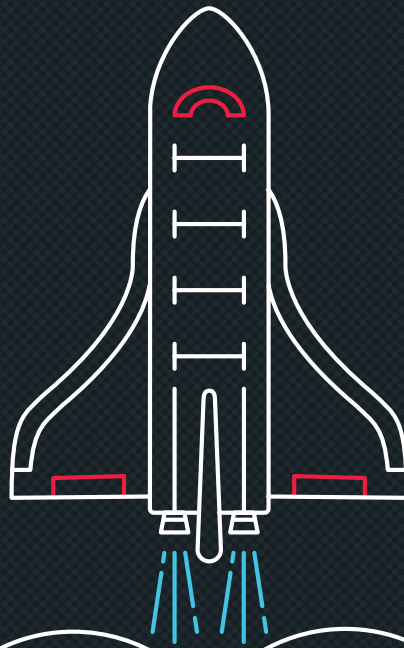


Beyond the Horizon

A manifesto on long-term growth

Kaustav Dutta, Rory Sale,
Duncan Campbell & John Hosking



horizon

from

cognosis

Every successful business is intent not just on surviving, but thriving into the future. Way into the future. This means generating long term, sustainable growth.

Sustainable growth is not only the lifeblood that underpins corporate success, it also provides value for shareholders, customers, employees.

It helps fuel a successful economic structure – the creation of employment, the development of capabilities, and the investment in productivity and infrastructure.

And yet that is not what we are seeing in reality. Nowadays, out of every nine companies, only one sustains profitable growth for a decade or more¹. Sustainable growth is the headline ambition on virtually all company annual reports, but it is increasingly evasive – a distant achievement that only a rare few actually achieve.

Why is it so difficult?

There are three dilemmas placing new demands on 21st century businesses. Each is a silent barrier to value creation, and each is a central part of understanding why sustainable growth is so rare, regardless of industry:

- 1 We are surrounded by **exponential** patterns of growth, but we think in a **linear** way. Our intuition leads us to underestimate change, and that makes shaping a business for the future an enormous challenge.
 - 2 **Long-term** behaviours drive greater value creation, but the system increasingly demands a **short-term** focus. Often businesses, together with those that lead and manage them, just aren't given the latitude to think long term.
 - 3 The demands placed on businesses by communities, customers, employees and shareholders have never been higher. They are moving us to a place of '**multi-stakeholder capitalism**', but businesses do not yet have the understanding, nor the capability, to deliver **multi-stakeholder value**.
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In this context, it's a crucial question to ask:

How can a business leader break through the challenges posed by these dilemmas? How can they reset the agenda to build a sustainable future for their company?

In-depth analysis of our Sustainable Growth Index – one hundred of the world's foremost companies – shows that there is a distinct code for long-term success.

Whilst each industry faces different challenges and trends, four underlying behaviours are critical to generating and sustaining growth, regardless of sector:

The ability to look to the long term – beyond the current business model – and balance the allocation of resources appropriately.

The ability to adapt and respond to a changing environment with more speed and precision than the competition, underpinned by a flexible operating model, an open and challenging culture, and a versatile capability pool.

The ability to make delivery of customer value central to the whole organisation – not just being responsive to customer needs, but proactively anticipating and setting out to satisfy future needs.

And being driven by an organisational reason for existence – one that is specific enough to guide decision making whilst giving enough scope to adapt to a changing environment, and one that engages, motivates and ultimately maximises value from its employee resource.

All good, but hardly new – there's plenty of helpful (and even more unhelpful) material on each of these topics.

What is new is the understanding, built on extensive quantitative and qualitative analysis – that the power is not just in each of the four behaviours individually, but how they combine collectively.

It is this complementarity that is the 'keystone'. Each part is integral to the other's role in underpinning the successful delivery of long-term, sustainable growth.

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Chapter 1

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Why the long term?

Corporate performance is more volatile than ever. On average, one in three publicly listed companies will not exist in five years' time.

That's a **5x increase** compared to 50 years ago².

We see similar patterns across a number of other indicators. Past success in Market share and Total Shareholder Returns is increasingly inaccurate in predicting future success³. Once, scale brought stability. The largest firms in an industry could be confident they would remain so into the future. But in today's business world of greater change and complexity, so-called 'creative destruction' is playing an increasingly significant role. As external demands on businesses constantly shift, the firms who are unable to alter and improve their ways of working and proposition quickly make way for their more relevant competitors.

Behind the chilling statistics of shortening lifespans and inconsistent performance is the heightened effect of the 'growth paradox'. As companies grow, they gain complexity and inertia, which in turn limit and block growth. Growth over the short term is often achievable, but sustaining it is both rare and essential.

To that end, this study tackles two fundamental issues:

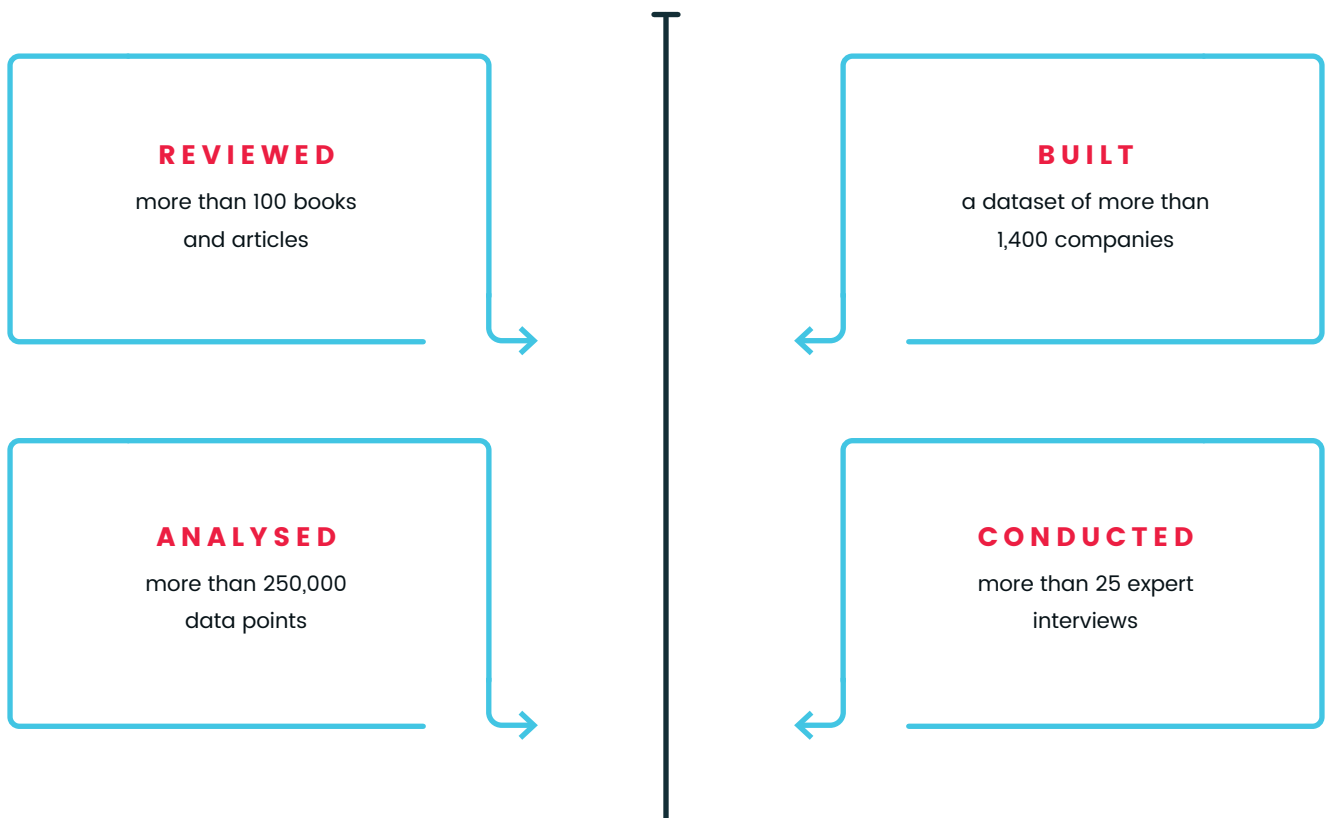
- 1 Which common behaviours, capabilities and principles unite the companies creating the greatest and most sustainable growth in their industries?
- 2 What can we learn from these companies, as a basis for long-term success in the future?

In the coming pages, we will shed light on the challenge of balancing short and long term. We will look into the macro-economic challenges shaping value creation today, and provide practical learnings on how to maximise and sustain your organisation's growth in this environment. Our conviction is that this is not just an issue for CEOs and their teams; we see this output as relevant across functions and across the globe. If you are a decision maker in a business and want to unlock sustainable value for your organisation, then **we believe our findings will be of real value.**

How we conducted our research

First, a word on our methodology. Our guiding principle has been to base our findings in empirical evidence, whilst at the same time making them practical, tangible and useful for other businesses.

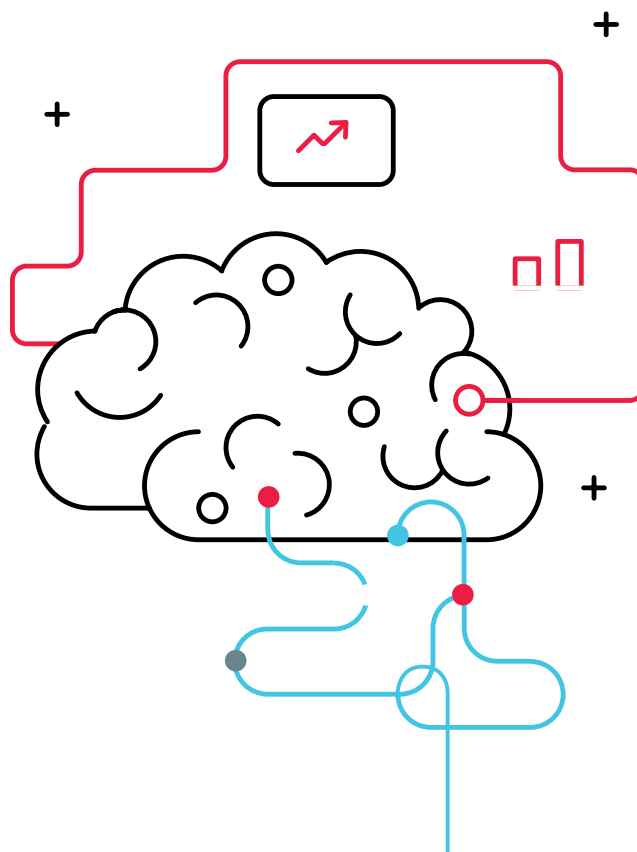
Along the way, we...



Our research, in essence,
was comprised of four steps.



Methodology: Our 4 key steps



KEY STEP		INPUTS	OUTPUT
1. Understanding the landscape	Develop an initial point of view to guide data gathering and analysis	<ul style="list-style-type: none"> • Extensive secondary research • Working sessions with x10 business leaders and/or investment professionals 	Hypotheses for testing
2. Identify the most successful companies over the long term	Build the Sustainable Growth Index: An index of 100 established businesses; benchmarked and ranked according to the key indicators of sustainable growth	<ul style="list-style-type: none"> • Company financial data (Source: FactSet) 	Dataset for analysis
3. Assess the actions & behaviours that have driven their success	Understand the common capabilities, actions and behaviours differentiating companies at the top of the index from those at the bottom	<ul style="list-style-type: none"> • Quantitative analysis • Case studies of SGI companies (incl. interviews) 	Key drivers of long-term growth (looking back)
4. Draw out the future implications	Translate the common themes (from step 3) into recommendations, based on key trends affecting businesses	<ul style="list-style-type: none"> • Extensive secondary research • Working sessions with x15 business leaders 	Recommendations for the future

How we built The Sustainable Growth Index (SGI)



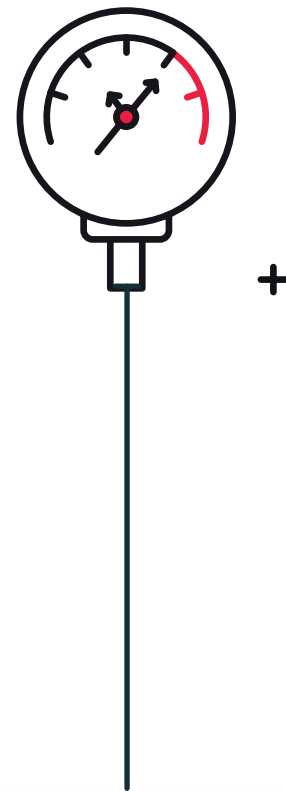
At the heart of Step 2 in our methodology is the Sustainable Growth Index (also referred to as the SGI).

It includes 100 companies, which have formed the backbone of our research, assessment and findings.

We built it in three stages:

a. Select the companies

We selected the SGI companies based on data availability and company size, ending up with 100 companies spanning across multiple sectors. These companies – ranging from high-flying outperformers to chronic underperformers then became the basis for detailed assessment and analysis.



SCOPE OF RESEARCH	SELECTION CRITERIA FOR SGI
What drives success in companies of significant scale and longevity (as opposed to recent start-ups)?	Company has existed for more than fifteen years and has revenues greater than £100m
What drives success across industries (as opposed to sector-specific success factors)?	No sector limitations
What drives success over the long term (as opposed to more immediate results)?	Company is publicly listed and has complete data going back fifteen years

b. Define what constitutes success

Next, we defined success: an objective way to measure sustainable growth and compare it across all 100 companies. Two principles guided the metrics chosen:

- **Fifteen-year timeframe:** We needed a time-frame long enough to show sustainable success
- **Relative to industry:** We needed to understand whether companies had outperformed their competitors, rather than just benefited from a growing industry

Applying the two principles, then, we defined sustainable growth using three measures:

MEASURE	IMPORTANCE
Revenue Compound Annual Growth Rate (CAGR)	Ability to grow sustainability
Average Return on Invested Capital (ROIC)	Ability to create value sustainably
Price : Earnings Ratio (PE)	Market assessment of ability to create value in the future

Why these three measures?

- Balance between growth (CAGR) and profitability (PE)
- Not skewed by M&A (which positively impacts CAGR, and negatively impacts ROIC)
- Balance between past success (15-year ROIC and CAGR) and future potential (PE)

c. Rank companies accordingly (a basis for analysis)

We then gathered financial filings data on the SGI companies, ranking companies according to their success across the three key measures over 15 years.


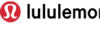








All this set us up to ask the crucial question:

What differentiates the SGI's top performing companies from the rest?

THE COGNOSIS SUSTAINABLE GROWTH INDEX:

Our top 10, and their keys to unlocking Sustainable Growth

The SGI Top 10 come from across sectors. They use different business models, have different products and sell them in different parts of the world. But they are united by outstanding results, and their ability to sustain performance over time.

