we estimate that the average labor hours required for powertrain assembly are 40% less for battery electric vehicles versus ICE vehicles.[6] One of the issues the United Auto Workersunion cited during its 2019 strike against General Motors in the United Stateswas anticipated job losses based on the company's announcement of significant future battery-electric-vehicle R&D spend and 20 new battery-electric-vehicle product launches by 2023.

How are companies responding to—or driving—disruption?

Given the uncertain nature of the uptake of the new technologies, the massive investments necessary to implement them, and the financial pressure from current economic headwinds, how are companies responding to those pressures?

The road to success is not yet clear. Some pioneers are not profitable, and it remains to be seen which companies will lead in the new mobility world. However, potential pathways are emerging.

The CASE for selectivity—in approach and timing

DEATH OF THE LINEAR VALUE CHAIN

The evolution of the CASE ecosystem is transforming the industry's historically linear value chain and requiring different operating models that work together in codependence—but no longer with a dominant center player orchestrating it. Automakers historically sat at the top of the food chain, as the five largest automakers controlled 50% of automaker value-add and ensured that no single supplier became dominant in any commodity. Automakers designed and assembled vehicles and core systems—including powertrains—whereas suppliers provided less-critical systems and just-in-time supply chain support to increase operational efficiency.

That traditional value chain is being replaced by the fast-changing CASE ecosystem, which opens the door for new entrants and which forces existing players to find collaborators or consortia with capabilities or resources they currently lack. The shift from ICE propulsion to electric propulsion is leading to new industry participants—such as Tesla and CATL—and will increase pressure on existing automakers. The shift between owned and shared assets may lower overall sales, change the traditional customer to a fleet customer, and open opportunities to provide per-mile service rather than products.

The CASE ecosystem will force automakers and many suppliers to reexamine their product strategies and business models. For some, that may mean investing in the emerging technologies. For others, it may mean maximizing existing ICE cash flows as well as benefiting from lower investment needs and higher free cash flow in the near term. Determining how to maintain their share of value and differentiation is a key strategic consideration for those most affected by this disruption.

CASE IS HAVING A SIGNIFICANT IMPACT ON THE VEHICLE SYSTEM LANDSCAPE; SUPPLIERS SHOULD PROACTIVELY ADDRESS THEIR PORTFOLIOS

Increasing value	Minimal change	Decreasing value
– Electrical propulsion	– Exterior	– ICE
– Safety	– Interior	
– Electronics	– Chassis	

MAKE, BUY, OR PARTNER

Investments in both electric and autonomous vehicles should be made wisely, and few companies can afford the massive investment required to lead on all CASE fronts. Inherent in the investment decision are such issues as where a company's core capabilities fit and how to adjust, given the rapid changes occurring in the CASE ecosystem.

Cost sharing through partnerships and consortia is one method automakers are pursuing to help them both manage the cost of their investments and recognize content strengths.

Externalizing production of systems that might previously have been considered core is another strategy. For example, the simpler design of electric motors compared with the design of ICE and existing industrial suppliers may mean they are not core differentiators for automakers going forward. As a result, whereas some automakers may decide to keep them in-house, others may decide to purchase electric motors from suppliers that can produce them more cheaply and efficiently. The challenge many face is that they have large employee bases and invested capital in ICE powertrains, and so the outsourcing advantage would have to be worth the transition cost.

CONTROLLED MIGRATION

For those positioning themselves around CASE technologies, change requires a controlled migration away from ICE technologies and the historical, automaker-led linear value chain. Some companies may choose to exit their legacy businesses; others may choose to run them as cash cows for future business investments.

What's next for the automotive industry?

The need for people and things to move is greater than ever, and there have never been more options from which to choose. Asset ownership is becoming an option rather than a necessity. ICE propulsion is on the road to regulated obsolescence in many markets, and in time, even the skills needed to drive a vehicle may become unnecessary. Automakers, suppliers, and new entrants are staking their claims to the emerging operating environment and facing potentially massive investment requirements.

It's unlikely that every automaker or supplier can be all things to all consumers. Each company must assess its core value propositions and decide how it will participate in the CASE ecosystem. For all companies facing the disruption, it will be critical to be strategically selective around those elements of CASE that they should make in-house, or should develop in partnerships or collaborations, or should buy outright from other suppliers.

Ultimately, a company's leaders must make decisions with a clear view of the future direction of this industry and where their company fits in. Companies not making those choices now may find the decision making taken out of their hands in the coming downturn.

Notes

1. AlixPartners research.

2. AlixPartners' 2019 Global Automotive Outlook Autonomous Vehicle Investment Study.

3. Waymo data from Morgan Stanley analyst report of September 27, 2019; GM value as of December 31, 2019.

4. AlixPartners 2019 International Autonomous-Vehicle Consumer Survey.

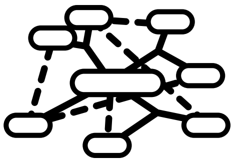
5. AlixPartners Electrification Index.

6. AlixPartners benchmarks and analysis for European powertrain manufacturing, based on averages across European plants.

CONTENT IS KING . . . AGAIN

Disruption in the media industry

In brief



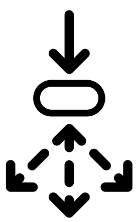
DISRUPTION THEMES

– With the growth of the Internet and social media, content creation is becoming more and more disintermediated and democratized, thereby creating an explosion of content. While it has created choices for consumers, it has also resulted in decreasing trust in quality of content and increasing uncertainty among consumers.

– Self-centric consumers now demand personalized media experiences that are tailored to their own preferences, contexts, and schedules and facilitated by ubiquitous and high-speed connectivity and innovative devices.

– Traditional business models have been disrupted, thereby reducing revenues from physical sales, advertising, and third-party distribution.

– Competitive lines are blurring as players in different segments begin competing for consumers' attention—and dollars.



IMPLICATIONS

– Content creation must respond to consumers' demands for personalization with regard to how and when they experience media across all potential devices.

– Consumer analytics, in conjunction with artificial intelligence, will increasingly empower media companies to target those consumer demands and customize experiences around individuals.

– To supplement revenues lost from traditional channels, many media companies are increasing their reliance on digital subscriptions, but for some industries and companies, subscriptions might not replace all lost revenues as new entrants take market share and consumer behaviors change.

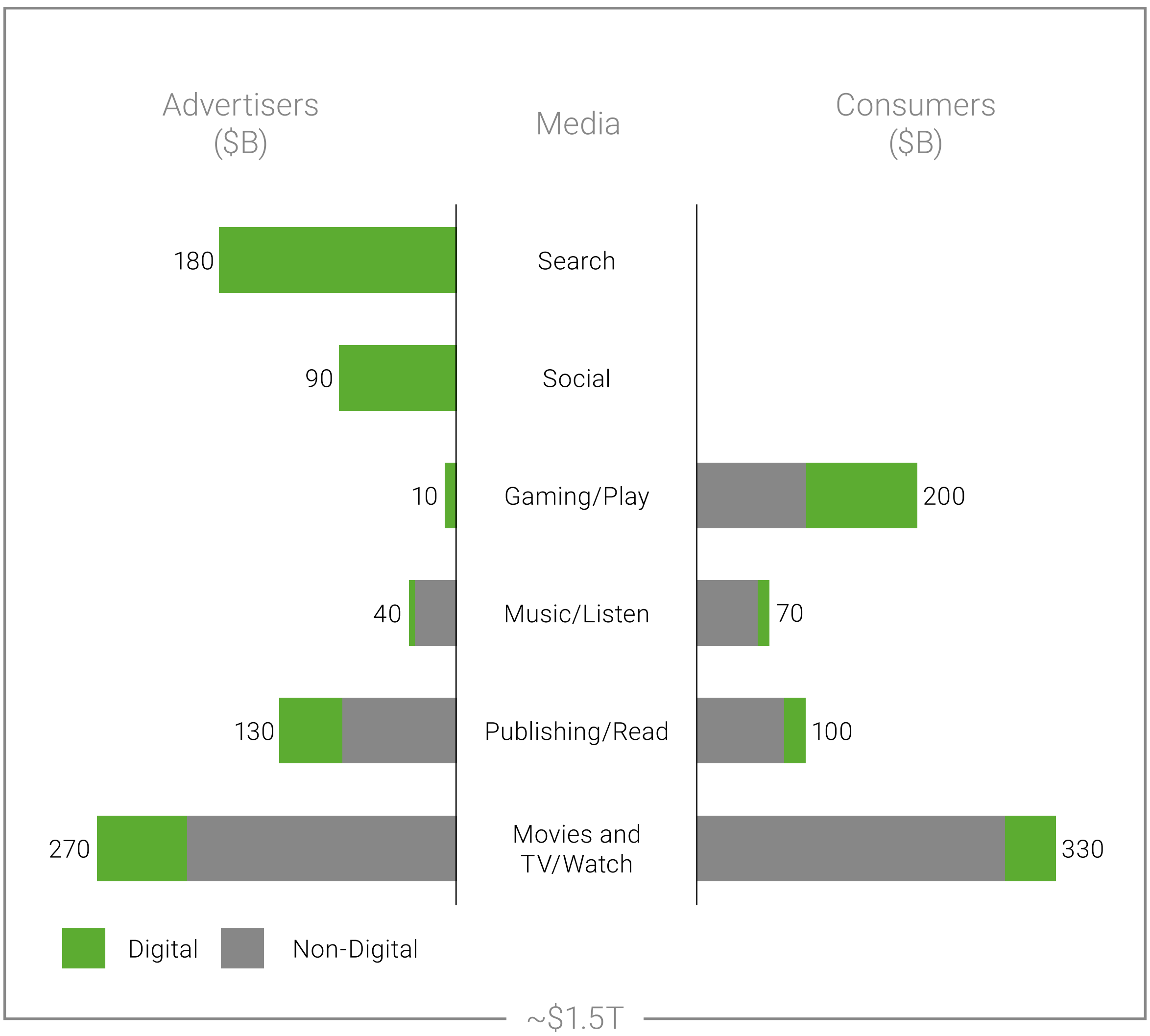
– Strong brands and quality products will differentiate companies in a more fragmented media environment.

