EXECUTIVE PERSPECTIVES ON TOP RISKS

Threats to supply chain, workforce and customer demand cited among top 2022 risks by CPS industry leaders

Whether it's disruptive technologies, supply chain bottlenecks, rising costs, labor shortages, data breaches, or restrictive government policies, the Consumer Products and Services (CPS) industry group faces numerous market-changing risks in 2022 and beyond. These risk issues and more are identified in Protiviti's latest annual Top Risks Survey, which polled C-suite executives around the globe from different industries on their perceptions of risks to their business in the coming year and a decade from now.

Heightened regulatory environment

In 2020, government restrictions on travel, congregating for social events and opening businesses had a devastating impact on organizations of all types and sizes. Heading into the new year, many CPS organizations (including retailers and consumer packaged goods companies) are weary of governments continuing to impose tighter restrictions on the movement of goods and people, especially if there is another breakout or should the virus become an endemic problem, which by all accounts it appears it probably will. This is the foremost risk issue identified by respondents in retail and the broader CPS industry group.

The consumer packaged goods industry also views pandemic public health policies as a major threat to their business, with survey respondents ranking it third on their top-risk list. In September, the Consumer Brands Association, which represents consumer packaged goods companies, expressed concern over conflicts between federal government guidance on vaccine requirements and certain state and local rules.[1]

[1] https://consumerbrandsassociation.org/wp-content/uploads/2021/09/Letter-to-President-Biden-on-Vaccination-Requirements-Questions-9.13.21-1.pdf

It sought clarification on requirements for documenting proof of vaccination, addressing claims of natural immunity, falsified test results, and resolving collective bargaining agreements.

For an industry that isn't accustomed to being heavily regulated, the post-pandemic period has introduced an uncomfortable new era of heightened regulation for CPS organizations. As an example, the Biden administration has stepped up efforts on price gouging and anticompetitive practices as part of its plan to address supply chain issues that are driving prices up for consumers. The administration's data privacy crackdown, enforcement of antitrust laws and investigations of so-called anticompetitive mergers are all part of an intensifying regulatory landscape that is impacting all CPS organizations.[2] This heightened regulatory environment requires companies to pay closer attention to government policies and strengthen their compliance programs to flag potential problems before they materialize into bigger issues.

[2] www.protiviti.com/US-en/insights/white-papers-finding-equilibrium-era-heightened-regulation.

Supply chain, inflation and workforce-related challenges

The global supply chain has been in crisis for several months, but with the holiday season in full swing, retailers and consumer products companies across the world are scrambling to stock up on items that, for various reasons, are stuck on factory floors and on container ships. In the 2022 survey, consumer packaged goods respondents ranked the supply chain crisis their number one risk issue, above even market conditions related to the pandemic and pandemic-related government policies.

Regarding the workforce, Amazon recently noted that the labor shortage on top of inflation added $2 billion of operating costs in the third quarter, particularly in August and September. CFO Brian Olsavsky projects this cost will likely be close to $4 billion in the fourth quarter. In another example of the rising cost of labor, Costco increased its minimum wage to $17 an hour in August, the second time it had done so in the last eight months.[3] If the labor issue worsens, CPS organizations fear that it would restrict growth opportunities or impact their margins in 2022 and beyond.

Like all other consumer businesses today, inflation is weighing very heavily on the minds of CPS industry leaders. This issue ranks in the top 10 for all the various sectors in the CPS industry groups. While the Federal Reserve insists that current inflationary pressures are "transitory," some economists disagree.17 Regardless, CPS companies should spend more time and effort building their pricing strategy and understanding their outsourcing and concentration risks to develop effective mitigation strategies against supply chain challenges. Also, this is a good time to seriously consider using strategic sourcing, an information-based process for developing a superior procurement ecosystem.[4]

Pandemic's impact on market and economic conditions

The impact of market conditions due to COVID-19 and emerging variants on customer demand is another lingering concern identified by CPS respondents in the survey. Fear that the pandemic could continue to upend consumerism in 2022 and beyond doesn't come as a surprise. Since the beginning of 2020, while some retail and consumer packaged goods sectors experienced record revenue growth (like pharmacies, grocery stores, household products, and food and beverage providers), many brick-and-mortar retailers (e.g., apparel and department stores), especially those without a strong online and digital presence, have struggled to keep their businesses afloat.

In addition to the pandemic, the ability of companies' business models to adapt to emerging social change is cited as a top risk issue. This concern underscores the very clear message that business leaders have come to recognize in recent years and throughout the pandemic: Companies that fail to address environmental, social and governance (ESG) issues or embed ESG principles into their DNA could incur significant economic costs and brand erosion as well as jeopardize their ability to earn long-term, sustainable profits going forward.

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[3] www.businessinsider.com/costco-raising-wages-to-17-an-hour-2021-10.
[4] www.federalreserve.gov/newsevents/pressreleases/monetary20211103a.htm.