RANK	NAME	ROIC	SECTOR ROIC	ROIC SCORE	CAGR	SECTOR CAGR	CAGR SCORE	P/E	SECTOR P/E	P/E SCORE	TOTAL SCORE	KEY TO UNLOCKING SUSTAINABLE GROWTH
1	 Netflix Inc	14%	4%	0.72	33%	15%	0.54	101.59	18.16	1.00	2.26	Significant investment into long-term bets, continual assessment of business model and a willingness to pivot in anticipation of the macro environment
2	 Lululemon Athletica Inc	24%	22%	0.53	40%	8%	1.00	39.47	16.71	0.61	2.14	Innovation, through proprietary fabrics and a yoga-led purpose to establish a strong brand, expanding into new markets to exploit a growing niche
3	 Chipotle Mexican Grill Inc	15%	12%	0.54	22%	7%	0.88	50.69	21.23	0.61	2.03	Consistently providing 'food with integrity', maintaining industry leading quality standards whilst focusing on executing a winning menu with few frills
4	 Under Armour Inc Class A	12%	14%	0.51	31%	9%	0.65	81.47	21.12	0.87	2.02	Despite a recent slump, they have delivered outstanding historical performance through digital innovation and a powerful brand
5	 Choice Hotels Int. Inc	56%	9%	1.00	14%	8%	0.59	18.58	17.46	0.37	1.96	Driving hospitality innovation to deliver great customer service, and unlocking growth through strategic partnerships
6	 Apple Inc	26%	9%	0.59	30%	5%	1.00	19.25	23.36	0.32	1.92	Growing share of North American and European smartphone markets with the iPhone whilst exploring future growth categories in wearables, healthcare and personal finances
7	 T-Mobile US Inc	4%	6%	0.48	37%	6%	1.00	19.17	27.99	0.29	1.77	Consistent outperformance of the critical US market, through heavy capital investments in infrastructure
8	 Amazon.com Inc	13%	-2%	0.67	30%	16%	0.55	75.86	19.45	0.52	1.73	Self-proclaimed 'most customer-centric company in the world', investing heavily in the future and creating whole market segments through innovation and relentless execution
9	 Domino's Pizza Inc	50%	11%	0.82	8%	7%	0.44	29.27	21.85	0.42	1.68	Fortressing through a loyal franchisee network, constantly striving to improve delivery efficiency and leading the industry from a technology perspective
10	 Monster Beverage Corp.	35%	15%	0.66	28%	7%	0.60	27.89	22.72	0.41	1.66	Standing on the shoulders of giants with a successful Coca Cola partnership, whilst becoming a go-to lifestyle brand with a loyal consumer set

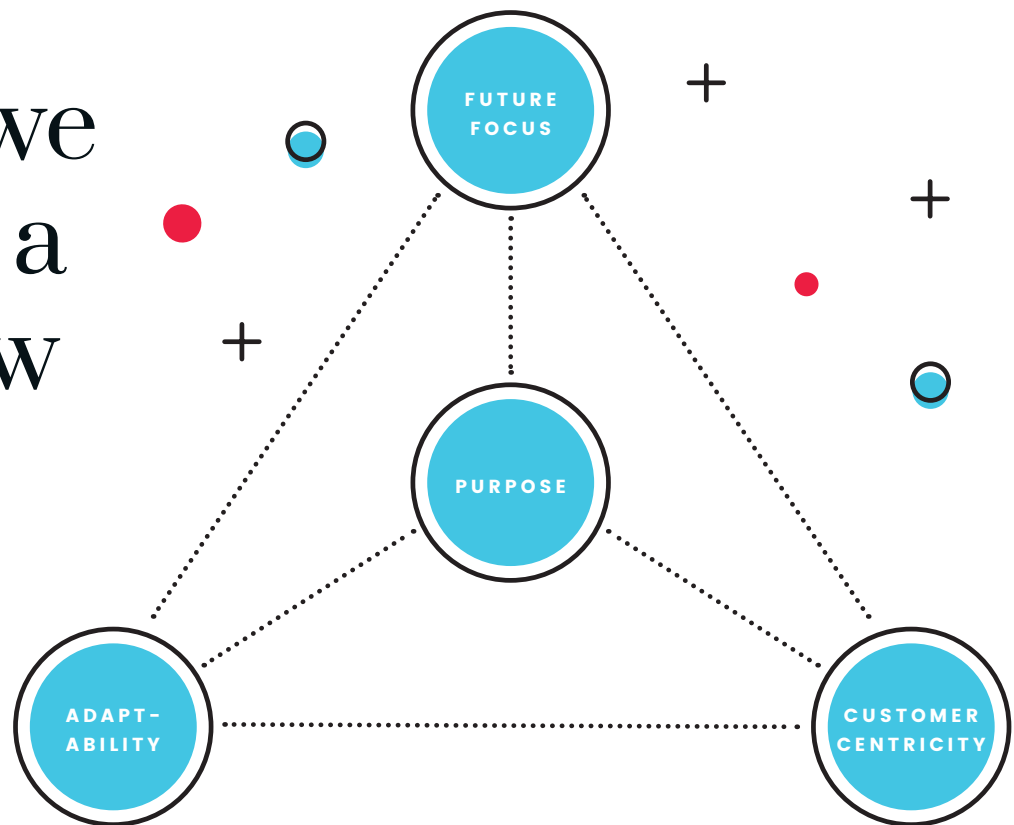
Source: Company Annual Reports (FactSet) & Culture 500

THE COGNOSIS SUSTAINABLE GROWTH INDEX:

All 100 in full

- 1 Netflix, Inc.
- 2 Lululemon Athletica Inc
- 3 Chipotle Mexican Grill, Inc.
- 4 Under Armour, Inc. Class A
- 5 Choice Hotels International, Inc.
- 6 Apple Inc.
- 7 T-Mobile US, Inc.
- 8 Amazon.com, Inc.
- 9 Domino's Pizza, Inc.
- 10 Monster Beverage Corporation
- 11 Anheuser-Busch InBev SA/NV
- 12 Starbucks Corporation
- 13 Costco Wholesale Corporation
- 14 AT&T Inc.
- 15 Estee Lauder Companies Inc. Class A
- 16 Dollar Tree, Inc.
- 17 Alphabet Inc. Class A
- 18 Reckitt Benckiser Group plc
- 19 H&M Hennes & Mauritz AB Class B
- 20 Ross Stores, Inc.
- 21 Charter Communications, Inc. Class A
- 22 eBay Inc.
- 23 Hershey Company
- 24 CVS Health Corporation
- 25 NIKE, Inc. Class B
- 26 Walmart Inc.
- 27 Marriott International, Inc. Class A
- 28 Kohl's Corporation
- 29 TJX Companies Inc
- 30 Expedia Group, Inc.
- 31 L'Oreal SA
- 32 Hyatt Hotels Corporation Class A
- 33 Vail Resorts, Inc.
- 34 Wendy's Company
- 35 Urban Outfitters, Inc.
- 36 MGM Resorts International
- 37 Lowe's Companies, Inc.
- 38 Walgreens Boots Alliance Inc
- 39 Papa John's International, Inc.
- 40 Colgate-Palmolive Company
- 41 InterContinental Hotels Group PLC
- 42 Walt Disney Company
- 43 Verizon Communications Inc.
- 44 Coca-Cola Company
- 45 Microsoft Corporation
- 46 Dollar General Corporation
- 47 PepsiCo, Inc.
- 48 General Mills, Inc.
- 49 Electronic Arts Inc.
- 50 Clorox Company
- 51 Fiat Chrysler Automobiles N.V.
- 52 Henkel AG & Co. KGaA Pref
- 53 Dillard's, Inc. Class A
- 54 Kellogg Company
- 55 Kroger Co.
- 56 Campbell Soup Company
- 57 Norwegian Cruise Line Holdings Ltd.
- 58 DISH Network Corporation Class A
- 59 Abercrombie & Fitch Co. Class A
- 60 Ralph Lauren Corporation Class A
- 61 Six Flags Entertainment Corporation
- 62 American Eagle Outfitters, Inc.
- 63 Intel Corporation
- 64 Fossil Group, Inc.
- 65 HP Inc.
- 66 Discovery, Inc. Class A
- 67 Target Corporation
- 68 United States Cellular Corp
- 69 Telefonaktiebolaget LM Ericsson Class B
- 70 Avis Budget Group, Inc.
- 71 Macy's Inc
- 72 McDonald's Corporation
- 73 Tech Data Corporation
- 74 Nordstrom, Inc.
- 75 Procter & Gamble Company
- 76 Kimberly-Clark Corporation
- 77 Unilever PLC
- 78 Royal Caribbean Cruises Ltd.
- 79 Comcast Corporation Class A
- 80 Hertz Global Holdings, Inc.
- 81 Tyson Foods, Inc. Class A
- 82 ViacomCBS Inc. Class B
- 83 Mondelez International, Inc. Class A
- 84 Frontier Communications Corporation Class B
- 85 NortonLifeLock Inc.
- 86 Marston's PLC
- 87 Conagra Brands, Inc.
- 88 Levi Strauss & Co. Class A
- 89 Gap, Inc.
- 90 Big Lots, Inc.
- 91 Ford Motor Company
- 92 Thomson Reuters Corporation
- 93 Jack in the Box Inc.
- 94 J. C. Penney Company, Inc.
- 95 Nokia Oyj
- 96 Motorola Solutions, Inc.
- 97 Caesars Entertainment Corporation
- 98 Overstock.com, Inc.
- 99 General Motors Company
- 100 Rite Aid Corporation

What we found: a preview



So what has unlocked sustained success for the best of the Sustainable Growth Index? Which common threads unite those at the top of the index and differentiate them from those at the bottom?

Our analysis reveals that a new code for long-term success is emerging. 4 behaviours – **Future Focus, Adaptability, Customer Focus and Purpose** – will differentiate companies over a long-term horizon.

Whilst these findings are not the only drivers of long-term performance, they are becoming increasingly important as our economy and society evolves. Correspondingly, they also offer greater opportunity for companies to differentiate from and outperform their competitors. We identified these critical behaviours before the Covid-19 pandemic, but this crisis has only accelerated their relevance. The 4 behaviours, as we will explain, are inherently tied to an environment of increasing volatility. Their importance is therefore elevated in moments of crisis and recession, underlining their significance in a discussion about sustainability.

From here, we will explore the 4 critical behaviours in more detail. Empirical evidence and in-depth examples from the Sustainable Growth Index will show us their value, and the outstanding and sustainable results made possible by embedding them. Ultimately, we will show how you can

help bring the 4 behaviours to life in your own organisation, with practical tools and frameworks gathered from both primary research and our own consulting experiences.

Before exploring the behaviours in detail, though, we will take a step back to explore the context behind their significance. In particular, we will return to our opening statement: **That 3 growing dilemmas will shape value creation in the 21st century.**

- 1 We are surrounded by exponential patterns of growth, but we think in a linear way.
- 2 Long-term behaviours drive greater value creation, but the system increasingly demands a short-term focus.
- 3 We are moving towards 'multi-stakeholder capitalism', but don't yet have the ability to deliver multi-stakeholder value.

Chapter 2

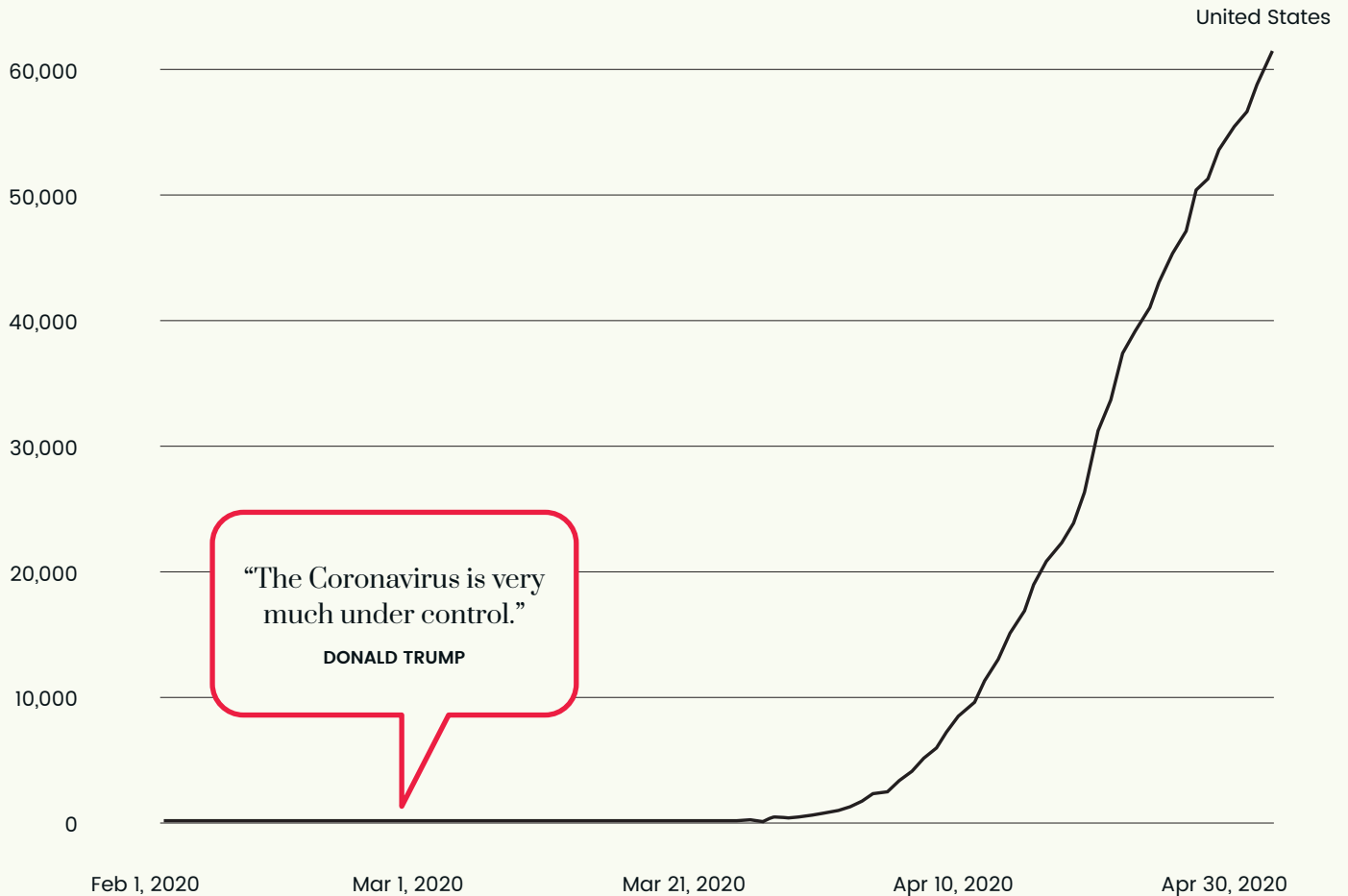


The three dilemmas shaping value creation in the 21st century

- p.15 Dilemma 1:** We are surrounded by exponential patterns of growth, but we think in a linear way
- p.19 Dilemma 2:** Long-term behaviours drive greater value creation, but the system demands a short-term focus
- p.23 Dilemma 3:** We are moving towards 'multi-stakeholder capitalism', but don't yet have the ability to deliver multi-stakeholder value