Disruption in the media and entertainment industry

In many ways, the media and entertainment industry is experiencing a golden age. New technologies have enabled creators of content to connect to a broader array of consumers in more-direct and more-impactful ways than ever before. As barriers to entry have fallen, an explosion in the amount and types of content has occurred, which has served to democratize the creation process. Consumers have been spoiled by an abundance of choices, and revenues for the industry continue to rise steadily. We estimate that global revenues will reach $1.5 trillion in 2022, with digital accounting for 40% of the market.

THE RISE OF DIGITAL HAS RESULTED IN AN ABUNDANCE OF CONSUMER CHOICES AND WILL ACCOUNT FOR 40% OF THE INDUSTRY BY 2022

2022 Global Media Ecosystem Estimate



Note: Ecosystem revenue includes all advertising and consumer-paid media content.

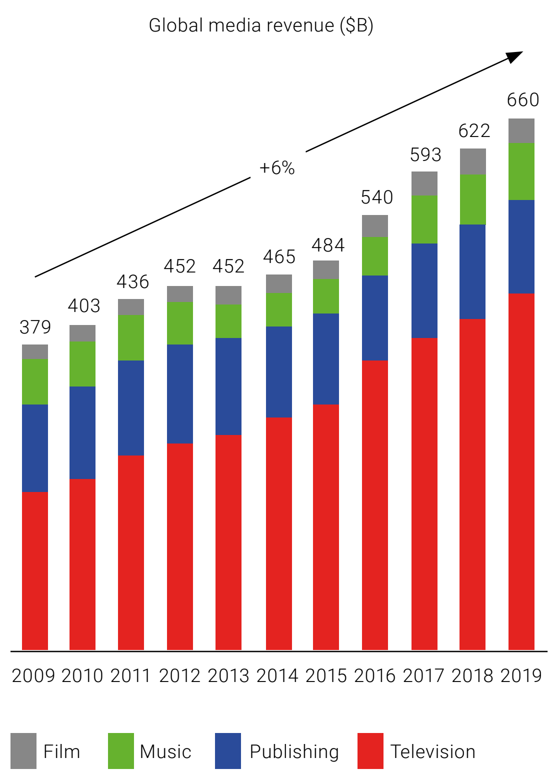
Source: AlixPartners

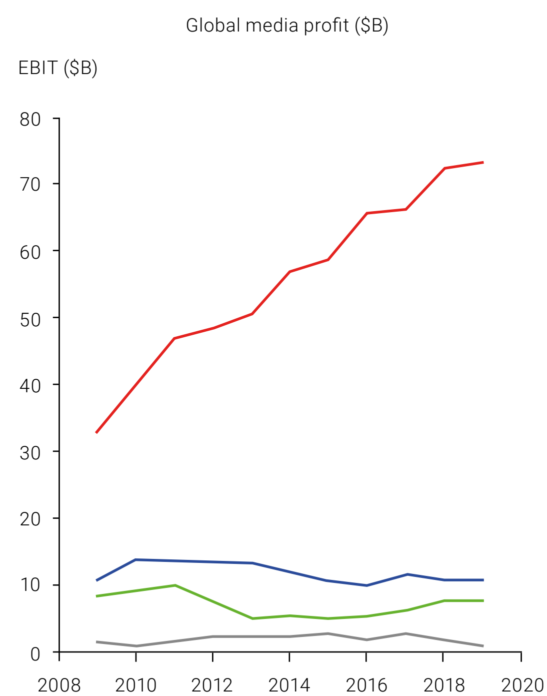
But beneath that top-line number lies a fundamental disruption in business models, which has necessitated new ways of operating and which is demanding a transformation in the types and quantities of content produced. Distribution has become disintermediated because consumers are increasingly relying on digital and mobile technologies to directly access and curate content. The platforms are more and more converging on the same devices, and competitive lines are blurring as consumers start choosing not between the alternatives in one form of entertainment—like television shows—but between all the various forms of digital entertainment now available to them, including television, films, news, gaming, and social media.

Indeed, with mobile devices connecting us continuously everywhere, media and entertainment companies compete for every minute of our time and all of our attention. As Netflix CEO Reed Hastings said, “We actually compete against sleep, and we’re winning!”

The graphic on page 3 shows these various entertainment alternatives and our estimates for the revenues these segments will generate by 2022. The first three categories—search, social, and gaming—are new entrants and disruptors in this industry. The latter three—music, publishing, and movies and television—are the incumbents who are facing fundamental disruption to their business models. The following graphs show revenues and profits in these segments. We will go into a deep-dive analysis on each of these to see the forces at play and how companies are responding.

BOOMING TELEVISION REVENUES ON THE BACK OF STREAMING COMPENSATE FOR ANEMIC PERFORMANCE IN OTHER SEGMENTS





Sources: CapIQ, AlixPartners analysis

Connectivity and digital media are growth drivers

As seen in other industries, ubiquitous and high-speed connectivity has facilitated a metamorphosis in consumer behaviors, but the very designs of mobile phones, tablets, and computers—which optimize individuals' consumption of media and entertainment—has accelerated the pace of change in this industry. And that is what the smartphone was built for.

INCREASINGLY CONNECTED TO THE MOBILE/SMARTPHONE

5 HOURS

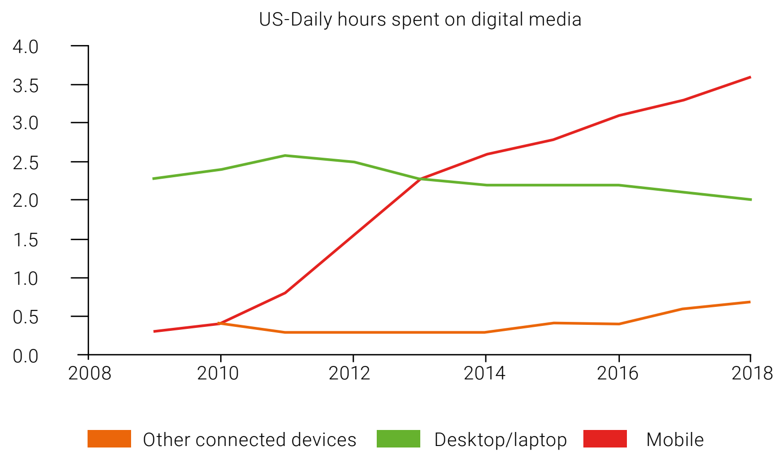
Average time per day on our mobile device

~2,600

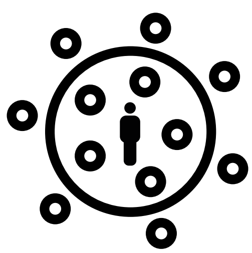
Times we touch our phone per day

~79%

Internet usage originates from mobile device



Source: Bond Capital Internet trends



Self-centric consumer

As demand has increased, so has the amount of content. In one month, YouTube users post the same amount of video as the three main US broadcasters have created in the past 60 years. Upwards of 350 million photos are uploaded to Facebook every day. And in 2018, Netflix alone created 1,500 hours of original programming. In such an environment, it becomes difficult to win, and hold, consumers' attention.

