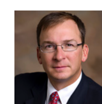
Incumbent Firms Change Course to Counter Tech Disruption

Disney, Walmart, and GM are undergoing notable strategic shifts.

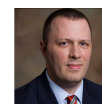
October 2019

KEY INSIGHTS

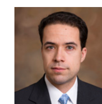
- Disruption is increasingly a harsh reality for many once-dominant incumbent, or legacy, companies, but these days some of these firms are fighting back.
- Varied efforts to counter disruption abound, with incumbents developing their own capabilities, acquiring or partnering with innovators, or some combination of these.
- Some of the strategic shifts are just defensive—aimed at stemming losses—and the outcomes are mostly yet to be determined.



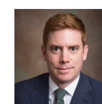
Rob Sharps
Head of Investments



Paul Greene
Portfolio Manager of the Communications & Technology Strategy



Jason Nogueira
Portfolio Manager of the Global Consumer Strategy



Joel Grant
Investment Analyst, Industrials and Business Services Sector

Disruption is increasingly a harsh reality for many once-dominant incumbent, or legacy, companies. Netflix and other streaming content services have upended cable TV. Amazon and other online vendors have challenged brick-and-mortar retailers. Tesla has pushed automakers to innovate with its electric vehicles and the promise of self-driving ones.

But these days, "some of the legacy companies have recognized how this is playing out and are fighting back aggressively," says Rob Sharps, T. Rowe Price head of investments.

Varied efforts to counter disruption abound across a wide range of endeavors. For example, Marriott has launched an Airbnb-type property rental service called Homes & Villas. And Prudential is buying online life insurance startup Assurance IQ.

"Incumbents are going about this in many ways: by developing their own capabilities, acquiring or partnering with innovators, or some combination," says Jason Nogueira, manager of the Global Consumer Strategy. "Some are just trying to stem losses to upstarts. A lot of the outcomes are yet to be determined."

That said, here are three examples of areas in which disruption has taken place—each with an example of a particular incumbent firm that has shifted its strategy to fight back. (The examples were chosen to illustrate T. Rowe Price investment managers' thinking about industry and corporate trends.)

1. Disney Breaks With the "Linear Television Ecosystem"

Traditional cable and broadcast TV are dying—and, along with it, the business models of Disney and other incumbent creators of movies and television shows.

TV viewing is down with all age groups, except those age 65 years and older; it's fallen more than 60% for viewers ages 12 to 24 since 2010, according to

150 million

With about 150 million global subscribers, Netflix can invest huge sums in creating content.

Nielsen ratings. As ratings fall, so does ad revenue. And cord cutting means the cable subscriber fees paid to content creators are shrinking.

Disney—and other content creators like Warner Brothers, CBS, and Viacom—traditionally sold their products to such distributors as Comcast or Dish in what's termed the "linear television ecosystem." This provided content companies with great leverage, according to Paul Greene, Communications & Technology Strategy manager, as content creators didn't have to build relations with individual consumers and could stuff some channels with syndicated reruns.

But then came Netflix, offering high-quality content globally, with no ads, on demand, and at an affordable price—demonstrating that "TV's future is direct to consumer," Mr. Greene says. With currently about 150 million global subscribers, he says, Netflix can invest huge sums in creating content—it came out with more than 50 new shows in August 2019 alone.

To counter, Disney has taken the radical step of pulling back its content from distributors and launching an online, direct-to-consumer service, Disney+. It also will offer a separate bundle that includes Disney's majority-owned Hulu and a spinoff of its ESPN subsidiary, ESPN+.

From now on, Star Wars, Marvel, Pixar, and other Disney movie franchises—which collectively accounted for about half of this summer's U.S. box-office receipts—will go to theaters first and then right to Disney+, skipping premium cable channels and DVD sales, Mr. Greene says.

"By offering a limited number of blockbuster movies every year, Disney+ will be more event-driven and likely function well alongside the ongoing vast selection offered by Netflix," he says.

Disney of course is not alone. Many other content creators are taking similar steps, Mr. Greene says, but few—save perhaps Amazon—have the brand and resources to compete with Netflix for general entertainment.

"It's hard to find legacy media companies that are going to be successful at this," he says. "This is a great narrative right now, but let's check back in five years."