TOTAL CORONAVIRUS DEATHS (USA, FEBRUARY 2020 TO APRIL 2020)⁵

A rapid exponential increase



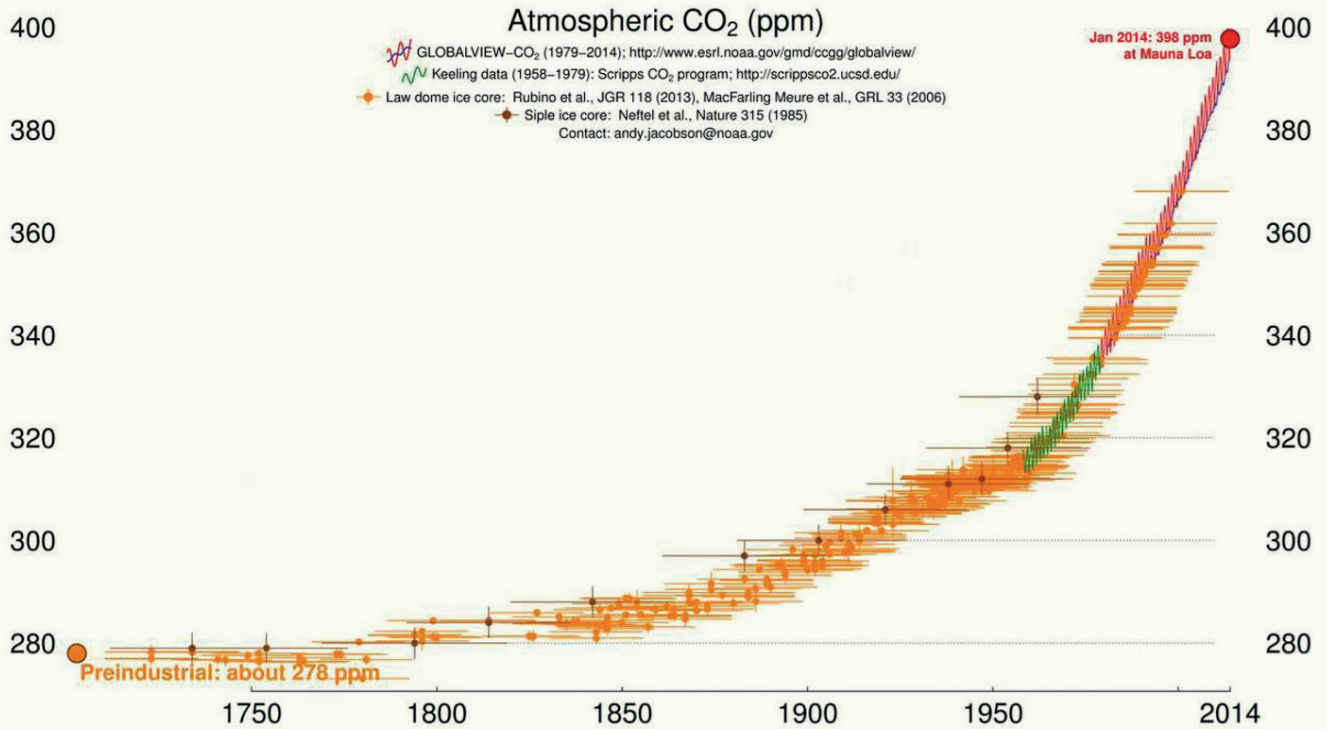
Source: European CDC - Situation Update Worldwide - Last updates 29th May 11:00 (London time)
OurWorldInData.org/coronavirus • CC BY

Our recent immersion and now familiarity with the Coronavirus' pattern of exponential growth offers a useful lens through which to understand our first dilemma – the disjuncture between expectation and reality when it comes to change. Climate change is another example of an exponential pattern without an exponential response (albeit on a more protracted time than Coronavirus). CO₂

emissions, ocean plastic levels and other key measures of climate damage have all increased exponentially throughout the 20th century. But as with the initial stages of the Coronavirus, the global actions and initiatives to address the threat do not yet acknowledge the exponentiality of the problem.

GLOBAL CO₂ LEVELS⁶

Exponential change over a protracted timeframe



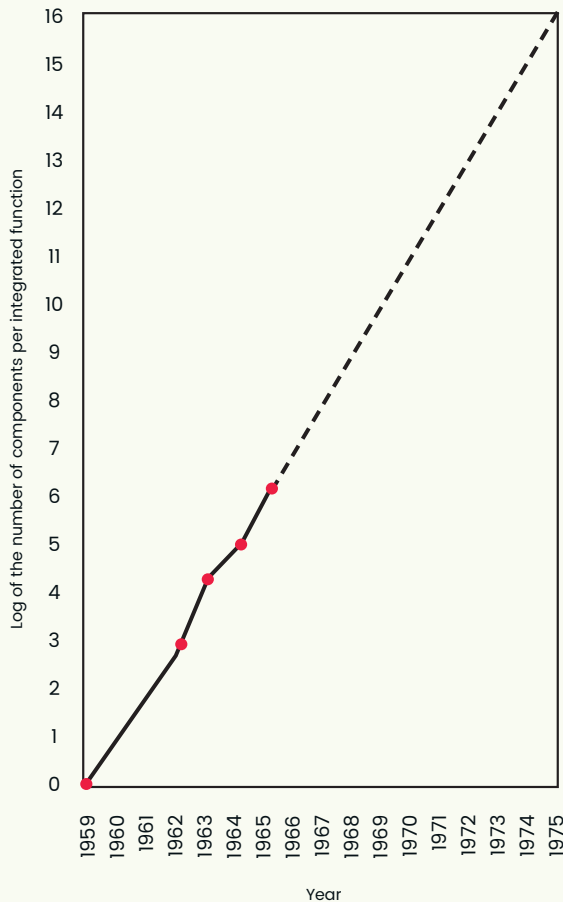
Source: MIT Sloan Management Review. 2020. Webinar: COVID-19, Climate, And The Clean Economy.

From the climate to computing. In 1965, Intel co-founder Gordon Moore wrote a now famous article entitled 'Cramming more components onto integrated circuits.' The number of transistors that could be fitted into a given unit of space on a microchip, he forecasted, would double every two years. In essence, he predicted that computing power and efficiency would grow exponentially, driving

what were then unimaginable leaps in technological progress. In the article's introduction he cites the 'electronic wristwatch' as an indicator of what is to come, and looks forward to a world of "home computers, automatic controls for automobiles, and personal portable communications equipment⁷."

EXTRACT FROM MOORE'S ORIGINAL PAPER

Number of components per integrated function for minimum cost per component extrapolated vs time.



Moore's forecast has held true for fifty years. Indeed, without it the incredible progress of modern society would not have been possible. As an example, The Apple A12 Bionic (the chip in the iPhone X series) has almost 1million times the processing power of the TMS 1000 – the most powerful integrated circuit chip of 1971^{8/9}.

It is this exponential progress, as identified in so-called Moore's Law, that has enabled us to fit into our pockets what were once great whirring machines filling whole rooms.

The examples of Coronavirus, Climate Change and increasing computing power illustrate two important phenomena.

1. Exponential change is mathematically inevitable in an interconnected world.

In any chain of activities, exponentiality occurs when step 2 is made easier or larger by step 1. In our computing example, engineers working with better, more efficient technology could in turn make better, more efficient components, and so the cycle perpetuates. Provided, then, that the steps in a given chain are interconnected, we can expect to see exponential patterns in all number of forms: across our society, economy and businesses.

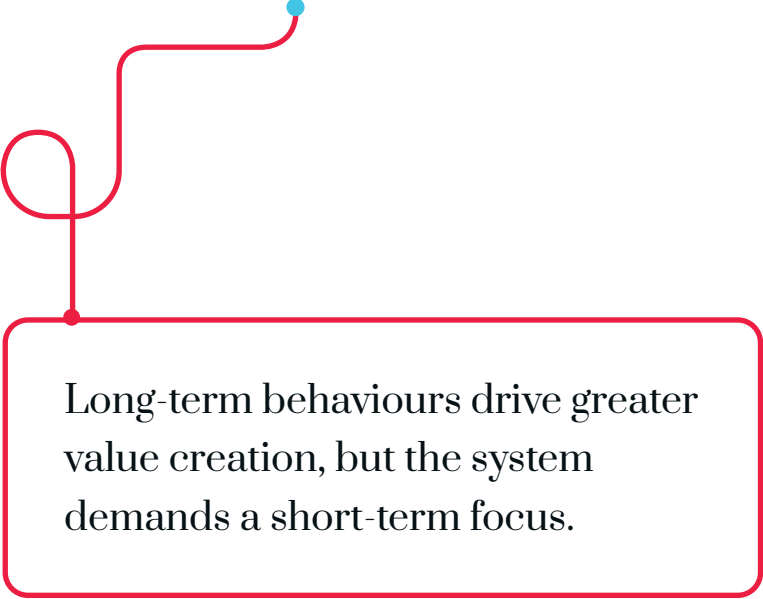
2. Exponential change will continue to amaze our linear human instincts.

Without careful attention, increasing change will continue to surprise us and catch us out. Typically, this comes in the form of an incorrect assumption: that what we did to succeed in the past will be the same as what we need to succeed in the future. The inevitable magnitude of change will require us to develop new capabilities at an increasing rate and be prepared to un-learn what worked beforehand.

The combination – inevitable exponentiality matched with a linear intuition – is a recipe for increased disruption of legacy businesses. As we have seen, company lifespans are decreasing as a result. Holding on to the old recipe – the business models and products that brought success in the past – is increasingly likely to become a risky strategy as the pace of change accelerates. In this environment (as we will expand on and evidence in later chapters), the abilities to plan for the future and respond to rapidly changing customer needs become cornerstones for success over the long term.

Easy to write, but incredibly difficult to do. Business leaders in today's context face a gargantuan challenge, to evolve and adapt in a highly volatile environment, whilst simultaneously managing the systemic pressure (particularly from shareholders) to deliver results in the short term. We will now turn to this tension in our second dilemma: the challenge of balancing short and long-term horizons.

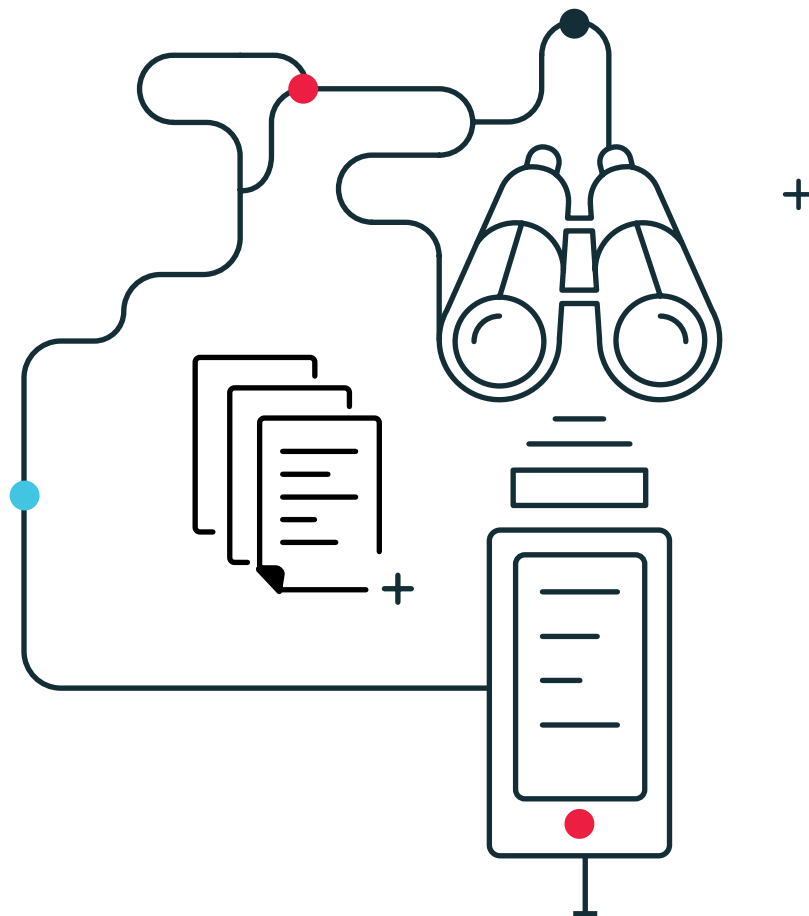
Dilemma 2



Long-term behaviours drive greater value creation, but the system demands a short-term focus.

In 1987, after 12 years at the helm of Intel, Moore passed the mantle of CEO to Andrew Grove. Moore, as we have seen, was an insightful, strategic thinker. He pushed the boundaries on innovation, taking Intel into a leading position in the memory market. And the profits followed. Grove inherited a “cash cow”: memory constituted more than half of Intel’s revenue when he became CEO. But as the technology sector evolved and Intel’s competitive position in the memory market came under pressure, Grove latched onto a crucial insight. Intel would thrive into the future not as a memory producer, but as a microprocessor supplier. Indeed, benefitting from the growth wave of PCs, Grove would proceed to transform Intel over an 11-year period into the leading microprocessor supplier in the world.¹⁰

Clearly not one for lazy weekends, Grove also wrote a number of management books during his 11-year tenure. The title of his most famous work, “Only the Paranoid Survive”, encapsulates both his philosophy on management and his reason for success as CEO. Underpinning the transformation was an attitude: success in the past does not guarantee success in the future, and so you need to keep changing. In other words, he needed to forget memory and build a new core business. Alongside ‘paranoid’, we would add another adjective: ‘brave’. The transformation overseen by Grove required him to slow short term shareholder returns (from the memory business) in order to maximise long-term value creation (from the microprocessor business).



The story of Intel's success is mirrored in more recent studies. Companies who manage with a long-term orientation outperform their short-term-focused counterparts across a range of metrics: revenue, earnings, market capitalisation and brand equity (to name a few).

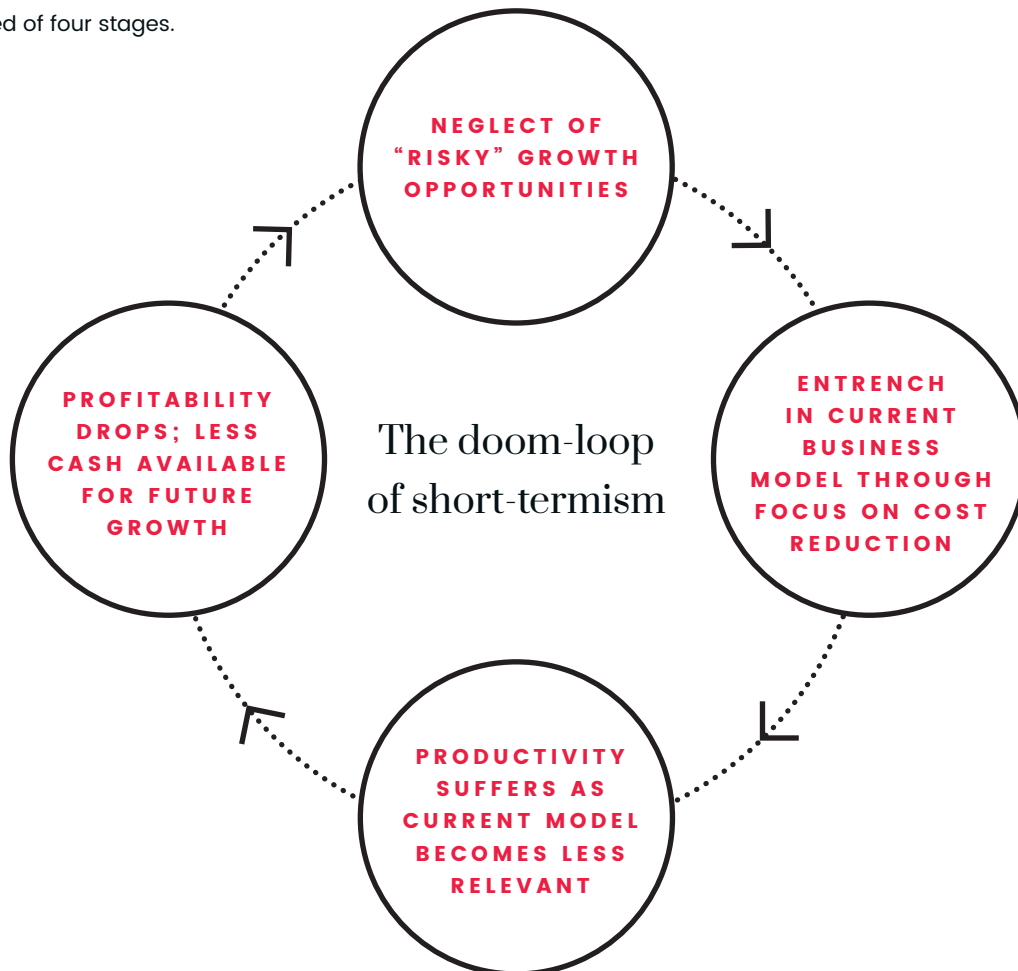
In essence, the companies who respond to accelerating change by defining clear visions beyond today's core business, perform better.^{11/12}

The problem, however, is that a long-term orientation simply does not appear feasible to many of today's companies. At the corporate level, the investment

community and PLC structure is partially to blame. Investment banks continually scrutinise short-term earnings fluctuations, forcing management to deprioritise longer-term initiatives that negatively impact the quarterly numbers. Company executives are driven to using stock buy-backs to deliver immediate returns to shareholders, rather than reinvesting in future growth drivers.