As a result of all those developments, people increasingly expect to enjoy their media experience how and when they want it. They tailor their selections across a range of services and devices to fit those demands, thereby curating a unique ecosystem that meets their personal preferences. An otherwise great product that is not delivered how and when and where consumers want it is likely to be ignored.

That personalization is something consumers are looking for in actual content as well. They want content optimized and available on the device of their choosing, and they're relying more and more on artificial-intelligence (AI)-driven recommendations to facilitate discovery. Netflix even designed a choose-your-own-adventure episode of its show Black Mirror, allowing a range of viewer-driven endings.

Different business models for publishers and content creators across consumers and advertisers

The industry has several different business models—primarily advertising, subscription, transactions, licensing, merchandising, and content marketing. Two segments—search and social—that have emerged during the past decade, rely primarily on advertising revenue, while the other segments are increasingly adopting the subscription model to "own" the consumer.

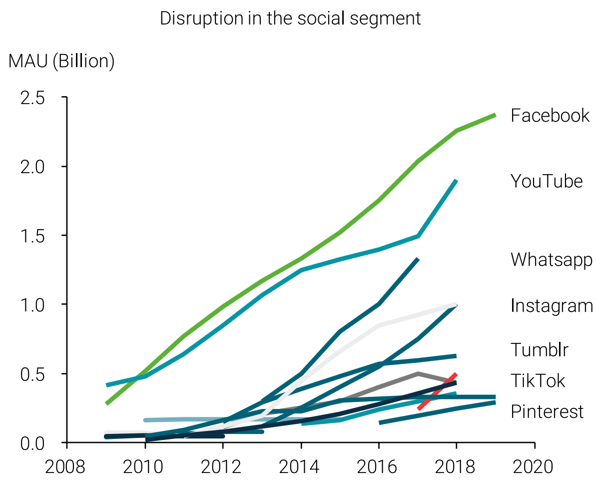
MONETIZATION BASED ON MULTIPLE BUSINESS MODELS ACROSS ADVERTISERS AND CONSUMERS

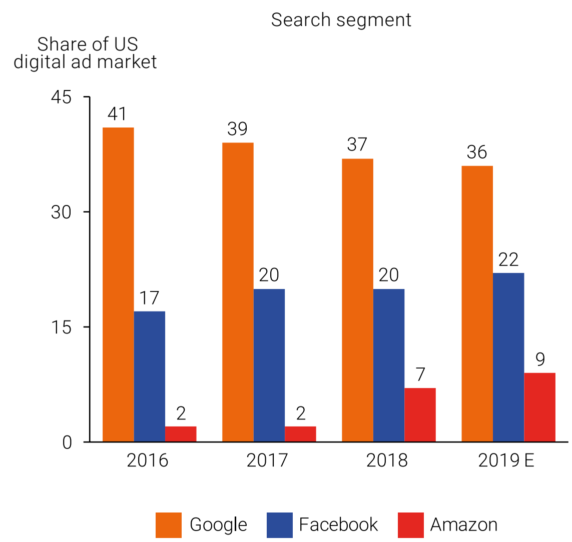
Advertiser			Consumer			
Call to Action	Branding		Subscription/ Tiered Membership	Transaction	Licensing	Merchandising
✓		Search		Free		
✓		Social		Free		
✓	✓	Publishing/Read	✓	✓		
	✓	Movies and TV/Watch	✓	✓	✓	✓
✓	✓	Music/Listen	✓	✓	✓	✓
✓	✓	Gaming/Play	✓	✓	✓	✓

Search, social, e-shopping, and e-gaming

Purely digital advertising revenue streams have emerged from search engines, social media, e-commerce platforms, and gaming. While Facebook dominates the social media segment, generational preferences for platforms (TikTok being the "youngest") with different features continue to rise and thrive. Today, Google's dominance of the search segment is being threatened by Amazon, which in addition to subscriptions is adopting advertising across its ecosystem. Armed with consumer data from its e-commerce platform, Amazon is positioned to target consumers across a wide range of platforms, including e-commerce, video, and music.

POTENTIAL DISRUPTION OF THE DIGITAL DUOPOLY





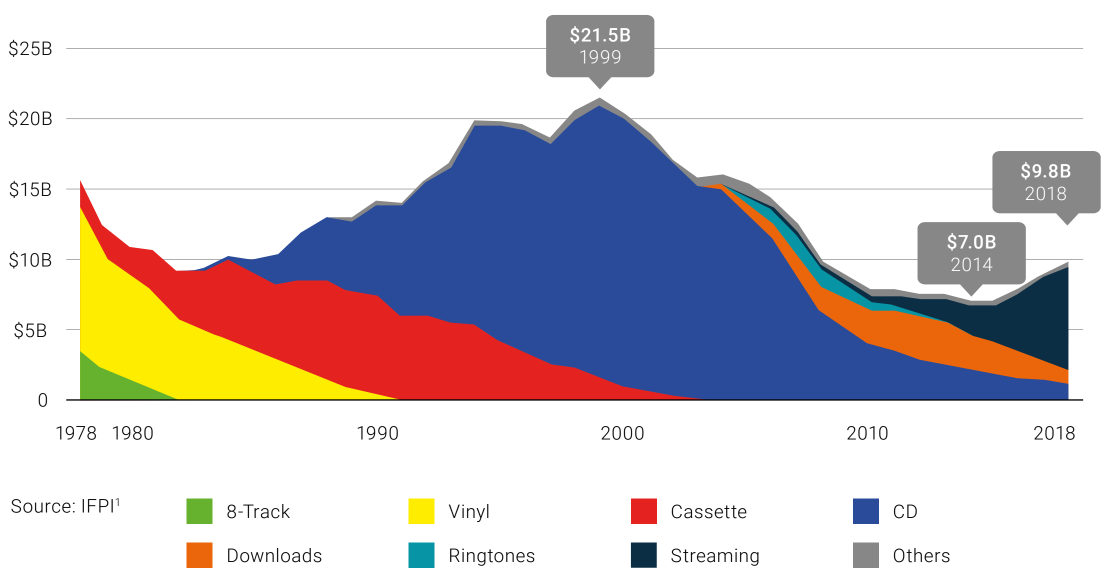
Sources: Business Insider Intelligence, Statista,and TNW (2019)

Although small, the gaming segment is growing rapidly. Monetization in this segment is primarily from in-game purchases, with many games adopting a free-to-play model, but subscription services are also becoming an increasingly important strategy.

Deep dive: music

The music industry was the effective canary in the coal mine in the media and entertainment industry, because the disruptive impact of new digital technologies and consumer behaviors was felt there first.

DIGITAL STREAMING REVENUE IS ON THE RISE



Source: IFPI[1]

The music industry has evolved from sale of physical assets (records and CDs) to the widespread adoption of subscription services like Spotify, Pandora, and Apple Music. And the industry is beginning to see growing revenues again.

Since 2015, global revenues have been increasing at a rate of 8.74% a year, with about half of the revenue now coming from subscription-based streaming.[2] Millennials and Gen Z are now spending more on music than their older generational cohorts. Spotify grew its subscriber base from 3 million in 2011 to 124 million in 2019 and is approaching profitability.

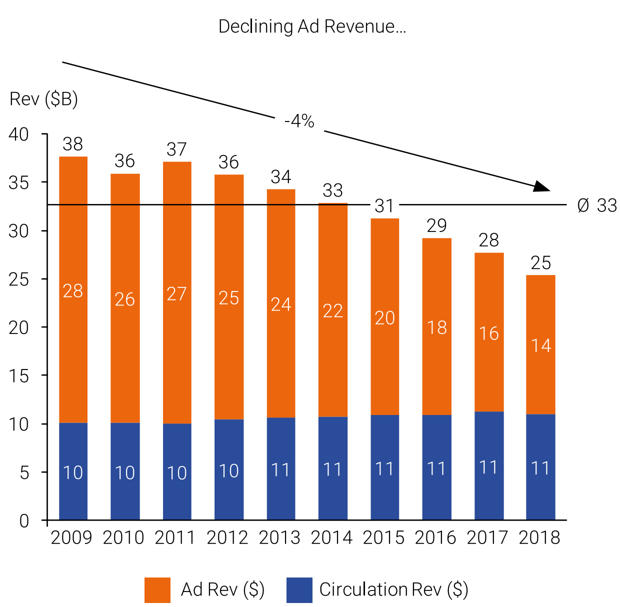
The industry has not recovered to pre-2000 levels of revenue, but the trendline is strongly positive.