2. Walmart Makes Gains With "Click and Collect"

Every day brings new evidence of the "retail apocalypse," the devastation of brick-and-mortar stores wrought by Amazon's rocketing growth. But long-dominant Walmart, itself once a disrupter, is fighting back by rapidly developing its online channels.

Walmart's transition began with the purchase of Jet, an online retailer, and Flipkart, an Indian online vendor—plus heavy investments in its digital capabilities. "In the beginning, the market didn't give Walmart the benefit of the doubt," Mr. Nogueira says. "But now it's demonstrated that it can win, at least in certain segments, such as groceries."

For now, the key to Walmart's grocery gains has been no-cost "click and collect." Customers order groceries online and pick them up at a designated time, with the orders brought to their cars—somewhat like a drive-through lane at a fast-food outlet. Recently, it launched an unlimited grocery home delivery service for USD 98 a year.

Ultimately, Mr. Nogueira says, "click and collect" is a hybrid solution. The endgame, he says, will be free home delivery of groceries within hours of ordering. "The question is who will get there first," he says.

In this, Walmart faces many competitors, not least Amazon; Target; Costco; and Kroger, the nation's largest supermarket chain, now partnering with British logistics firm Ocado, to master delivery.

"Hiring someone to go around a Walmart and pick up grocery items is not cost-effective in the long run versus having dedicated, fully automated warehouses to fill orders," Mr. Nogueira says.

> GM has decided that, in the next 10 to 15 years, it's all about electric vehicles.
>
> — **Joel Grant**
> *Investment Analyst, Industrials and Business Services Sector*

3. General Motors's EV Future Is Now

In the future, cars will be electric-powered, self-driving, and perhaps available on demand rather than individually owned. But no one knows when that future will arrive. Tesla is hurtling forward and pushing General Motors (GM), more than 110 years old, to undergo a historic transition faster than once anticipated.

GM has announced that over the next few years it will introduce about 20 new electric vehicles (EVs). "GM has decided that, in the next 10 to 15 years, it's all about electric vehicles," says Joel Grant, a T. Rowe Price auto analyst.

After more than a century of gas-powered engines, this profound change means all car components—save for the chassis and interior—are changing too, Mr. Grant says. GM and other original equipment manufacturers (OEMs) "are rethinking cars from the ground up," he says.

While GM's pickup and SUV franchises remain strong, Mr. Grant says, "it essentially decided EVs are going to be cheaper, better cars, and GM must embrace this and be really good at it. This is risky because no company is making money on EVs, and most consumers are unwilling to pay the EVs' premium. But that premium is expected to fall rapidly with greater production scale—to where the costs are relatively the same as combustion vehicles."

Beyond EVs, GM also has jumped into developing self-driving cars by buying a startup, now called GM Cruise LLC, as a separate entity to attract talent and outside capital. In the meantime, GM separately has come out with new technology on certain Cadillacs, called "Super Cruise," which GM says is "the first true hands-free driving assistance feature" for certain types of highways, but which Mr. Grant says is like Tesla's autopilot feature.

As with Disney and Walmart, GM is not alone in responding to disruption. Volkswagen and Daimler similarly are embracing EVs, for example. "There's still skepticism about EVs' profitability," Mr. Grant says. "So the question over the next couple years is how much profits from trucks and SUVs can sustain manufacturers transitioning to EVs."

WHAT WE'RE WATCHING NEXT

Among the key questions facing incumbent firms shifting their strategies in the face of disruption from technological innovators is how much their losses in these transitions may total before potential gains from their new business models kick in. For example, Walmart is going to have to invest more to compete with Amazon and others to widely offer low- or no-cost, same-day delivery of groceries. Similarly, Disney is likely to endure headwinds from forgone licensing revenue as it pulls its content away from legacy distribution channels. And GM likely will have to rely on pickups and SUV sales to see it through its historic shift to EVs. For GM and other automakers, notes Auto Analyst Joel Grant, beyond that is the ultimate question of how quickly a high level of semi-autonomous technology "can make it into our cars—making them safer and cheaper to insure and allowing us more productivity in cars. This will be a game changer."

The specific securities identified and described are for informational purposes only and do not represent recommendations.

Additional Disclosure

Copyright 2019 FactSet. All Rights Reserved. www.factset.com

INVEST WITH CONFIDENCE℠

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

T. Rowe Price®

Important Information
This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

China—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Issued by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

Malaysia—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2019 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.