But a critical factor – as relevant to the CEO defining company-wide capital allocation as to the line manager planning out the size of her team for the coming years – is straightforward uncertainty. In both instances, the decision maker can see and touch the impact of short-term initiatives, but long-term investments feel more uncertain. The commonly used term: 'big bets' is indicative here. When we think about long-term strategic initiatives, we imply an inherent risk, to the extent that we use the same language as around the roulette table.

Lack of confidence, when paired with challenges in financial performance, often results in a cycle of short-termism. Typically, it is comprised of four stages.

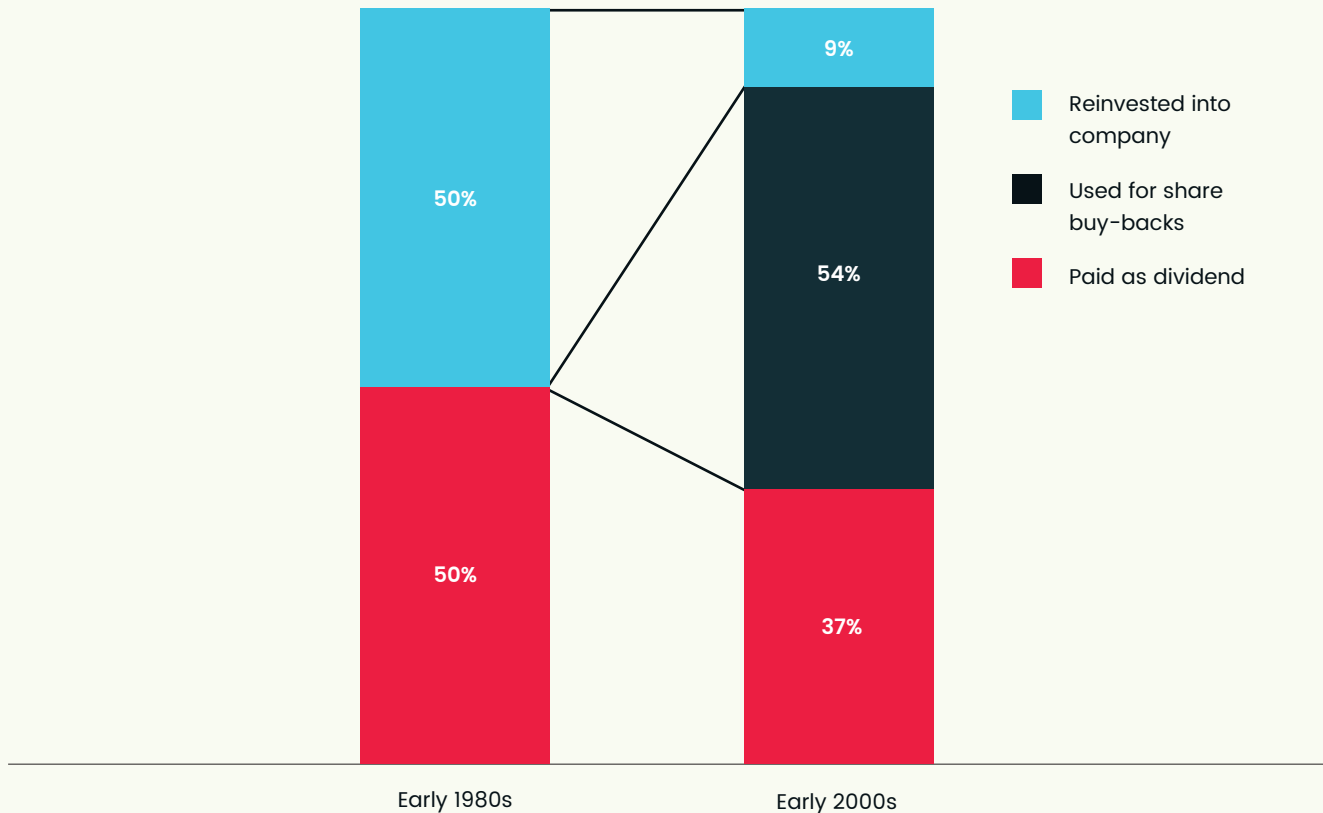


1. Uncertain in its value, managers do not invest in a growth opportunity. Be it a key trend, a new product, an overseas expansion or hiring more full-time employees to build new capabilities.
2. As a result, they focus on two areas to deliver their profit numbers:
 - Reducing cost through efficiency
 - Incremental revenue gains (pay-per-click marketing on existing products, for example)
3. The external environment changes. (Customers now have a better option on the market or regulations have been altered, for example.) Now heavily reliant on the current model due to lack of investment in other value drivers, overall business productivity suffers.
4. Profitability dips as a result, meaning there is less cash and less confidence to invest into future growth. If part of a larger corporate, investment into the business unit may be cut.

And so the cycle repeats.

Notice the misconception of risk as the cycle develops. At stage 1, the future growth option is considered the risky move. But by stage 3, the business suffers as it is overly reliant on one big area. Not investing in future growth transpired to have been the riskier move all along.

ALLOCATION OF CORPORATE PROFITS



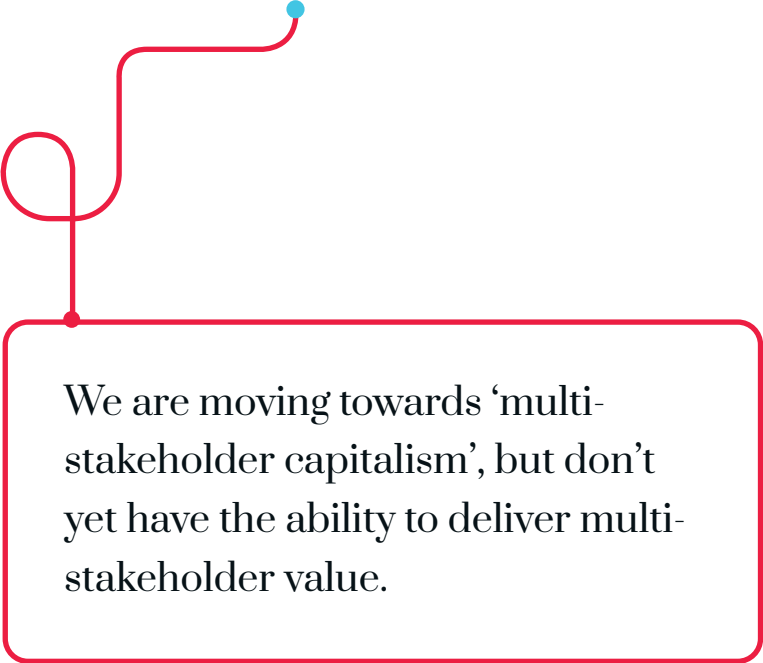
Source: Lazonick, HBR

The two demands – investor pressure and management uncertainty – are driving an increasing focus on the short term. Companies now more than ever focus on extracting value today, rather than creating value for tomorrow. A study done by economist William Lazonick shows that the long-term is receiving continually decreasing levels of investment over time. Lazonick looks at the aggregate profit of the S&P500 over time, tracking what companies choose to do with it. In 1980, approximately 50% of corporate profit was invested back into the companies themselves, used to fuel further growth and job creation. By 2005, only 9% was reinvested into the companies, the remaining 91% split between shareholder dividends and stock buybacks¹³. In the battle between short and long term, the short term currently has the upper hand.

The companies that avoid the downward spiral of the short term altogether are a rare minority. Amazon springs to mind – because it is constantly delivering outstanding results, it has the luxury to invest in the long-term: in new infrastructure, products and services. But in the most cases, the balancing act of keeping short term performance strong whilst catering to the different demands of the future takes exceptional skill to manage.

But ultimately, we see opportunity. As shown, there is a striking value premium in going long, and the increasing paucity of companies consistently managing to do so effectively will mean greater wins for those that do exhibit long-term investment and behaviours. We explore how in Chapters 3-6, but for now we turn to the 3rd dilemma shaping long-term performance today. Financial results are no longer enough.

Dilemma 3



We are moving towards ‘multi-stakeholder capitalism’, but don’t yet have the ability to deliver multi-stakeholder value.

At an open news meeting in 2019, Unilever CEO Alan Jope was discussing the role of business within society. One of his comments really caught our attention.

“Investors are the last stakeholders we concern ourselves with. It (Unilever’s stakeholder hierarchy) begins with consumers – the people we serve, then customers, then employees, society, the planet, and then shareholders. We believe that’s a sequential list of priorities. If we serve those groups in that order, then we believe that shareholders will be well rewarded – superiorly rewarded – as a by-product.”¹⁴

Jope’s comment is in stark contradiction to the idea of shareholder primacy, the notion that the ultimate purpose of a corporation is to maximise profits for its owners, and that all other concerns are secondary. Popularised by Milton Freedman in the 1960s, shareholder primacy has been the dominant economic dogma of the past half a century. Businesses exist for their shareholders, and as such all decisions should be taken through the lens of “will this make our owners more money?”.

Unilever is at the forefront of the conversation around the role of a corporation. Former CEO Paul Polman led with the mantra that ‘purpose’ and ‘profit’ need not be at odds, and re-directed Unilever around the vision of “making sustainable living commonplace”¹⁵. Jope, clearly, has picked up where Polman left off, reflected in Unilever’s rating as the most responsible company on the FTSE 100 Index (as measured by Tortoise)¹⁶. So, is Unilever an anomaly, swimming against the tide of shareholder primacy? Or is it a leader, the first among many firms to take us towards a new, more inclusive model for business?

At the time of writing, the evidence is mixed. Without a doubt, the language around the role of the corporation has changed. The Business Roundtable is a non-profit organisation whose members are the CEOs of many of the USA's largest businesses. Its periodically updated "Principles of Corporate Governance" had every year since 1997 stated that "corporations exist principally to serve their shareholders". In August 2019, though, it issued a statement declaring commitment to all business stakeholders, stating that customers, employees, suppliers and communities should all be on an equal footing with shareholders¹⁷. On the statement are the signatures of approximately 200 CEOs of the world's leading companies. Indeed, 19 companies from our own Sustainable Growth Index companies have signed the declaration. Shortly after the Business Roundtables declaration, The Financial Times launched its first major brand campaign since the 2008 financial crisis. With the bold title of "Capitalism, Time for a Reset", it has since published extensively on the topic of corporate purpose and the need for organisations to work towards broader stakeholder needs¹⁸.

2019, undoubtedly, was a breakthrough year in terms of how some of the globe's most influential individuals defined the role of business.

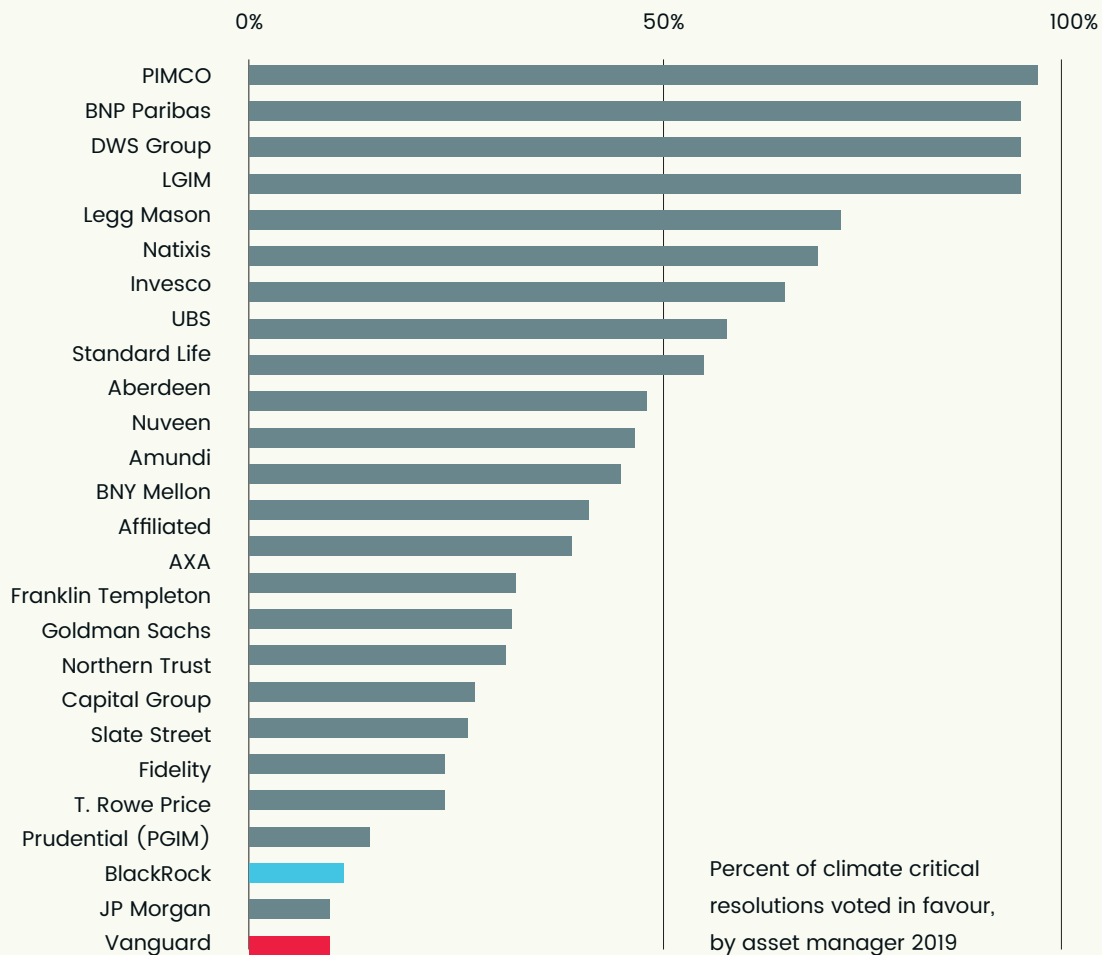
At the center of this nascent change is Laurence Fink, CEO and Chairman of Blackrock, the largest asset manager in the world (with a modest 7.4 trillion assets under management).

Each year, Fink issues a letter to CEOs: the individuals who run companies on behalf of Blackrock's investors. In 2018 and 2019 alike, his letter framed the role of business as serving the interests of multiple stakeholders and communities (not dissimilar to Alan Jope's comment). In 2020, his letter followed a similar theme but was more single-minded around one issue: climate change. He made two key points. First, he stressed the importance for all companies to confront climate change in their strategies. Secondly, he anticipated that "in the near future – and sooner than most anticipate – there will be a significant reallocation of capital" in an attempt to reduce climate risk¹⁹.