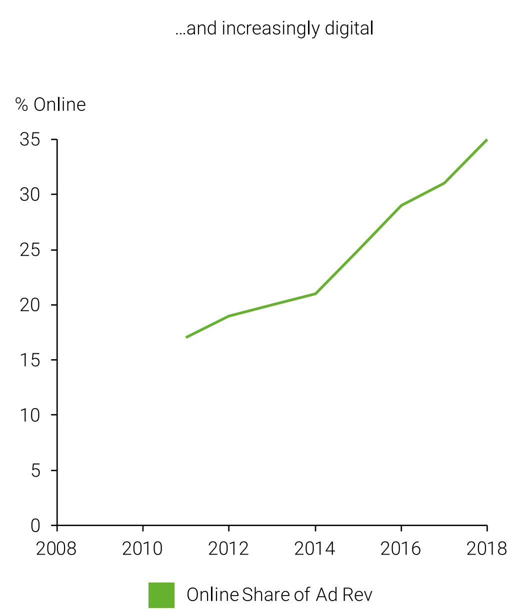
Deep dive: newspaper publishing

Disruption in the news business has been equally dramatic. Newspaper publishing long relied on a combination of subscription and advertising revenues to fund its business, with advertising representing more than 35% of the total.

The advent of the Internet, smartphones, and social media combined to drive a democratization of content creation and disintermediation of traditional news sources. When barriers to entry fell, anyone and everyone became an arbiter of the truth; and the news profession, which consumers traditionally relied on to provide that lens of trust, was increasingly characterized as slow and biased.

NEWSPAPER REVENUES HAVE FALLEN IN THE LAST DECADE AND AD REVENUE IS INCREASINGLY TRANSITIONING TO ONLINE ADS





Source: Pew Research Center: Journalism and Media

Note: Advertising and circulation revenues include both physical and digital sales.

The publishing industry faced challenges on several fronts. Free services like Craigslist decimated the classified advertising departments of newspapers, while Google and Facebook dominated the online digital advertising space.

However, emerging success stories in news publishing show the promise of new operating models. Companies like Dow Jones, the Financial Times, and the New York Times are demonstrating the importance of developing premium content for which readers are willing to pay—and they're growing their subscriber bases.

Google and Facebook still dominate the online ad game, but demonstrations of engaged subscriber bases and the control and understanding of customer data can help drive digital advertising revenues, which are rising for the industry as a whole.[3] The United Kingdom's Guardian newspaper recorded a profit in 2019 for the first time in many years—on the back of growing digital advertising revenues and increased contributions from its engaged readers.

Advertising-only models can also work for publications with sufficient viewership. The Daily Mail in the United Kingdom grew digital revenues by 15% in 2019 not through subscriptions but through digital advertising on the backs of stories about celebrities, scandals, and breaking news. And today, it's one of the world's most-read websites.

A FOCUS ON CONSUMERS AND QUALITY CONTENT

Along with the rest of the newspaper industry, the New York Times has struggled with declining advertising revenues and falling physical newspaper sales. The advent of the Internet, followed closely by the growth of Google and Facebook as primary means of news discovery, fundamentally undercut the company's traditional business model, as consumers began expecting to access content for free.

Even though overall advertising revenue continues to fall, the company has responded to its challenges by maintaining its journalistic quality, by engaging with audiences in expanded types of content—including audio, video, and data visualizations—and by demanding that consumers pay to access it.

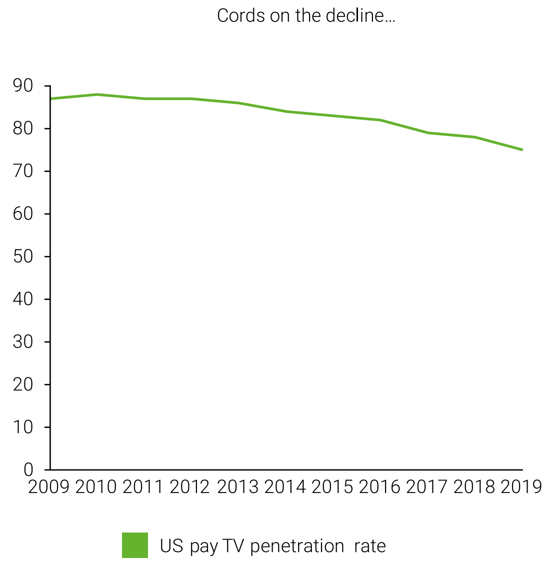
Maintaining value alignment with readers has helped drive subscriptions higher. In what has been termed the Trump bump, the New York Times has added about 200,000 paid subscribers per quarter since Donald Trump's election in 2016. The New York Times now has 4.7 million paid digital subscribers and hopes to have 10 million by 2025. Its unique cooking and crossword content also requires additional subscriptions, thereby adding incremental revenues along with services like Wirecutter, which provides product review and recommendations.

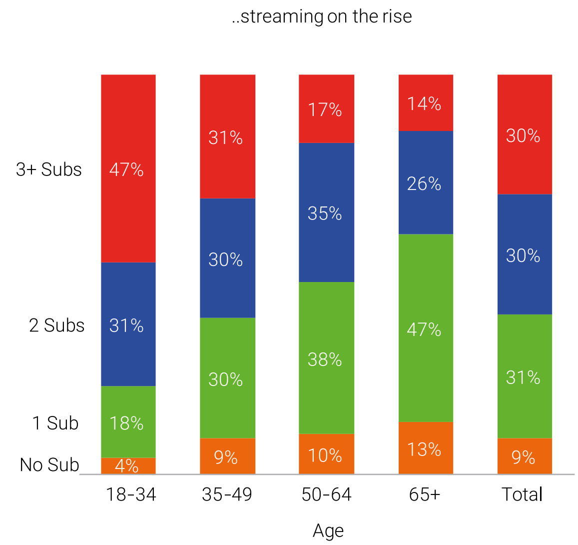
Deep dive: movies and television

The story for movies and television is certainly rosier than for either news publishing or music. Global box office revenues have grown 4% year over year for the past 10 years.[4] In 2017, a record 487 original television shows were produced, reaching a global audience of over 1 billion and generating $265 billion in revenues.[5] But the ways that consumers are engaging with all this content is changing fundamentally, as are the types of content they're demanding.

Cord cutting is now a well-documented phenomenon that has only accelerated in recent years and has impacted cable and satellite providers as well as television studios.

CORD CUTTING IS ACCELERATING AS YOUNGER GENERATIONS ARE WILLING TO PAY FOR MULTIPLE SUBSCRIPTIONS





Sources: Leichtman Research Group, Axios

As consumers have shifted to individualized suites of entertainment choices, viewership has become more fragmented, and streaming services have dramatically increased the amount of content available. Reliant on growth in subscription revenues, program creation for services like Netflix and Hulu has focused on engaging with otherwise untapped audiences. And success is dependent on how many subscriptions a show helps generate or maintain—not on the size of the audience. That's meant more niche and idiosyncratic programs.

Individualized entertainment choices are also increasingly driving the creation of content that is more easily watchable on mobile devices. As the CEO of AT&T, which owns WarnerMedia and HBO, said of the company's marquis show: "Think about things like Game of Thrones. In a mobile environment, a 60-minute episode might not be the best experience. Maybe you want a 20-minute episode."

With the exception of sporting events like the Olympics or the FIFA World Cup, gone are the days when one television event or series brings a large viewing audience together. HBO set a record for streaming services by garnering 19.6 million viewers for its Game of Thrones finale in 2019. Compare that to the 105.9 million people (primarily in the United States) who watched the last episode of M*A*S*H in 1983. Game of Thrones doesn't even make it into the top 100 programs in historical terms—despite the global reach that digital media provide.

As a result of audience fragmentation and the growth in viewership of advertising-free services like Netflix and HBO, advertisers are increasingly investing in digital media and away from traditional broadcasters as ratings decline. Television advertising, although not disappearing, is therefore an area of flat to slowly diminishing revenues for entertainment companies. Furthermore, as advertising moves to programmatic (automated), TV remains a laggard, with programmatic accounting for only 3% of the US linear advertising market compared to over 80% of digital display and video advertising.