Digital disruption

To succeed in an increasingly omnichannel world, CPS companies (including those selling direct to consumers) are adopting technologies to improve internal processes, engage with customers more fully, and enhance overall customer experience. As an example, brick-and-mortar footwear retailer Payless opened its first concept store in March 2021, providing an immersive, omnichannel experience with features like interactive touch screens and augmented reality-driven foot measurement charts.[5]

While companies are eager to adopt these technologies (e.g., artificial intelligence, automation in all of its forms, natural language processing, visual recognition software, virtual reality simulations) they recognize that to do so may require new skills that either are in short supply in the market for talent or may require significant efforts to upskill and reskill existing employees. The survey shows this to be the fourth top risk issue for the retail industry, and among the top 10 risk issues identified by consumer packaged goods respondents overall.

Closely related to this issue is another concern around legacy IT infrastructure and lack of digital expertise in the workforce (including in the C-suite and boardroom), which many CPS respondents fear may result in failure to meet performance expectations related to quality, cost, time to market and innovation as well as competitors, especially rivals that are either “born digital” or investing more heavily in technology. The inability to adjust to changing customer preferences and needs can impair competitiveness.

For CPS organizations caught in this age of digital disruption, it is important that their leaders understand their brand purpose and invest in the technologies that enable, align to and help project that purpose. CPS organizations that do not anchor to brand purpose[6] run the risk of spending millions of dollars on technologies that do not align to what customers care about, and may hurt their ability to sustain customer loyalty and retention.[7]

Hospitality, leisure and travel risks

Survey respondents in the hospitality, leisure and travel industry identified the impact of the pandemic and emerging variants on customer demand for their products as their number one top risk issue in 2022, followed by government policies and anticipated increases in labor costs.

No doubt a potential new outbreak this winter or next spring would have a chilling effect on travel plans, particularly business travel, which is slowly picking up. Also, additional government mandates on crowd limits, vaccinations and other public health practices could worsen the already dire financial situation of restaurants, cruise lines, nightclubs and other leisure establishments.

[5] https://blog.protiviti.com/2020/09/10/beyond-supply-chain-stopgaps-how-strategic-sourcing-can-drive-resilience-in-todays-market/.
[6] https://blog.protiviti.com/2021/08/12/amplify-customer-experience-to-propel-next-level-growth/.
[7] Learn more about how your organization can transform itself using automation and technology in Protiviti’s *Guide to Technology Modernization and Transformation*: www.protiviti.com/US-en/insights/report-guide-technology-modernization-transformation.

Even before the pandemic, labor costs in the hospitality sector were rising, with millions of jobs unfilled. Conditions have since worsened, with hotels struggling to staff cleaners and front desk workers, and restaurants cutting operating hours (many are open only five days a week) because they can't find enough waiters or cooks.

One piece of good news for many large operators in the hospitality, leisure and travel industry is that their business model is less susceptible to the current inflationary pressures. The pricing model for hotels, for example, allows room rates to be adjusted nightly, depending on demand and other criteria.

The emerging social change is both a source of risk and a growth opportunity. Increasingly, the sector's largest organizations are prioritizing supplier diversity, employee diversity, equity and inclusion, as well as sustainability issues (e.g., reducing carbon footprint and launching green initiatives). Hospitality industry leaders recognize the need to adapt to the changing expectations of their customer base, but they also know, as the survey confirms, that they could find themselves at a disadvantage if they fail to respond.

Airlines

Pandemic-driven travel restrictions have had a devastating impact on airlines, so it is no surprise that restrictive government policies sit above all the 2022 risk issues for airline respondents in this survey. Should there be another outbreak of COVID-19 or its variants, the severity of impact on flying customers, particularly business travellers, and on the workforce, especially pilots, flight attendants and mechanics, cannot be overstated.

In recent months, airlines in the United States have been working on coming into compliance with the Biden administration's vaccination and regular testing mandate for companies with more than 100 employees. Additionally, since many are government contractors, they must meet the administration's vaccination requirements, without the testing option, requiring close attention to compliance. Reports of flight disruptions due to workers calling in sick or refusing to vaccinate have been on the rise.

In the survey, airline respondents identified their ability to access sufficient capital or liquidity as the fourth top risk issue in 2022. The airline industry had hoped to see an uptick in revenue during the summer until the Delta variant sent COVID-19 cases soaring again. Since many airlines operate on low margins, flying half-loaded planes during the summer created a significant cost burden. Based on that experience, the industry is taking a more conservative capital approach heading into 2022. For example, some airlines are financing new aircraft purchases, rather than outright acquisition, to conserve cash and free up liquidity.

Also, airline respondents listed difficulty in identifying and implementing growth opportunities through acquisitions, joint ventures and other partnership activities as a top risk in 2022. This is expected given the industry's capital constraints and need to take a conservative approach during this unstable environment.

The survey confirms that sustainability is a front-and-center issue for airlines. They are being driven to act by their corporate customers, who are asking them to declare their sustainability practices so customers can gauge whether they align with their own sustainability goals. As such, many of the larger airlines have committed to reduce carbon emissions intensity and cabin waste, regularly use sustainable fuel sources, and maintain carbon-neutral growth, among other sustainability goals.

"Today's business challenges, which include the biggest surge in U.S. inflation in 30 years, supply chain bottlenecks, stiff competition and digital disruption, require organizations to think differently, act quickly and communicate confidently. The current risk environment presents an opportunity for CPS companies to incorporate technology and sustainability into their business models, as well as invest in resources that will enhance their understanding of the many complex changes in consumer preferences and behaviors stimulated by the pandemic."

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