Fink's 2020 letter and the simplicity of its message around climate change is particularly interesting, since it gives us a lens through which to test the substance of the various claims of a 'capitalism reset', or pivot towards serving a broader set of stakeholders. "Climate in the Boardroom", a report conducted by non-profit Majority Action allows us to do exactly that. The report identifies that 41 climate-critical resolutions took place in 2019. Climate critical resolutions are shareholder votes on issues directly related to environmental risks. As the largest asset manager in the world, Blackrock has a significant stake (and therefore voting power) in all of the companies in which these votes occurred. Out of a total 41 votes, Blackrock voted in favour of the climate-critical resolutions on only 5 occasions. Relative to other major asset managers, Fink's firm voted against the climate more than almost all other asset managers, and with a stake upwards of 5% in all the companies assessed by Majority Action, Blackrock's vote was in many instances the deciding factor²⁰.

BLACKROCK'S VOTING RECORD ON CLIMATE CHANGE IN 2019

Percentage of votes in favour of climate-critical resolutions overall



Source: Climate in the Boardroom, Majority Action

As the example of Blackrock and its climate policy indicates, there is currently a gap between rhetoric and action when it comes to businesses serving broader stakeholder interests. To what extent exactly it is difficult to

determine. The response to the Coronavirus crisis will be telling, but at the time of writing it is too early to make an informed judgement on the level of stakeholder inclusivity in the response of large businesses to the crisis.

But as we know, we do not live in a static (or even linear) world. Whilst a snapshot of today is indeterminate as to the relationship of businesses with other stakeholder groups, the direction of travel – kick-started in 2019 – is clear. Jope's prioritisation will increasingly move to the mainstream, with more organisations using a multi-stakeholder approach as a means to delivering financial value. In other words, 'Corporate Social Responsibility' will not be seen as an afterthought, but an increasingly important part of the core business model. In particular, we see two factors driving the shift.

1.

Information transparency will continue to increase thanks to technology.

Whereas once, shareholders were the stakeholder group that monopolised information on a company, the same information will now be increasingly accessible to consumers, employees and society. With enhanced transparency comes the ability for all stakeholders to make more informed decisions based on your own priorities (and in turn influence the financial outlook of the company).

2.

Global gigatrends with social implications will continue to advance.

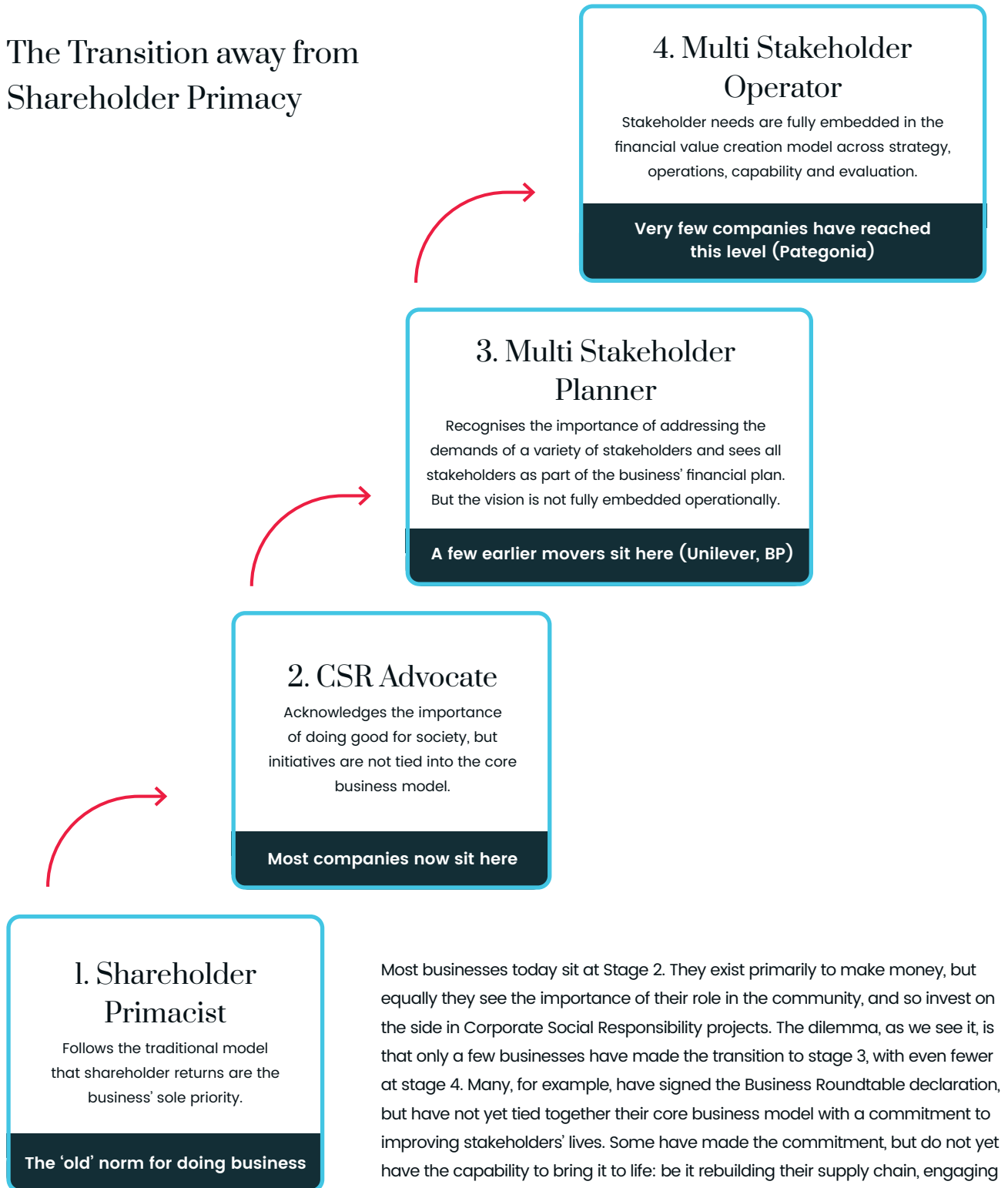
Global gigatrends with social implications will continue to advance. To the climate change example above, we would add the increasing Gini Coefficient – a measure of inequality. As the human need for businesses to act in the interests of all their stakeholders increases, and as more stakeholder groups have better access to information, the financial incentives of a multi-stakeholder view will continue to sharpen.

As these two factors increase in significance, they are manifesting in a number of (exponential) trends, each creating greater financial incentives for a multi-stakeholder approach. The employer-employee relationship, for example, is changing. As of 2015, for example, 62% of millennials said they wanted a career with social impact, with the majority also indicating that social impact would also increase their discretionary effort²¹. Consumer demands are changing in step. The ethical food and drink market grew by 43% from 2013 to 2018, significantly outpacing the category rate of growth as consumers increasingly look for products that align with their values²².

As these trends escalate over the coming years, long-term shareholder value will increasingly be underpinned by a broader set of stakeholder criteria.

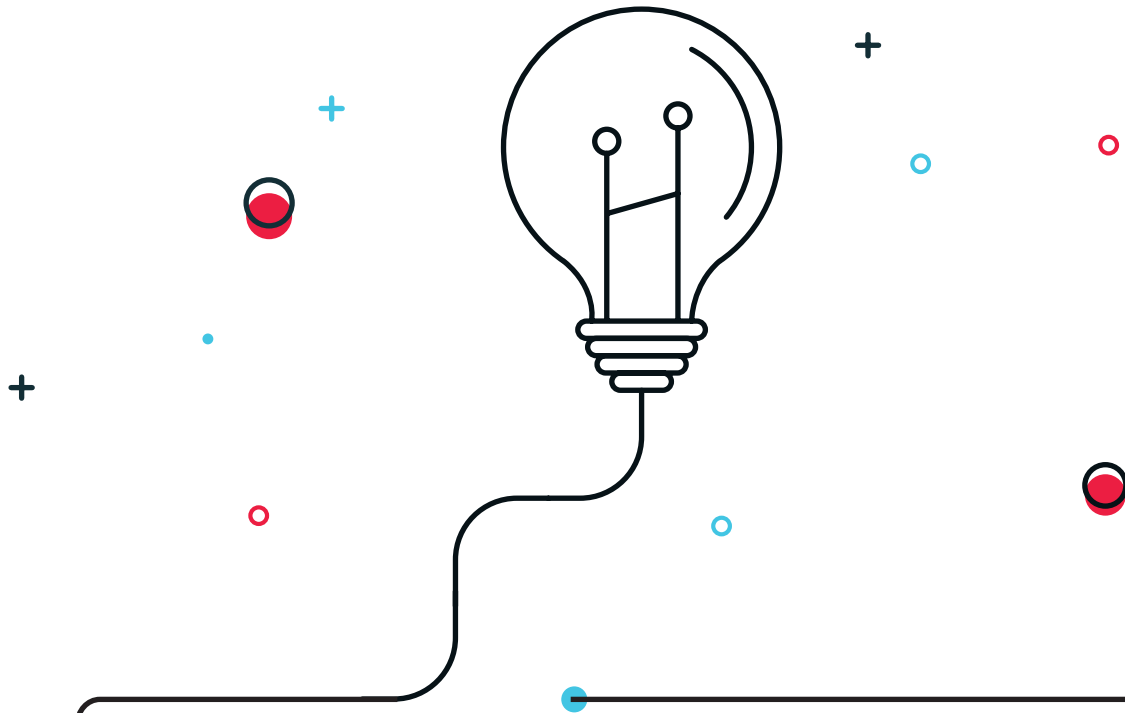
And it is in this context that we find our third dilemma. Businesses have been set up to focus first and foremost on their shareholders. They have grown to be effective and efficient at planning through a shareholder lens, at building capabilities to satisfy shareholders and at evaluating initiatives from a shareholder's viewpoint. But now they are going to have to unravel and unlearn that cumulative experience if they want to deliver greater value to their customers, employees, suppliers, communities as a means to creating financial value. Today – as we saw with the Business Roundtable declaration and the Financial Times brand campaign, businesses are beginning to recognise their responsibility to a broader set of stakeholders. What (for the most part) they do not see is the importance of integrating this into the heart of what they do and how they make money. We see four stages of competency.

The Transition away from Shareholder Primacy



Most businesses today sit at Stage 2. They exist primarily to make money, but equally they see the importance of their role in the community, and so invest on the side in Corporate Social Responsibility projects. The dilemma, as we see it, is that only a few businesses have made the transition to stage 3, with even fewer at stage 4. Many, for example, have signed the Business Roundtable declaration, but have not yet tied together their core business model with a commitment to improving stakeholders' lives. Some have made the commitment, but do not yet have the capability to bring it to life: be it rebuilding their supply chain, engaging their employees, or tracking their broader impact on society.

On the one hand, this is a dilemma for society. But it also sits at the heart of the corporate challenge. As the twin factors of information transparency and social need increase, businesses who cannot move beyond Stage 2 will be at an inherent long-term financial disadvantage. The ability, therefore, to create change and to embed a consistent set of values will become all-critical.



Implications of Dilemmas

Dilemma 1: We are surrounded by exponential patterns of growth, but we think in a linear way.

Dilemma 2: Long-term behaviours drive greater value creation, but the system demands a short-term focus.

Dilemma 3: We are moving towards 'multi-stakeholder capitalism', but don't yet have the ability to deliver multi-stakeholder value.

So, businesses are looking ahead to a world of accelerating change, of intense short-term pressure restricting long-term opportunities, and of more demanding, better informed stakeholders. These three intersecting dilemmas are reshaping what underpins long-term success. The age-old factors will still be important – leadership, strategy, execution, commitment – but they will need to be deployed differently.

Our next four chapters discuss how. Based on our analysis of the Sustainable Growth Index, we show that – in light of the three dilemmas – a new set of critical behaviours are emerging.

First, we will look at the three behaviours needed to create meaningful change: Future Focus, Adaptability and Customer Centricity. In each case, we will explore best-in-class examples that illustrate their importance as well as the data that prove it. We will overview the key behaviours exhibited by the most effective firms in each area. Finally, we will turn to the need for organisational purpose – and the critical role that embedding a purpose can play in enabling and guiding your business for the long term.

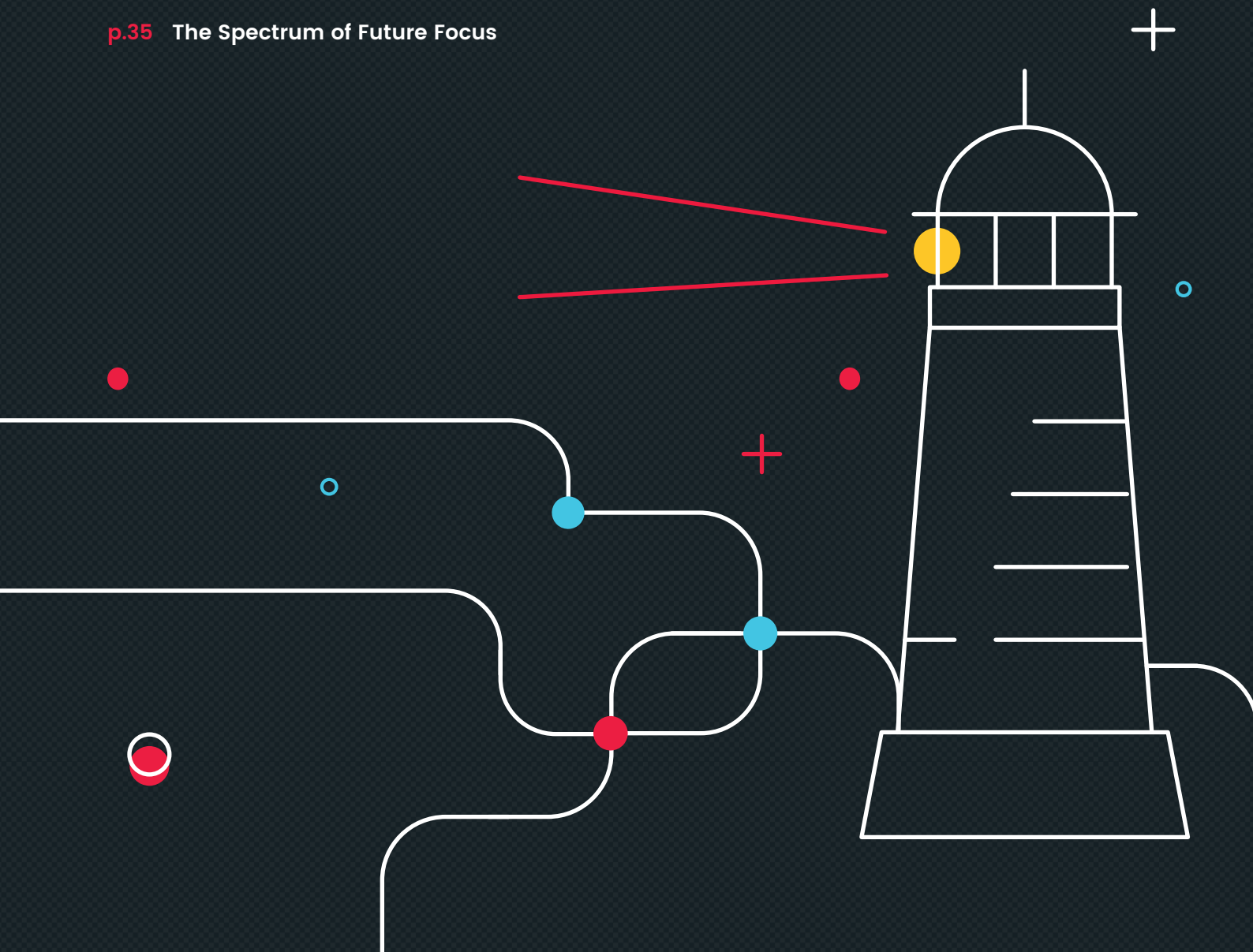
Chapter 3

Future focus

p.30 Summary

p.32 Appetite for change unlocks and sustains growth

p.35 The Spectrum of Future Focus



Summary:

- Analysis of the SGI shows that a long-term orientation and an appetite for change creates more value, particularly when companies invest in future growth 'cyclically' (as opposed to continuously).
- But only a select few companies are actually able to resist the systemic pressures of short-termism: we call these 'Visionary Companies'.
- A Visionary Company typically relies on a robust, cash-generative core business and uses this to disproportionately invest into future growth opportunities. It supports growth ambitions with compelling strategic story-telling and a multi-dimensional operating model.
- On the other extreme is the 'Myopic Company': those unable to focus on the long-term. Most companies bear more resemblance to the 'Myopic' than the 'Visionary', and should therefore look to learn from the latter's behaviours.