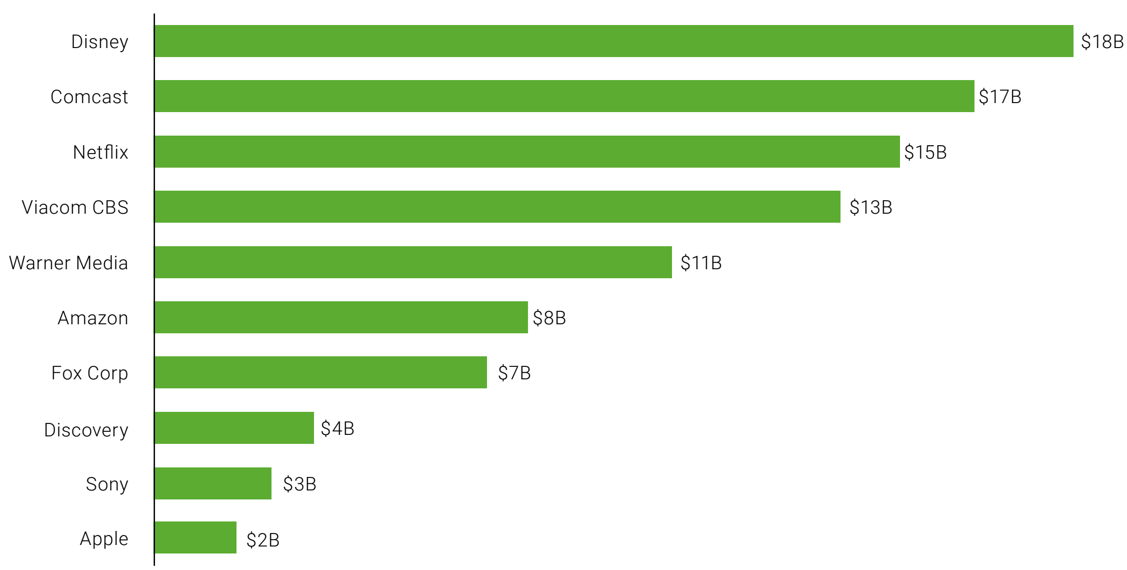
For movie studios, box office revenues continue to climb but largely on the backs of international distribution and inflation in ticket prices. Major motion picture releases are designed to minimize risk through a reliance on franchises or sequels and to maximize international viewership. In 2018, 7 of the top 10 grossing films globally were either franchise films, sequels, or remakes.

Much of the market for smaller, independent films has shifted to streaming services, which blur the lines between television and movies. In 2018, Netflix spent an estimated $12 billion on the creation of 700 original shows, which grew to $15 billion for original shows in 2019.[6] In the process, it expanded its subscriber base to 167 million worldwide by the end of last year.

To compete in this new world, media companies have accelerated the pace of consolidation in the industry. That consolidation, in part, has happened by means of vertical models that combine distribution channels with production. Others have focused on collections of brands and production capabilities.

That consolidation represents a new wave of competition, a so-called second wave of disruption, that is about to commence in the form of a battle over streaming video on demand.

MORE COMPANIES ARE INVESTING INTO ENTERTAINMENT CONTENT TO ENSURE THEY REMAIN COMPETITIVE



Note: Includes spending on sports. Estimates rounded to the nearest $ billion.

Source: FT (https://www.ft.com/content/03b86b7a-014e-11ea-be59-e49b2a136b8d)

This second wave of disruption promises a more-fragmented reality for consumers, for whom an already-complicated entertainment environment is becoming even more complex and burdensome. In a multiplatform world, consumers may end up paying for bundles of shows and movies they will never watch. And questions about the optimal number of streaming services that can reasonably compete in such an environment remain to be answered.

INVESTING IN BRANDS AND DISTRIBUTION

In 2016, just days into his job as CEO of Viacom, Bob Bakish began holding meetings with senior executives to develop a strategic plan for turning around the media giant. The company was struggling with the disruptive effects caused by shifting consumer behavior and the disintermediation of its primary distribution channel: traditional cable television. Revenues were flat across its core businesses. And combined with financial concerns about the amount of leverage the company was carrying, the challenges were significant.

Prior to its merger with CBS in 2019, Viacom had implemented a successful transformation program and seemed positioned for renewed growth. The company was investing in its core brands and made substantial changes to both its management and its financial and creative strategies. It also diversified outside its core businesses by expanding its content for digital platforms and experiential businesses. And its US advertising revenues grew for the first time in five years.

The newly recombined ViacomCBS will be first in every US audience demographic—a powerful value proposition to both distributors and advertisers—as they separately build their direct-to-consumer streaming capabilities.

Response from industry: implications

EMBRACE THE SELF-CENTRIC CONSUMER

Content creation and delivery must respond to consumers' demands for personalization when it comes to how and when consumers experience media across all potential devices. The pursuit and monetization of consumers' attention is the critical task of all media and entertainment companies. As John Stankey, head of WarnerMedia said: "It's not hours a week, and it's not hours a month. We need hours a day."

Consumers are spoiled over choice, and the convergence of different types of content (music, video, news, social media, gaming, etc.) onto the same, interconnected devices means that the competition for their attention is intense. Even great product that does not get delivered how, when, and where consumers want it will not cut through the noise.

The evolution of streaming services in both the music industry and film and television is an acknowledgment of the necessity of responding to consumer demands. In 2020, every major film and television studio in the United States will offer a streaming service.

Similarly, those studios are adjusting the types of movies they market widely in theaters, in order to ensure that the movies meet a mass appeal—usually with an established fan base—and are designed to maximize international ticket sales, particularly in Asia. Studios will continue to make more niche films for the big screen, but the audience for much of that type of content is going online. In 2019, Martin Scorsese's The Irishman, financed by Netflix, had a limited run in theaters before it began streaming.

The Economist has implemented a reader-first circulation strategy that has expanded its offering of products and channels in order to give customers more choice. Both video and audio play large parts in the strategy, with the newspaper's 1 million YouTube followers beginning to drive growth by way of subscriptions. By placing the consumer at the center, The Economist has grown subscription revenues by 50% while doubling its gross margin in the past five years.[7]

Artificial intelligence will increasingly empower media companies to target demand and customize experiences around individuals. Recommendation algorithms can help maintain viewers' attention and keep them within companies' ecosystems, and data science will increasingly help inform programming choices. Netflix estimates that 80% of what its customers watch comes from AI-driven personalized recommendations.[8] And about a third of articles published by Bloomberg News use some form of automated technology.[9]

An understanding of consumer demands is critical, but not all trends are digital. Experiences represent an increasingly important demand from many consumers—because experiences are something they cannot get online. For instance, in 2017, 66 million music tour tickets were sold worldwide, marking the highest total in recent years. In the United States, revenues in the live-music industry are forecast to rise from around $9 billion in 2015 to almost $12 billion in 2021.[10]

Theme and amusement parks are experiencing similar growths in consumer demand. Global revenues in that sector outpaced worldwide GDP growth by 1.5 percentage points over the past five years. Disney has invested more in its theme parks than it did in the acquisitions of Pixar, Marvel, and LucasFilm combined. In 2018, its Walt Disney Parks and Resorts division reported operating profits of $4.5 billion—an increase of more than 100% from five years earlier.[11]

EMPHASIZE STRONG BRANDS, QUALITY CONTENT, AND SERVICE

In today's more fragmented media environment, strong brands and quality products will become even more important because they will generate trust in a sea of uncertainty. Owners of superb content that have the ability to distribute it widely will be the winners over the long haul.

Despite an unwillingness on the parts of many consumers to pay for news content, premium news organizations like Dow Jones, the Financial Times, and the New York Times are all growing their online subscriptions—partially replacing lost advertising revenue—on the strength of their product quality and their value alignment with readers. With news outlets ranking among the most politically polarizing brands,[12] value alignment will likely be a significant driver of subscriber growth going forward.

In late 2019, Disney entered into direct competition with Netflix by exerting the unparalleled strength of its brands and library of content to launch its streaming service, Disney+. Barclays Bank estimates the market value of the new business at $100 billion.[13]

A key point in the turnaround of Viacom was the company's newly realized commitment to managing its portfolio of assets less as cable television channels and more as a collection of valuable brands, including Nickelodeon, MTV, and Comedy Central.

CBS used the power of the Star Trek brand—and the brand's loyal fan base—to launch its streaming service, CBS All Access, in 2017 with Star Trek: Discovery. In 2020, the now merged ViacomCBS added an additional show, Star Trek: Picard, and has plans for an animated Star Trek series to run on its Nickelodeon network.

SUBSCRIPTIONS ARE BECOMING AN INCREASINGLY IMPORTANT AVENUE FOR REVENUES ACROSS THE INDUSTRY

To supplement revenues lost from traditional channels, many media companies are increasing their reliance on subscriptions. For instance, the music industry, which is seeing its revival, thanks to the growth of subscription-based streaming services. News publishers are increasingly relying on subscriptions to fill the hole left by absent advertising revenues, and tiered-subscription models for which consumers must pay for premium content may increasingly drive incremental revenue. Plus the battle over streaming video on demand will determine the fate of subscriptions in film and television.

By capturing consumers within a subscription ecosystem, a company can also mine personal data to increase its engagement with consumers, individualize consumers' experiences, and, potentially, generate incremental advertising revenue. Capitalizing on those trusted consumer relationships can also open new revenue lines like live entertainment and product reviews and recommendations.

For some industries and many companies, though, subscriptions are unlikely to close the gap from lost advertising revenues, physical sales, or third-party distribution. Consumer behaviors have fundamentally shifted, and new entrants have captured market share that may be difficult to recapture.

For example, despite its success in growing its online subscriptions, the New York Times, along with its competitors, continues to see declines in advertising revenues. In 2018, advertising revenues were $558 million, including both print and digital channels, which represents a fall of some 69% from ten years prior, when the company enjoyed advertising revenues of $1.8 billion. Circulation revenues during the same period grew 55%, but not enough to replace lost ad sales.[14]

LEGACY REVENUE STREAMS WILL DECREASE BUT NOT DISAPPEAR FOR MANY YEARS

Don't throw the baby out with the bath water. In other words, even though they may not pave the way for future growth, revenues from traditional distribution channels are not going away tomorrow. A diminishing but still substantial set of consumers will continue using satellite and cable television services. Likewise, television advertising will remain an important source of revenue for many companies. And sales of CDs still accounted for $1.1 billion of revenue in 2018.[15]

The cash generated from those legacy businesses can help fund investments in new technologies and distribution models. For larger companies, those revenue streams may prove to be crucial tools for competing against new, technology-enabled entrants.

Comcast, the largest cable TV provider in the United States, continues losing bundled cable-video customers, but its cable business still generates about one-half of all revenues and continues to add high-speed broadband customers. The cash from that business helped Comcast acquire European pay-TV giant Sky in 2018 for $39 billion and is helping finance the firm's investments into streaming via the company's new, Peacock service, which will launch in 2020.

COST MANAGEMENT AND OPERATIONAL EFFICIENCIES REMAIN PRIORITIES

Revenue growth, of course, remains essential, but many companies in the media and entertainment industry remain stuck in old operating models, tied to legacy cost structures and ways of working. New technologies offer major opportunities to rein in costs and align with realistic projections for future revenues.

The costs associated with the necessary digital transformation of the industry and competition with new entrants are escalating. To launch its streaming service, Disney invested $2.6 billion to acquire new technologies and reshuffle management and operating lines in order to create a new direct-to-consumer division. The company ended its distribution deal with Netflix, forgoing $150 million in annual income. Its $71-billion acquisition of 21st Century Fox was also directly related to enhancing the firm's production capabilities and content library to prepare for streaming. All of that comes before spending on new content for this platform, which is estimated at $1 billion for 2020.[16]

Non-content-related expenses are also growing at many firms. The New York Times has grown revenues, on average, 6.2% per year since 2016, but SG&A expenses have risen over the same period by 8% per year.

In an environment of increased competition and higher and higher expenses, media companies must be disciplined and must find ways to identify optimizations that will help drive their transformations. Many media companies have overly complex and duplicative systems and organizational models–many of them legacies of acquisitions or historical idiosyncrasies. The simplification of organizational structures can help companies take advantage of cross-functional synergies. And new technologies such AI-enabled data analytics can help identify opportunities for organizational efficiency.

The media and entertainment industry has been fundamentally reshaped by how and where people consume content. Those trends are unavoidable, but the pace of change may have actually slowed, given the rate of adoption of new technologies to date. What remains true, as media companies expand subscription models across the industry, is that consumers are perhaps even more committed than ever to pay for quality content that aligns with their values and lifestyles.

Success will, therefore, build on:

– What to offer: Empowering the self-centric consumer and building top-quality service and content

– How to monetize: Charging the consumers for content through either subscription or transactions

– How to operate: Building operational excellence for both incumbents and new entrants

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THE CONNECTIVITY TRAP

Disruption in the telecommunications industry

In brief

DISRUPTION THEMES

– A saturated consumer market and intense competition are keeping prices low.

– Capital expenditures are accelerating as the next generation of technologies—particularly 5G—begins to get rolled out, requiring an additional $1.3 trillion of capex across the industry.

The environment is complicated by:

– Ongoing competition from a multiplication of sources

– Continued convergence of fixed and mobile technologies

– Regulatory constraints on consolidations and cooperation

IMPLICATIONS

– Radical simplification of legacy service propositions, systems, and operating models is a prerequisite to any transformation enabling telcos to be more competitive.

– A digitized customer journey and extension into the back-office functions can finally achieve integrated, data-based operations.

– Operators should seek to optimize new technology rollouts (like 5G) with a focus on monetizable propositions in the B2B sector and increased levels of collaboration or sharing.

– New revenue streams from 5G and elsewhere will be tough, but a transformed digitally enabled operator—with a healthy core—will be better placed to pursue adjacent business opportunities.

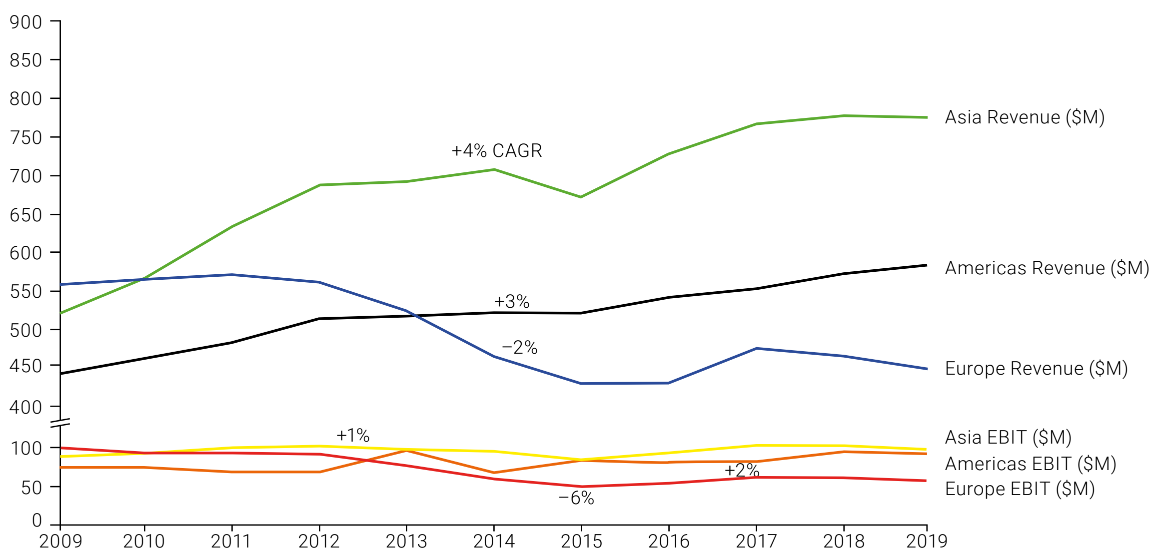
The connectivity trap

The connective infrastructure that is keeping consumers online, informed, and empowered is the primary accelerant of disruption across the industries we studied last year. However, the main enabler of that connectivity—the telecommunications industry—has been unable to fully take advantage of the disruption.

The networks that telecommunications companies provide have facilitated the growth of technology giants like Facebook, Google, and Amazon, whose networks are helping drive the complete reorientation of industries like retail and media. But telecommunications operators have not been able to extract the revenues from their own networks that others—especially technology companies—have.

That frustration has been caused fundamentally by a combination of strong competition, rising costs, and regulatory controls in much of the world. Consumers increasingly view telcos as providing commoditized services that compete primarily on price. And as a result, revenues and expenses have decoupled, negatively affecting profitability across the industry.

TELECOMMUNICATION INDUSTRY REVENUE GROWTH AND EBIT



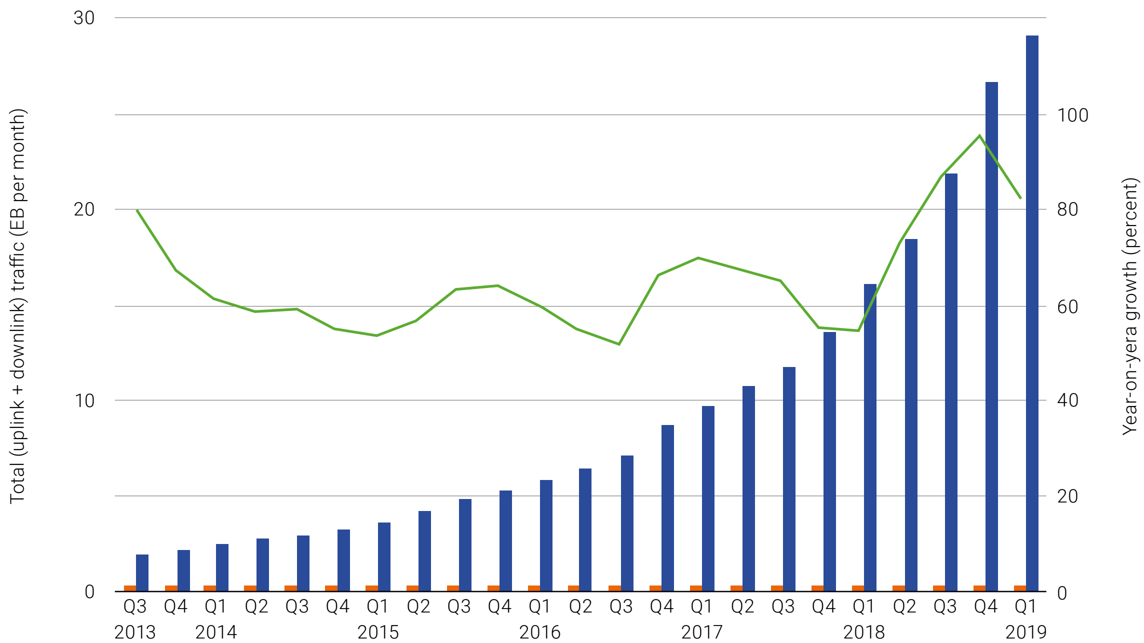
Demand is going up...