“That guy literally saw the future, and he took the company there.” So began our interview with a former Vice President at Intuit, when we asked him on ex-CEO Brad Smith. Intuit is the accounting software company behind QuickBooks. Ranked number 30 on the SGI thanks to strong performance across growth, value creation and shareholder value, it is – in our view – the embodiment of future focus. Particularly under Smith, it has combined strategic clarity with a unique innovation-led culture, delivering outstanding and sustainable results. But before we move to Smith, a little context on Intuit itself.

In 1983, the personal finances and accounting software market was burgeoning with several providers. But Scott Cook, Intuit’s founder, noticed that these products were difficult to use and were aimed at professional accountants and large corporations. Out of frustration that he and his wife were unable to balance a check book, Cook created Intuit to answer the following question: “Why isn’t there something to make people’s financial lives fast and easy?”. Intuit’s Quicken, followed by QuickBooks were aimed at home-users and small businesses. The products’ ease and simplicity meant the company crossed the \$1bn revenue mark by the turn of the century.

When Smith joined the company in 2008, his first step was

to go on a ‘listening tour’, engaging employees, board members and shareholders to understand the following: “What are the biggest threats and opportunities that we aren’t currently addressing?”. He learnt that the environment around Intuit was rapidly evolving. The world was becoming more ‘social, mobile and global’ (the three words rhyme in Smith’s southern-American accent), and was as a result seeing a significant platform shift away from desktop and towards the cloud. The launch of the iPhone in 2007 symbolised and led this movement; Intuit needed to move to a cloud-based model to survive. Smith invested heavily in making the transition, and with stunning success. Intuit delivered a 600% return to shareholders across the duration of Smith’s tenure²³.

Intuit exemplifies our first differentiating factor when it comes to long-term growth: An ability to self-reinvent in a world of continued and exponential change. It has achieved remarkable results precisely because it was able to move to the future horizon, focusing on initiatives that may not have paid back immediately, but that ultimately unlocked consistent growth (10% Revenue CAGR) and value creation (24% average ROIC) across the fifteen years of our study. This pattern – a correlation between investment in the future and long-term results – is consistent across the Sustainable Growth Index.

'Appetite for Change' unlocks and sustains growth

To understand if investment into future growth is decisive in unlocking success, we used an analysis which we call Appetite for Change. First, we gathered year-by-year data on all 100 companies on the SGI, in three key areas: capital expenditures, mergers & acquisitions, and patent registrations. Based on these data, we then assessed companies relative to their industry in three ways:

1. **Scale of investment**
Are the companies allocating significant capital towards future value creation initiatives?
2. **Focus of investment**
Are these investments within the current core business, or an attempt to build new business models and markets for the company?
3. **Consistency of investment**
Does the company constantly invest at similar levels, or does it cycle its future investments over the years?

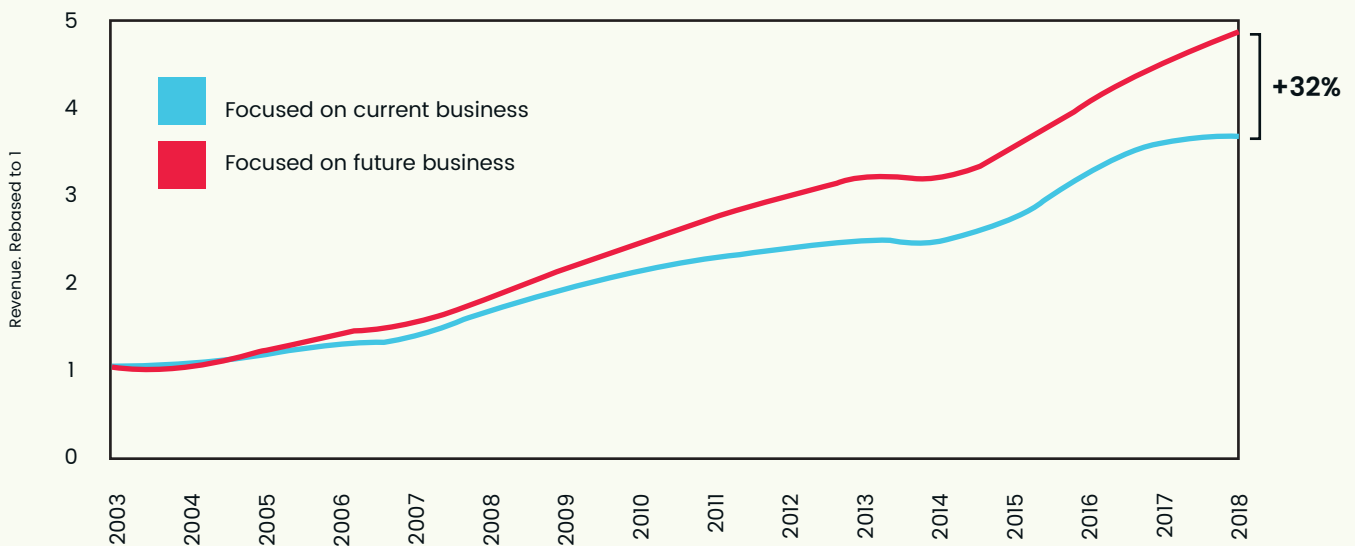
Based on these questions, we split the SGI 100 into 3 segments:

INCREASING SCALE OF INVESTMENT; INCREASING FOCUS BEYOND CORE		
	Focused on current business (50/100)	Focused on future business (50/100)
Consistent investment (50/100)	'Business-as-usual-ers' Companies who focus more on their core business relative to competitors e.g. McDonalds	'Consistent changers' Companies who are more focused on future markets than competitors, investing consistently year-on-year e.g. Intuit
Cyclical investment (50/100)		'Cyclical changers' Companies who are more focused on future markets than competitors, with very large levels of investment in some (but not all) years e.g. Alphabet (parent of Google)

SGI Revenue Evolution: The Benefits of Investing in the long-term

Across the entire Sustainable Growth Index, a consistent theme emerged. Over a 15-year horizon, the companies focused on their future business drove greater growth on average. By the end of the 15-year period, they had an average 32% revenue benefit in comparison to those more focused on their current business.

SGI 100: AVERAGE REVENUE OVER TIME
segmented by the scale of investment beyond core



Source: Company Annual Reports (FactSet)

Looking to the future, we expect the performance gap between the future-focused and the rest to continue to widen. As we saw in Dilemma 1, the pace of change will continue to accelerate, causing faster customer re-appraisals and shorter product and category lifecycles.

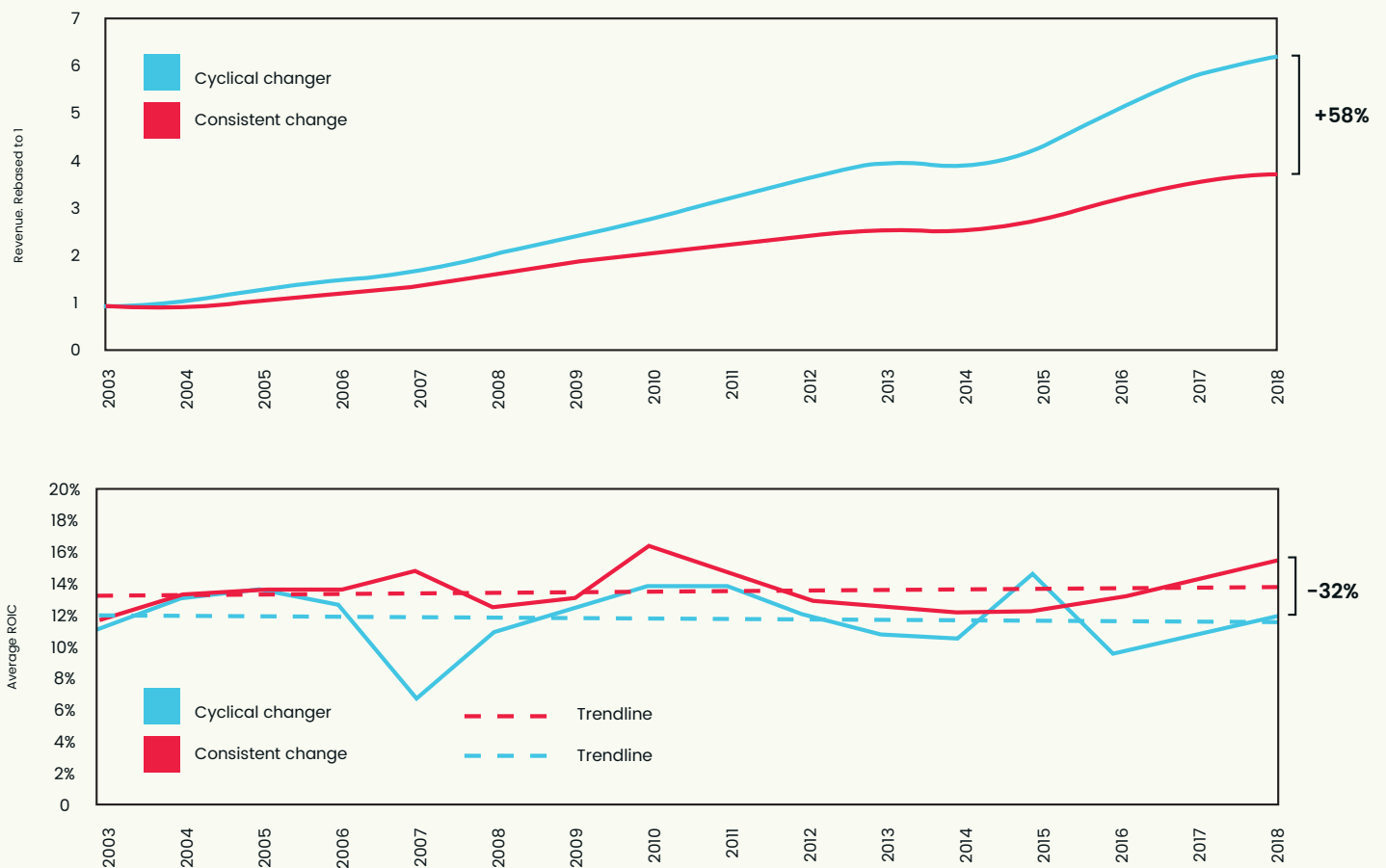
The global number of patents per year, a useful proxy for rate of disruption, is growing at 6.7%, for example²⁴. Many of the businesses who are not investing in new sources of value will therefore be left behind, unable to sustain prior levels of growth.

SGI Future Focused companies: Revenue and ROIC evolution

So investing in the future – all things being equal – will generate more growth than focusing down on the current business model. In this light, we see two viable models.

Companies can invest either 'cyclically' (by using very large, but irregular investments) or 'continuously' (by constant rate of investment over the years).

SGI: FUTURE FOCUSED COMPANIES segmented by frequency of investment



Source: Company Annual Reports (FactSet)

Between these two models for investment, our analysis indicates that a trade-off needs to be made between growth and returns. Being a 'cyclical changer' uplifts revenue (by an average 67% over 15 years), and erodes ROIC (by an average 19% over 15 years).

So which is the better route? In terms of the overall value created, the revenue benefit outweighs the ROIC erosion.

Over the long run on average, companies will make more economic profit (the ultimate yardstick for value creation²⁵) through cyclical change, despite the overall negative impact on profitability ratios. So whilst each individual company will need to plot its own course through capital allocation dependent on its own specific context, in most instances the numbers favour the companies who invest most boldly in future value.

The Spectrum of Future Focus



Our experience is that most decision makers, regardless of role within the business, would not be surprised that greater future investment creates greater long-term value. They would, however, cite the challenge of actually implementing a long-term mindset when the system all around you is focused on short term results.

In Dilemma 2 we explored the forces driving a short-term orientation. Investor demands, cash constraints and a straightforward inclination to stick to familiar territory all push businesses away from the long-term. Together, these factors contribute to a downwards spiral, where managers neglect growth opportunities due to perceived risk and entrench their reliance on the current business model. When the external environment shifts, performance suffers and a short-term mindset is further perpetuated.

The responsibility for preventing and combatting a downward-spiral of short-termism sits with three parties: investors, regulators and business managers themselves. For the purpose of this research, the roles of investors and regulators are largely out of scope, but thankfully there is plenty that business managers can do, to re-orient their organisations to the long-term and to become more effective at changing in response to a changing world.

Intuit, for example, has resisted the temptations to a short-term mindset. In its move from desktop to cloud (as well as other shifts over the years), it has consistently taken the long view of the trends affecting its business and the changes it needed to make. Intuit embodies what we call a 'Visionary' Company – businesses who are able to avoid the

pressures of the short term and create exceptional value as a result. Visionary Companies are often in high growth industries, but not always. The approach has been used across sectors as a means to generating greater growth and value creation than competitors.

But most companies are not so lucky. Pressures from investors, incentives and uncertainty mean that most companies operate with a more 'Myopic' mindset. These companies focus primarily on extracting value in the short term, rather than creating new long-term value. As a result, they are often resistant to change, regardless of the extent to which they need it.

Between these two paradigms – the Visionary Company and the Myopic Company – there is a spectrum of ability. Most companies, from our experience, are closer to the Myopic than to the Visionary paradigm. Indeed, in some cases, the behaviours exhibited by the Visionary Company may not be appropriate or feasible for all. But as we expand in detail on the behaviours of these truly future-focused companies, readers should reflect on two key questions.

1. What do the Visionary Companies do that our organisation does not?
 2. Would adopting these behaviours help us focus more on the future, and deliver more sustained growth as a result?
-

THE FUTURE FOCUS SPECTRUM

Myopic	←	Paradigm	→	Visionary
<ul style="list-style-type: none"> • Focused on a short-term horizon (quarter-to-quarter results) • Exploits the current business model 	←	Description	→	<ul style="list-style-type: none"> • Focused on a long-term horizon (multi-year) • Explores the future business model
<ul style="list-style-type: none"> • Inconsistent cash generation in core business 	←	1. Capacity for change	→	<ul style="list-style-type: none"> • Strong cash generation in core business
<ul style="list-style-type: none"> • Focused on the current environment • Focused entirely on core business (the 'Now') 	←	2. Opportunity identification	→	<ul style="list-style-type: none"> • Focused on future scenarios • Willing to explore adjacent and transformational opportunities (the 'Next' and the 'New')
<ul style="list-style-type: none"> • Capital allocated to the core business only 	←	3. Resource allocation	→	<ul style="list-style-type: none"> • Disproportionate capital allocation to future growth opportunities
<ul style="list-style-type: none"> • Lack of clarity on long-term direction 	←	4. Strategic narrative	→	<ul style="list-style-type: none"> • Compelling and clear strategic direction for employees and shareholders
<ul style="list-style-type: none"> • Incentives, time allocation and organisational capabilities push the organisation to a short-term focus 	←	5. Operating model	→	<ul style="list-style-type: none"> • Incentives, time allocation and organisational capabilities enable a multi-horizon focus

1. Capacity for Change

One might imagine the Visionary Company as far-sighted, interested only in a made-up future full of science-fiction-esque technology. But the reality is far different. Everyone has to answer to short-term shareholder pressures, no matter how visionary. What differentiates the Visionary Company is not a neglect for short-term profit, but the fact that they do not have to compromise between profit and growth at all.