It is estimated that more than 5 billion people around the world have mobile phones and that more than half of those are smartphones, thereby keeping all the people who have them constantly connected. The average smartphone user spends almost three hours a day on the device, the processing power of which has increased 10 times in the past five years.[1]

In 2019, Facebook had 2.41 billion active global users.[2] More than 500 hours of video were being uploaded to YouTube every minute.[3] Each of Spotify's 232 million subscribers were streaming, on average, 25 hours of music per month.[4] Even as the number of mobile users stabilizes across most markets, demand on infrastructure does not because people are spending more and more time online, and they expect to use ever-richer services like video while they're on the move.

As a result, network traffic is growing at 30 to 40% per year. A majority—about 82%—of data usage continues to be through fixed broadband networks, but increasingly, consumers are using their mobile devices and networks to access all of the forms of content now available to them—whether streaming music or video, social media, online news, or digital commerce, to name a few.[5]

GLOBAL MOBILE TRAFFIC AND YEAR-ON-YEAR GROWTH (EXABYTE PER MONTH)



Source: Erricson traffic measurments (Q1 2019)
Note: Traffic does not include DVB-H Wi-Fi or Mobile WiMAX. VaIP is included in data traffic.

- Circuit-switched voice
- Data
- Year-on-year growth

...as are costs

Massive investments in infrastructure are required to build networks with the flexibility to accommodate the growth in traffic. The investments are in the areas of spectrum licenses, fiber installation, and the newest generation of wireless network technologies, 5G. From 2019 through 2025, mobile operators around the world will spend about $1.3 trillion in capex, with more than three-quarters of that related to 5G, according to estimates by GSMA Intelligence.[6]

Wireless technology 5G promises faster speeds, larger data volumes, and greater reliability compared with 4G and may open up new applications for industrial or business Internet of Things like smart factories or mobile health. Indeed, 5G will likely have a bigger impact on businesses than on individual consumers, who are unlikely to perceive an obvious difference in performance with this new technology. Given strong competition for telecommunications services in much of the world, however, operators find it necessary to make those investments if they are to remain competitive and maintain market share.

No one wants to market themselves as offering the previous generation of technology.

Intense competition and regulation

Operators have generally been unable to pass the costs of their investments on to consumers because of the competitive environment in most markets. In Europe, regulators in Brussels have intervened to level the playing field among telecommunications companies and promote competition. Through a combination of market access and antitrust activity, European consumers enjoy a range of inexpensive service choices. Today, for example, users in France pay, on average, 27% less for telecommunications services than those in America do.[7]

Even in the United States, competition between the four primary operators has limited their ability to increase consumer prices. The US Bureau of Labor Statistics Consumer Price Index for wireless services fell almost 28% in the 10 years from 2009 to 2019.[8]

Companies in this industry are accustomed to competition not only among themselves—as mobile, fixed, and broadband services have converged—but also from new entrants that are unencumbered by legacy cost structures and traditional business models. Mobile virtual network operators (MVNOs) are gaining increasing market share in Europe—which represents more than a third of the market—in such countries as Germany and the Netherlands. In the world's largest market, China, regulators greenlighted MVNOs for the first time in 2019. In the United States, MVNOs represent less than 1% of subscribers, suggesting there is potential for substantially increased competition if regulators pave the way.

In addition, government actions are limiting sourcing options for key 5G network components. The US actions limiting Huawei's participation in 5G infrastructure will increase capex by limiting competition—from a lower-cost provider—in the network infrastructure market.

Soft-SIM technologies may replace traditional SIM cards with software applications that would perform all of the functions of a SIM card but enable consumers to select their network on demand. Consumers could then choose the best or cheapest available networks—without being locked into one provider. When soft-SIM technologies get released, mobile operators may resist for a time, but it's unlikely that they can do so for long. Inevitably, soft-SIM technologies will increase levels of competition and exert price pressure in an already challenging environment for mobile operators.

And some of the largest drivers of network traffic are cutting telcos out altogether. Amazon, Facebook, and Google have their own data centers, which are connected by their own fiber-optic infrastructures. Private networks account for about 60% of transatlantic data traffic, according to research firm TeleGeography. As WIRED magazine put it, "Put it all together and you can see a day when you're watching content that Google produced disseminated via infrastructure that Google owns on a phone that Google made using wireless service Google brokered."[9]

IS CONTENT KING (OR JUST ANOTHER WAY TO SINK CASH)?

As consumers have increasingly turned to their range of electronic devices to consume the wealth of content now available to them, telecommunication and broadband cable companies have struggled to find ways of capitalizing on their central role in the delivery of that content. As the value of Facebook, Amazon, Apple, Netflix, and Google has soared and as traditional media companies have begun offering their content direct to consumers via streaming services, the divergence between content and distribution has been placed in stark relief.

Both Comcast—with its acquisition of NBCUniversal and, subsequently, Sky in Europe—and AT&T, which acquired Time Warner, are making the calculated gamble that they can succeed by marrying content and distribution.

In justifying its acquisition of Time Warner in the face of activist shareholders in 2019, AT&T lauded the synergies the company believes can be achieved through combining businesses. The company's film and TV studios can produce the content. Its cable network—comprising TBS, CNN, and the Cartoon Network—can distribute it. Its satellite business, DIRECTV, can carry it into homes. And it can reach AT&T's wireless customers anywhere on their mobile devices.

The data AT&T collects through all of these points of distribution provides increased opportunities for targeted-advertising revenues. Bundled services, too, can help improve customer retention rates and reduce churn.

On the flip side, AT&T is entering an increasingly competitive and fragmented media marketplace. Rivals with deep pockets, like Amazon and Apple, are ramping up their streaming offerings. Some competitors, like Disney, combine their cash with extensive libraries, premium brands, and long and accomplished histories in running successful media companies.

For 2019, AT&T announced it had taken a $1.2-billion charge related to preparing its new HBO Max streaming service. At the same time, its traditional cable video business lost 4 million subscribers over the course of the year. However, the company did add 229,000 new wireless customers in the fourth quarter.[10]

Whether the integrated approach will be successful remains to be seen, but over the short to medium term, competitive pressures in pay TV are likely to mount.

Industry consolidation and regulatory control

A solution for the management of those escalating expenses and for expansions of service might be in the forms of mergers or partnerships between operators, and indeed, some companies have been pursuing that path, as evidenced by the announced merger of T-Mobile and Sprint in the United States. However, regulators have limited such activity in order to protect consumers from higher prices and less choice. Indeed, in the case of T-Mobile and Sprint, the US Justice Department is requiring Sprint to sell its prepaid business and spectrum to satellite provider DISH and provide DISH with access to T-Mobile's wireless network in order to preserve a fourth competitor in the US market.

In the United Kingdom, the sale of Telefónica's O2 to Hutchison was blocked in 2015 because of concerns that competition at the physical infrastructure level would become too reduced. That same year, the European Commission also blocked the merger of TeliaSonera and Telenor in Denmark, which would have reduced the number of mobile operators in that country from four to three.

Response from industry

Telecommunications operators around the world are at a fork in the road: On one hand, demand for their services will likely only increase, as will the costs associated with upgrading and maintaining services to meet that demand. But on the other hand, the competition is intense and will also likely only increase, thereby limiting the companies' pricing power.