Specifically, a Visionary Company ensures strong cash generation in its core business. To some extent, everything else is secondary. We will go on to explore the importance of being able to identify future opportunities, to allocate resource across horizons, and to develop a compelling strategic narrative. But without consistent and reliable cash generation, these behaviours will be doomed to fail: either through lack of investment or through lack of confidence. For companies trying to break the cycle of short-termism, then, the first step often needs to be around making sure the core business is

robust, as a basis for funding a move beyond it.

Tobacco company Phillip Morris International (PMI) illustrates that strategic vision only works if it is enabled by consistent cash generation. In response to continued regulatory pressure, stakeholder challenge and weakening demand PMI has committed to the vision of a "smoke free future" through its range of reduced risk nicotine products. But it funds the future plan through a rock-solid base business: its EBITDA is 43% of revenue, higher than any other major tobacco player and almost all consumer goods companies. Without a robust cash-generative core business, its commitment to moving into new categories would be unfeasible.

PMI illustrates the need to build up a capacity for change. Lofty visions need to be built on an efficient base. Without this crucial first step, meaningful change becomes an uphill battle.

2. Opportunity Identification

To the businesses which have built up a capacity for change comes the next critical question: need for change. To what extent does my business need to pivot its direction? Fundamentally, we see this as a challenge of opportunity identification and prioritisation. The Visionary Company is better at understanding where it needs to go in the future, and then pursuing that direction.

Intuit, as we have seen, outperformed its peers by absolute clarity on its opportunities: the move from desktop to software-as-a-service chief among them. Here, there are two key points: firstly, Intuit's strategic actions were not driven by their capabilities and assets at the time of its decision-making. Instead the primary driver of the decision-making was the commercial opportunity, or more specifically – the consumer problem (which we will explore in more detail in subsequent chapters). Secondly, whether explicitly or implicitly – the assessment of future value took into account that change is exponential – in Intuit's case the rise of three trends: 'social, mobile, global'.

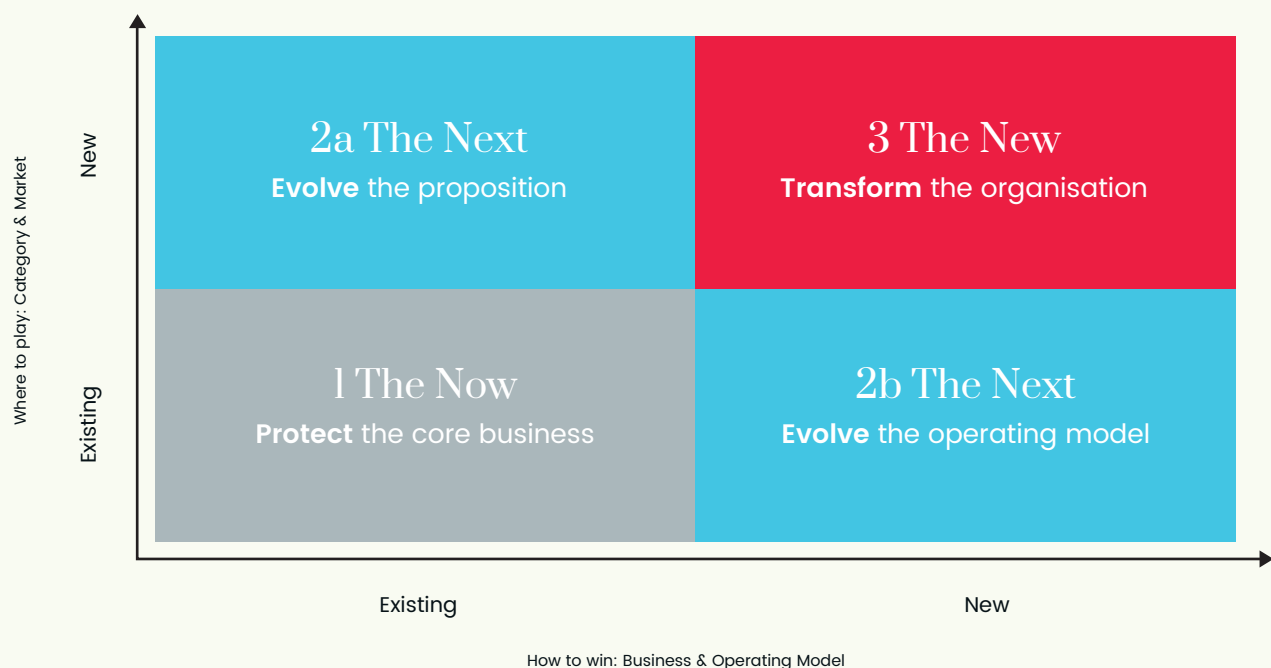
So, you need to identify opportunities from two perspectives:

- a) **What are the big opportunities for our business today?**
- b) **How will these opportunities evolve in the future?**

In moving from question (A) to question (B), it is critical to challenge pre-held views about the marketplace. If the future market looks the same as today's in your analysis, stress test your assumptions about growth and change. Ask which exponential factors you could be ignoring.

So once (and only once) you have defined your potential opportunities, it's time to think about their proximity to the core business. We look at this through two lenses: proximity to the core category, and proximity to the core operating model. Based on these two factors, you can plot your future opportunities on the 'Value Pool Matrix': a basis for prioritising opportunities and understanding the level of organisational change that is needed²⁶.

FUTURE VALUE POOLS: PROXIMITY TO THE CORE BUSINESS



Based on where your opportunities sit, a different strategic mandate is required:

Box 1: THE NOW:

If you wake up halfway through life to find out that all your future opportunities sit in box 1, then you are very lucky! You should 'double down' on the core: invest in retaining and strengthening the market position you have today. But a word of warning: just because this is your biggest your biggest value opportunity today, there is no guarantee it will remain so indefinitely in the future. If you find yourself in this position, each planning activity should look to challenge assumptions and push thinking. Are there other value pools you should be considering for the long term? Another risk is in how you are looking at the firm's playing field: are there areas in boxes 2 and 3 that you just have not considered? The famous quotation from former Blockbuster CEO Jim Keyes springs to mind here: "Neither RedBox nor Netflix are even on the radar screen in terms of competition"²⁷. That Blockbuster filed for bankruptcy two years later in 2010 should serve as a cautionary tale to think broadly about your category, opportunities and competitive set²⁸.

Box 2a: THE NEXT

In box 2a, your core capabilities and assets are still relevant, but you need to deploy them in a different way. Think about your most powerful assets: your brands, infrastructure, manufacturing and people. How could these be redeployed in new ways to make new products or meet new consumer needs more often and more effectively?

Box 2b: THE NEXT

As with many companies in the wake of the digital revolution, Intuit found themselves in Box 2b. The problem here was not so much the product but the environment around it: people still needed quick and easy accounting software when Smith joined the company, but they wanted it on their phone, and they wanted updates to take seconds, not years. In these instances, companies need to evolve how they deliver products and services to consumers, but not necessarily what they deliver.

Box 3: THE NEW

If your biggest opportunities sit in Box 3, to be frank – you face an uphill challenge (but not an impossible one). Typically, the 'downward spiral of short-termism' will have set in, meaning that there is a challenge freeing up cash to invest in the future. The first point of call, where possible, should be to act sooner – to evolve your strategy 'up' or 'across' the value pool matrix so that a jump from 1 to 3 is not required. But if it's too late already, a transformative leap is required: be it through an acquisition or significant investment into new organic growth.

Orsted, a Danish energy company, shows that moving directly to The New is not impossible. In 2012, when gas prices dropped and Orsted's business model came under increasing pressure, it was left with two options. First, it could cut cost and wait for gas prices to rise again. It chose the second option – transforming its business model to the growing corner of the market: renewable energy. Whilst the journey was not easy, by 2019, 37% of Orsted's revenue was in wind energy. Even more remarkable, their share price has consistently grown ahead of the market in the same period²⁹.

With change ever-constant, the reality is that very few companies face a box 1 situation (where they are already in position to address the big opportunities of the future). As such, the majority of corporate strategies should be calling for fundamental change. Inherent in this – you will need to be prepared to cannibalise your core business. Whilst this is an uncomfortable thought, if the future of the market is outside of box 1, then disruption is inevitable. The only question is who the disruptor will be: your own company or competitors.

3. Resource allocation

The Value Pool Matrix and its process of opportunity-mapping can all too often be a theoretical exercise. What differentiates the Visionary Company, however, is the ability to translate insight into action. Here we take the Value Pool Matrix and its three spaces – the ‘Now’, the ‘Next’ and the ‘New’ to create strategic guidelines for an organisation.

Getting this right will ensure that your key opportunities receive the investment, attention and attitude that they need based on their proximity to the core business.

The exact version needs to be tailored to business context, but we start with something like this³⁰.

OUR FRAMEWORK FOR RESOURCE ALLOCATION AND INNOVATION FOCUS

	HORIZON 1 THE NOW	HORIZON 2 THE NEXT	HORIZON 3 THE NEW
Growth Mandate	Protect (and extend) the core business	Evolve to address adjacent opportunities (where to play or how to win)	Transform to address new growth areas
Resource Allocation (financial and human resource)	~60%	~30%	~10%
Innovation Strategy	Renovate existing products (the ‘Now’)	Create products / business models that are new-to-the business	Create products / business models that are new-to-the world
Risk Management Approach	Hyper-focused: 1 big bet	Future priorities: 3-5 bets	Portfolio of small bets to test and learn
Priority KPIs	Efficiency: Profit metrics	Scale: Market share metrics	Customer need: Customer metrics (NPS, etc.)

The numbers in the Resource Allocation row are vital, and should be flexed based on the business’ need to change. If, for example, you are one of the lucky candidates where all your future opportunities sit in Box 1, resource allocation to the Next and the New should be minimal.

The numbers displayed show how it might have looked in Intuit’s case, where the Next (moving to desktop) required disproportionate investment in the early phases, despite not immediately contributing to revenue.

As well as different resource allocation needs, each horizon needs a different mindset and behaviour.

THE NOW will create the cash to fuel the Next and the New, so prioritise efficiency and focus on as few initiatives as possible. Profit delivery is the ultimate success metric here.

THE NEXT will often be a company's key strategic priority. In this case, focus most discretionary investment here and look to build scale, with the assumption that profit can come later on if you have the customers and capabilities in place.

THE NEW is inherently more uncertain, and as such it is the place for experimentation and innovation. This shouldn't be the space for 'big bets': test and learn on a small scale before making significant investments. Success in this horizon should not be defined from day one in terms of financial metrics: understand whether the market really wants your new products before you scale them.

Of course, these are only guardrails. Each individual organisation will have to shape the 3-horizon model to fit their specific needs, capabilities and future growth opportunities. Google, number 15 on the Sustainable Growth Index, used a 70:20:10 ratio across the three horizons. The 10% allocated to The New was focused on its so-called moonshot scenarios: futuristic new-to-the-world innovations such as driverless cars³¹.

Whatever the right balance is for your organisation, two points are critical. Firstly, the business needs to be able to track its allocation of human and financial resource across the three horizons (which can often be a significant auditing and data-gathering exercise in itself). And secondly – once it is understood where you sit today – the business needs to set up clear rules and guardrails. Most organisations do not have such guardrails in place, and as a result time and focus is pulled towards the Now. Whilst this might benefit quarterly results, it will be to the detriment of a business' sustainability if the big opportunities lie beyond.

4. Strategic Narrative

Once you've developed clarity on strategic priorities, the next challenge is selling the idea, both internally to employees and externally to shareholders.

The number one blocker of any growth strategy is the human inclination to resist change, to settle for what's known and comfortable. In previous research, Cognosis identified that to work effectively, strategy needs to engage and persuade individuals on four levels:

Rational:

Having absolute clarity on what the strategy is and why it is being pursued.

Interpersonal:

Feeling a personal connection and commitment to the strategy.

Practical:

Seeing that it is feasible and translates into workable plans.

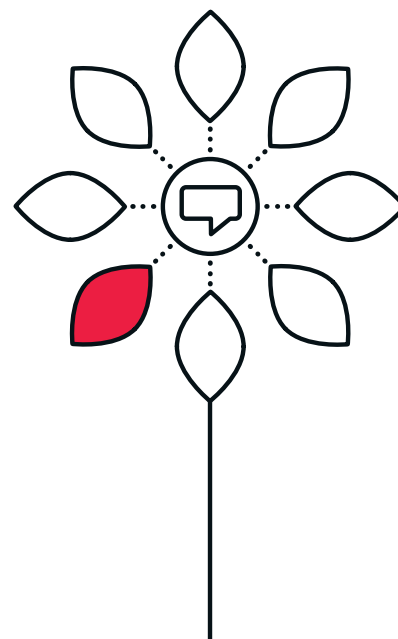
Intuitive:

Believing in the future organisation created by the strategy.

The more radical the change, the more challenging it is to get buy-in on each of these fronts. Which brings us to the all-critical importance of vision. Without a clear and compelling vision of where the business can go, any growth strategy is set up to fail. Intuit's rallying cry of "Social, Mobile, Global" delivered on exactly that. Not only did it show employees where the firm needed to go, it made them want to go there, unlocking genuine commitment and motivation³².

Narrative plays a critical role, too, in resisting the short-term pressures from investors that we explored in Dilemma 2. Shareholders will inevitably demand quarterly earnings, but they will demand it from some companies more than others. This can be seen most clearly in the classification of companies into 'Growth' and 'Value' stocks. In simplistic terms, if you are seen as a Value stock, you need to deliver earnings today (beyond the market's expectations). If you are a Growth Stock, you need to grow over time to deliver future earnings. Getting into the 'Growth' camp is therefore attractive to company management on two counts; they have higher relative share prices and they receive less scrutiny over short-term earnings delivery.

While classification into 'Growth' and 'Value' is linked with sector – technology companies would typically be Growth stocks – it is not totally determined as such. Companies in mid-low growth sectors with a perceived sustainable competitive advantage can also be classified as Growth stocks. But only if the strategic narrative is compelling. In reframing quarterly results within a long-term picture of where the firm is heading and the growth it will deliver, investors will be less aggressive around the more immediate short-term indicators, and companies can in turn devote more attention to creating sustainable growth.



5. Operating Model

As we have seen, The Next and The New have different objectives and challenges compared to operating the core business. So if your future opportunities sit in these areas, simply applying the same organisational model to new initiatives won't work. In particular, we see three common risks (from an organisational design perspective) that block plans in The Next and The New from flourishing:

- a) **The risk that a long-term focus is “incentivised out” of employees.** Whilst the strategy might be sound and have buy-in, if evaluation systems and financial incentives are not recalibrated in accordance with the long-term goals, employees will naturally return to old behaviours. To quote Berkshire Hathaway Vice Chairman Charles Munger, “show me the incentive, I'll show you the outcome”³³.
- b) **The risk that share-of-attention is diverted away from the future and back to the core.** Another problem we often see is that employees who learnt their trade inside the core business do not feel as comfortable outside it, and so neglect the demands of The Next and The New. Again, the solution lies in a structure that makes priorities clear and safeguards against this (natural) tendency. Intuit, for example, borrowed the concept of “unstructured time” to guard against attention being diverted back to today's business. Smith mandated that 10% of all non-executive employees' time was dedicated to experimentation on new ways to solve new customer problems.
- c) **The risk that the capability needs are just too different.** But often (unlike in Intuit's case) it is just not feasible to have the same people working across different horizons. Often the capabilities needed are too different, and the capabilities needed to succeed in your core business can actively harm new initiatives. In this instance, the company needs to go a step further and set up a separate unit with the permission to seed and grow new and adjacent ideas outside of the core business. Two models are possible:
 - **Internal Incubator Model (e.g. ABInBev's ZX Ventures).** Use a separate team to innovate, test and nurture new ideas before you bring them into the corporation.
 - **External Venture Model (e.g. Diageo's Distill Ventures).** Use Venture Capital-style investment to nurture start-ups and new ideas aligned to your growth opportunities. When the initiatives have reached sufficient maturity, they can be acquired and integrated into the core business.