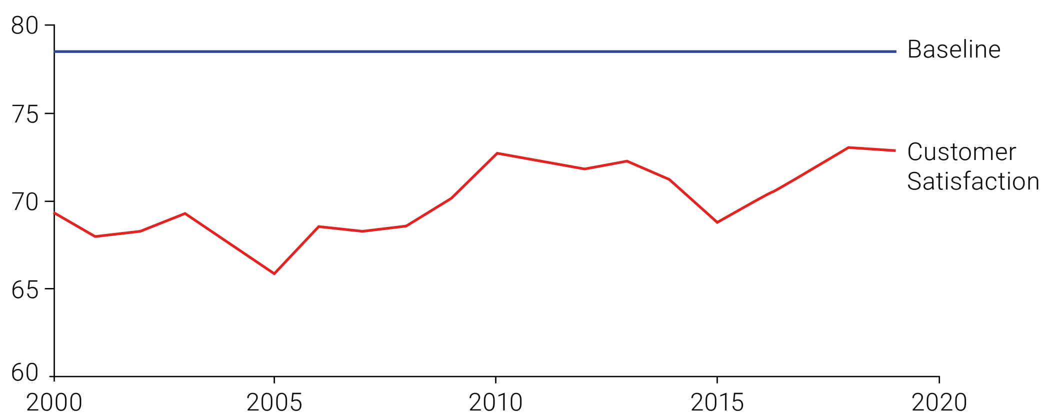
To compete in such an environment, operators must simplify legacy products and systems, digitize customer interaction points and processes, and seek to mitigate the vast costs of infrastructure with further cooperation with competitors. Increased revenues will also be a focus for many operators, but we believe the potential for most companies to do so in the current environment is limited.

Telecommunications companies that do not take those steps to realign cost structures and business models face a bleak future.

RADICAL SIMPLIFICATION

Through the years, telecom operators have accumulated unnecessary layers of complexity across their organizations and their product and service portfolios. In response to consumer demands, competitors' moves, and new technologies, telcos have been innovating—probably overinnovating—on the portfolio front more than ever. That innovation has led to a largely underutilized and commercially irrelevant set of service components and price plans that offer little value to customers. On the other hand, the labyrinth of complex portfolio elements that has resulted drives inefficiencies, delays, and dissatisfaction across the organization and among consumers.[11]

THE AMERICAN CUSTOMER SATISFACTION INDEX RATES THE US TELECOM INDUSTRY AS THE POOREST-RATED INDUSTRY



Simplification is essential. The reduction of technology costs and manual processes with fewer legacy systems all begins with first simplifying the offering to the customer—not just tariffs but also additional perks and promotions. A simple yet competitive portfolio would offer a limited set of transparent pricing plans built on top of fewer modular service components. Although that may sound straightforward, the trick to unlocking real efficiencies lies in changing how a business thinks about customer value propositions.

Reducing the complexity of a company's portfolio also leads to a reduction, or redistribution, of investments in the areas of marketing, technology, and training. New technology takes less time to bring to market, and operating expenses would be reduced. A simplified structure also frees management to focus on the core business. With fewer moving pieces, management can focus on what really matters.

Customers like it simple. Simplification leads to fewer customer service calls about billing complaints or for queries about underlying services and, ultimately, to happier and more-satisfied customers.

DIGITAL TRANSFORMATION

Many telcos continue their outmoded ways of interacting with consumers and their legacy infrastructures—including excess brick-and-mortar retail locations and staff—that lead to higher costs and ineffective outcomes. Digital channels offer ways to reduce customer management costs while improving customer engagement and experience.

Operators that have made coherent, customer-centric pushes to digitize customer interactions typically see a 30 to 35% reduction in customer interaction costs across all touch points. However, few operators are taking full advantage of such savings by taking a holistic view of their customers.

Far too often, telcos focus on developing digital capabilities—including apps and the website—in silos. Online channels get developed with more bells and whistles than needed, but customer uptake remains low. The right set of Web and app features is necessary but drives only about 40% of desired savings.

The key to success in digital transformation is its combination with radical simplification. Eliminating the complications from multiple tariff combinations, features, network types, and overvalued premium services paves the way for successful digitization.

By focusing on customers' usage, interaction histories, and preferences, companies can build a foundation for an enhanced customer experience. Such focus also ensures coherent and customized customer interaction across all channels. Companies should identify areas that are valued by customers and for which they are willing to pay a premium to make them profitable service additions on top of the basic core.

In 2020, it is no longer sufficient to digitize back-office processes. The extent of disruption in this industry necessitates starting at the front, applying a customer-centric approach, and defining the value for the customer. Anything that is not delivering on that value must be eliminated. This means adjusting channel-incentive structures, training, marketing, promotion, and pricing, followed by a simplification of customer service, billing, and finance. Network cleanup should be combined with the rollout of 5G or fiber.

Successful digital transformation also increases the number of opportunities to apply artificial-intelligence-enabled data analytics with a view to improve, or to create a completely new, customer experience.

OPTIMIZE NETWORK ROLLOUT AND BRAND PERCEPTION

Given the massive investments necessary to fully roll out 5G technologies and given the marginal improvement in user experience that can be gained, mobile operators should be asking themselves whether they can spread those capital expenditures over a longer time horizon.

Infrastructure cooperation within the industry offers another avenue to reduce capital expenditures. To do that, though, requires changing established attitudes toward asset ownership and management. It also needs agreement from regulators. By focusing on their true value-add for customers, telecom operators can move away from an operating model wherein they own and manage all infrastructure end to end.

Examples of that are the sharing of passive infrastructure such as towers and more-advanced sharing in rural areas where collaboration brings a superior service experience to consumers that strict competition rules would not allow. Unlike in the United States, active network-sharing agreements are commonplace throughout Europe, but 5G introduces a new wave of updates to existing collaboration models and introduces new ones (for example, the rural sharing model in the United Kingdom).

Operators should also look at how they can monetize their assets such as towers, which would generate significant cash injections to help lower the burden of new investment. Alternatively, coinvesting on fiber buildout with public bodies or private investors, rather than assuming the traditional 100% owner-operator model, could also provide tangible benefits.

Many companies perceive that an aggressive 5G rollout can strengthen their brand, and in a crowded marketplace, this becomes more important than ever. What they forget is that the core is the provision of connectivity services, not network deployment and management. In Mexico, for example, network sharing between AT&T and Telefónica allowed the two competitors to focus on high-value-added (and higher-margin) activities. The key is understanding that being a top connectivity provider does not necessitate building and maintaining proprietary networks. You can make the best omelet without having to lay the eggs.

NEW TELECOMMUNICATION REVENUE STREAMS BUT WITH LIMITED UPSIDE

Some telecom operators are planning differential pricing for 5G speed and reliability. Consumers who want to be in the fast lane will have to pay an extra monthly charge. Verizon is currently charging an additional $10 a month for 5G plans in the admittedly still-limited markets it has rolled out, and AT&T has announced its intention to introduce a tiered-pricing plan as well. These markups will soon become part of the standard package as prices converge and, ultimately, decline.

The ongoing convergence between wireless and broadband will also likely intensify, with potential revenue opportunities for telecom operators. As speeds and data capacity increase with 5G, the differences between fiber, satellite, and wireless begin to disappear. In the United States, both Verizon and AT&T are already in the broadband business, but 5G may open the door for broader competition.

In the business-to-business space, corporations may be willing to pay premium pricing for superior performance. In addition, many telcos cite new applications for wireless technologies—particularly with regard to the exponential growth in the Internet of Things—as having to drive further demand and new potential revenue streams. However, the potential upside the new applications can have on telco earnings is likely modest and unlikely to provide positive returns on investment for a nationwide rollout.

Indeed, our belief is that even the cumulative effect of all of the potential new revenue opportunities will be insufficient to fundamentally reshape most telecommunications operators' profitability. And given the substantial competition across most markets, together with a similar history with 4G, their ability to hold the line on pricing is likely limited. In the United States, T-Mobile, which admittedly lags in its implementation of 5G, has announced it will not introduce a tiered pricing structure. In Europe, which faces stiffer competition, the outlook is even less optimistic, with competitive operators already removing the premium.

Telecommunications operators, which play a critical role in providing connectivity services for the digital economy, are at a crossroads. Costs are going up as paths to higher revenues—either through traditional business lines or by means of diversification into content—are decidedly unclear. The 5G rollout is essential, but the financial benefits of a faster rollout may be limited. If competitors (and regulators) are not aligned on this point, it may trigger another race to the bottom, which may jeopardize sustainable rollouts across various nations.

Radically simplifying operating models and investing smartly in new digital technologies to transform their core businesses and get closer to customers are essential next steps for companies across the industry. On this basis, profitability of their core business can be increased, and incremental new businesses and revenue streams can be built.

By getting themselves financially and operationally healthy, operators may once again become the agile powerhouses they once were.

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For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges–circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring, and risk mitigation.

These are the moments when everything is on the line: a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference; it's how we do it.

Tackling situations when time is of the essence is part of our DNA, so we take an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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