Future Focus: Closing Thoughts

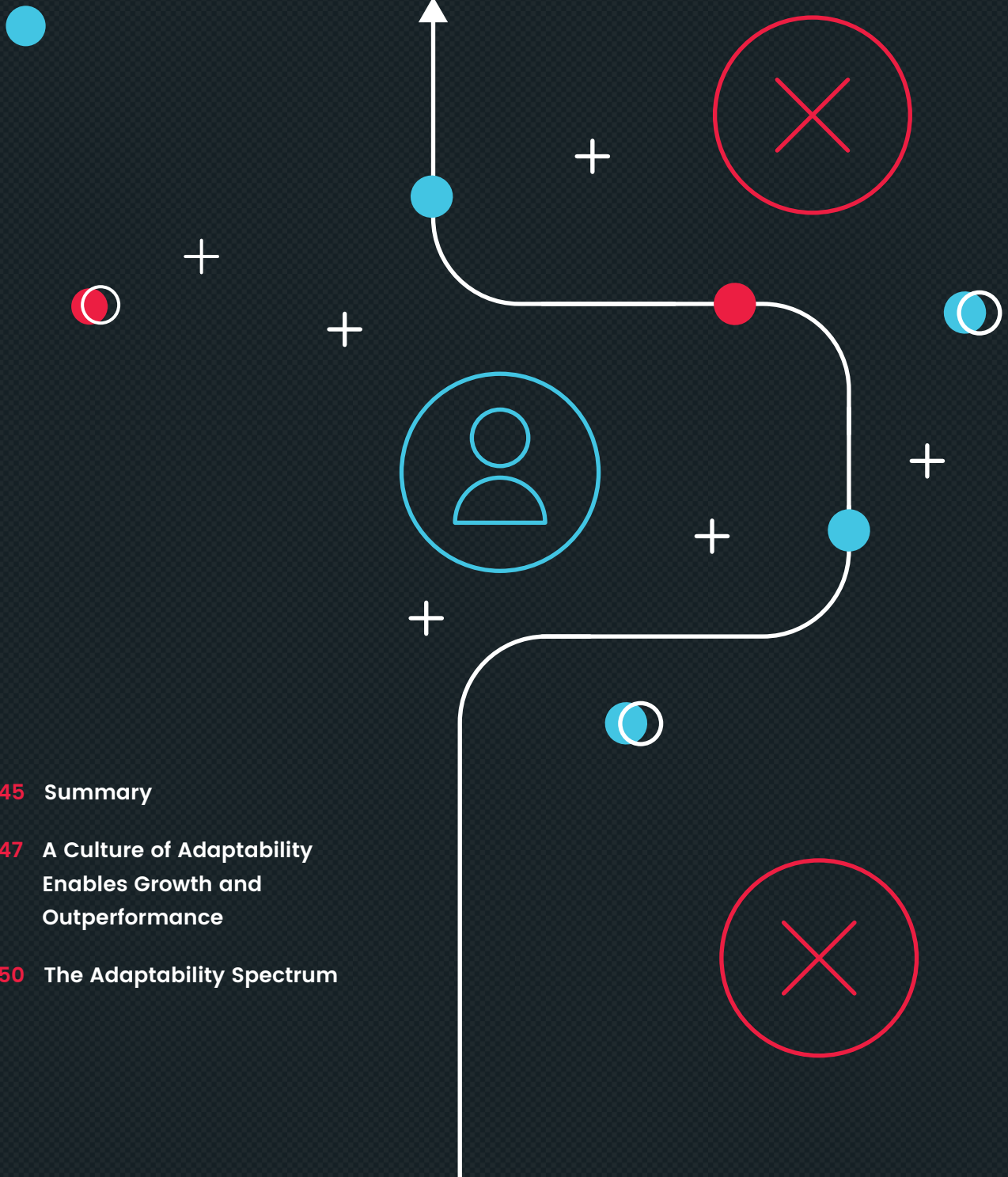
So Future Focus requires a cash-generative core business, a disproportionate focus on future opportunities, a compelling strategic narrative and a versatile operating model. **It also requires a continued commitment.**

By the time you have managed one disruption, reinvented the business, it will be time to do it all again. Intuit did not stop at the move from desktop to the cloud. In the face of further technology shifts, they have again updated their strategy in 2018 to becoming 'an "AI-driven expert platform," where we use Artificial Intelligence to solve the most pressing customer problems and deliver

awesome experiences.' In their first year since the change, they have increased the number of employees working in AI by 60%, indicating their commitment behind the new direction³⁴.

But what about when you lay out a strategy, and your assumptions don't hold true? To quote former heavyweight champion Boxer Mike Tyson, "everyone's got a plan 'til they get punched in the mouth". Next we explore the behaviour needed to complement a focus on the future: the ability to identify and adapt to new developments in the marketplace; the changes which you did not foresee coming from years out.

Adaptability



p.45 Summary

p.47 A Culture of Adaptability
Enables Growth and
Outperformance

p.50 The Adaptability Spectrum

Summary:

- To complement a long-term orientation, companies need to be adaptable: able to respond quickly and effectively to changes in the marketplace as they occur.
- Whilst evidence from the SGI (paired with MIT Sloan's Culture 500 analysis) shows that this is the most important behavioural contributor to sustainable, profitable growth, remarkably few companies think that they are actually good at responding quickly and effectively to change.
- Most mature companies should look to address their adaptability gap by learning from the new age of companies, symbolised by Silicon Valley, who have grown up in a high-change environment and have adaptability encoded into their DNA.
- Whilst not all learnings will be applicable to every industry, companies should look to become more adaptable in how they build strategy, work as a team, create products and utilise technology, all as a means to quicker, better responses to unforeseen change.

For a 200-year old incumbent, maintaining consistent outperformance would seem unlikely. But British multinational Reckitt Benckiser (RB) has outperformed its industry in terms of both revenue growth and profitability, granting it rank 19 on our SGI. Indeed, the comment of their former Head of Innovation on RB was telling: "It's the stuff of business school case studies". Whilst recent years have certainly been testing for RB (mostly stemming from its 2017 acquisition of Mead Johnson), we see its history as rich with best practice and learnings for other companies. Two factors in particular really stood out to us as what has differentiated RB from its competitive set.

The first point is its "Powerbrand" strategy. Developed in the early 2000s, the strategy split the RB portfolio into two halves. On the one hand were the Power Brands – between 15 and 20 flagship global brands such as Vanish, Dettol and Lysol. On the other, the local brands – typically smaller brands that did not have the same scale or international awareness. The basic principle was that the Power Brands (as the name suggests) had an inherent competitive advantage, and therefore a dollar invested in a Power Brand would generate higher returns than a dollar elsewhere. RB pursued the insight with ruthless focus, disproportionately investing behind the Power Brands at the expense of the rest of the portfolio's success. What struck us as unique, however, was that whilst the underlying portfolio strategy remained constant (RB was talking in terms of Power brands for all of fifteen years), the specific brands in the priority list evolved over time. RB was constantly evaluating which members of its portfolio deserved the title 'Power Brand', and shifted investment quickly to the different opportunities as and when they arose.

In addition to the Powerbrand strategy, RB's ways of working were a key point in their success. Their 'creative conflict' mindset, for example, encouraged employees to challenge their seniors in the pursuit of better outcomes. This was combined with a culture of empowerment and accountability. Decisions did not need to go through as many senior stakeholders, and as a result were made more quickly. A mindset of commitment and ownership was unlocked within the business, with employees who were able to take decisions at speed and had accountability for their actions.

In both instances, Reckitt Benckiser showed the ability to respond quickly and effectively to changes in the marketplace. Both strategically (through the ever-evolving list of Powerbrands) and organisationally (through a culture of radical empowerment), RB continued to adjust and course correct across the course of our study. As a result, it outshone competitors. In challenging trading conditions, its Return on Invested Capital averaged at 29% over the fifteen years, and its revenue grew at 8% CAGR.

In other words, RB outperformed its competitors in its Adaptability, our second key cornerstone of sustainable growth. Adaptability is comprised of three outcomes.

1 **New insight:**

Clarity on how the market is evolving in the near term

2 **Flexibility:**

The "permission" to change course as needed

3 **Speed:**

The ability to change course quickly

Adaptability is the perfect companion to Future Focus. You need both. Without Future Focus, a company lacks direction and is vulnerable to macro shifts in its environment. Without Adaptability, it is vulnerable to the unforeseen changes; events and shifts that could not have possibly been anticipated but require fundamental shifts to what you do and how you do it.

A Culture of Adaptability Enables Growth and Outperformance

To assess the importance of being adaptable, we leveraged MIT Sloan's Culture 500 research. Their study, carried out in partnership with Culture X, has gathered over 1.2million employee reviews from Glassdoor. It then processes and

standardises the information using artificial intelligence, ultimately assessing companies by nine standard measures of culture. Based on our research, it is the most robust quantitative study of company cultures ever produced³⁵.

THE 9 CULTURAL VALUES ASSESSED

Cultural value	MIT definition	Best in class company (SGI rank)
Agility	Employees can respond quickly and effectively to changes in the market place and seize new opportunities	Netflix Inc (1)
Collaboration	Employees work well together within their team and across different parts of the organisation	HP Inc (65)
Customer	Employees put customers at the centre of everything they do, listening to them and prioritising their needs	Estee Lauder Companies Inc (15)
Diversity	Company promotes a diverse & inclusive workplace	Telefonaktiebolaget LM Ericsson (69)
Execution	Employees are empowered to act, have the resources they need, adhere to process discipline, and are held accountable for results	Alphabet Inc (17)
Innovation	Company pioneers novel products, services, technologies , or ways of working	Amazon.com Inc (8)
Integrity	Employees consistently act in an honest and ethical manner	Colgate-Palmolive Company (40)
Performance	Company rewards results through compensation, informal recognition and promotions, and deals effectively with	Anheuser-Busch InBev (11)
Respect	Employees demonstrate consideration and courtesy for others, and treat each other with dignity	Kimberly-Clark Corporation (76)

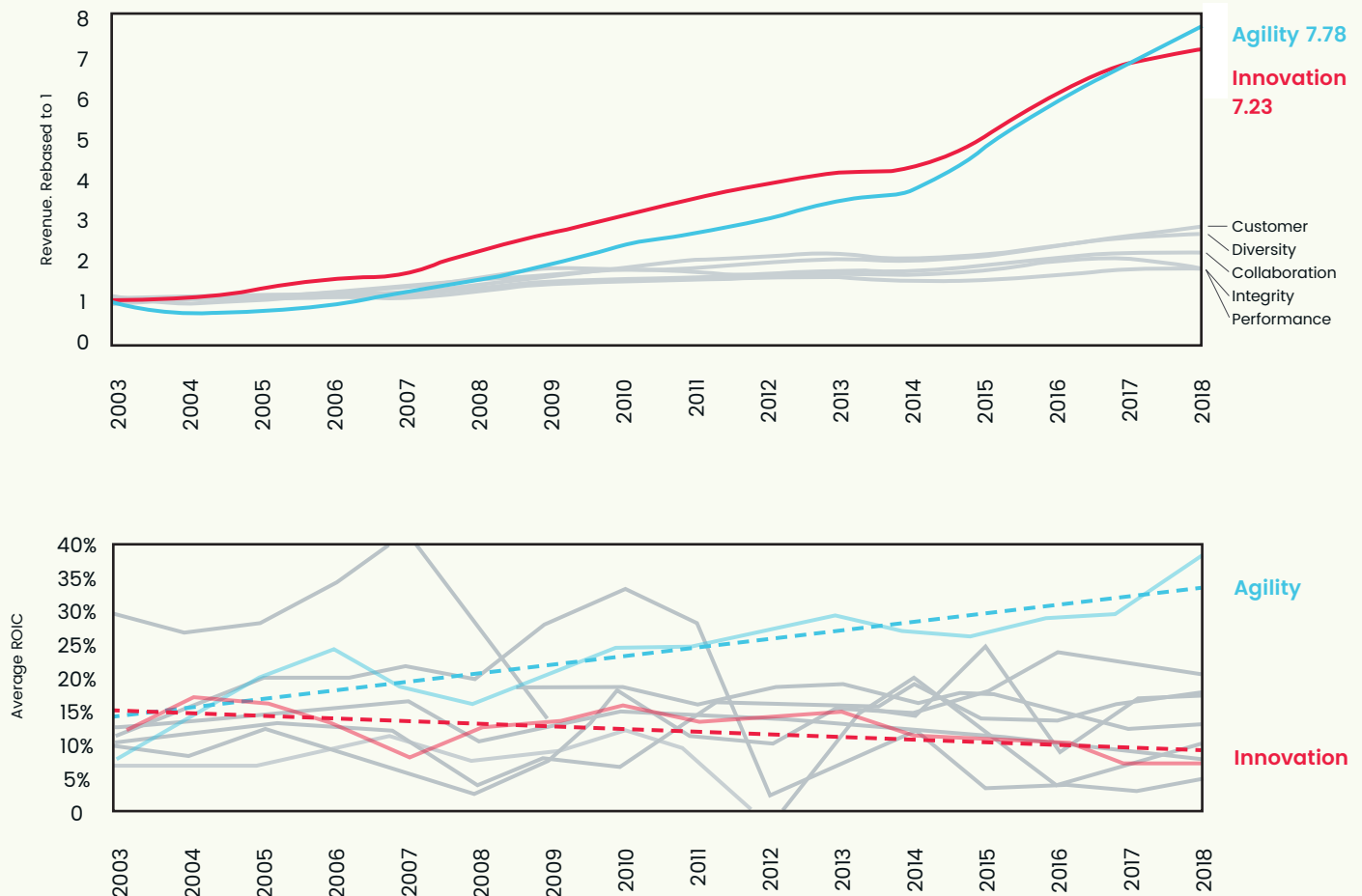
We applied MIT Sloan's dataset to the SGI companies, gathering scores against each of the nine cultural values to provide objective measures of a company's behaviours in each area.

Analysis of the data sources unlocked two key findings;

- 1. The companies that prioritise 'Agility' (our proxy for Adaptability) create significantly more value than competitors**
- 2. But companies are worse at being Agile (Adaptable) than at any other behaviour**

S&P 500 COMPANIES

Segmented by their priority Cultural Value



Source: Company Annual Reports (FactSet) & Culture 500

1. The companies that prioritise 'Agility' (our proxy for Adaptability) create significantly more value than competitors

Based on a company's score across the 9 different cultural measures, we gauged the particular cultural value which the firm prioritises.¹ For each cultural value, we were then able to track over time the average performance of the firms who prioritised any given cultural value; a means to assessing the relationship between each element and sustainable growth.

The results speak for themselves. Across the S&P 500 companies, those that prioritised agility (x7.8) & innovation (x7.2) outperformed the rest by a considerable margin. The latter finding validates conclusions drawn from the previous chapter on Future Focus: innovation is a key factor in long-term sustainable growth. But whilst a focus on innovation has a positive impact on growth, it can be a double-edged sword, leading to diminishing ROIC over time. Prioritising agility, on the other hand, leads to the greatest increase in both value creation and growth².

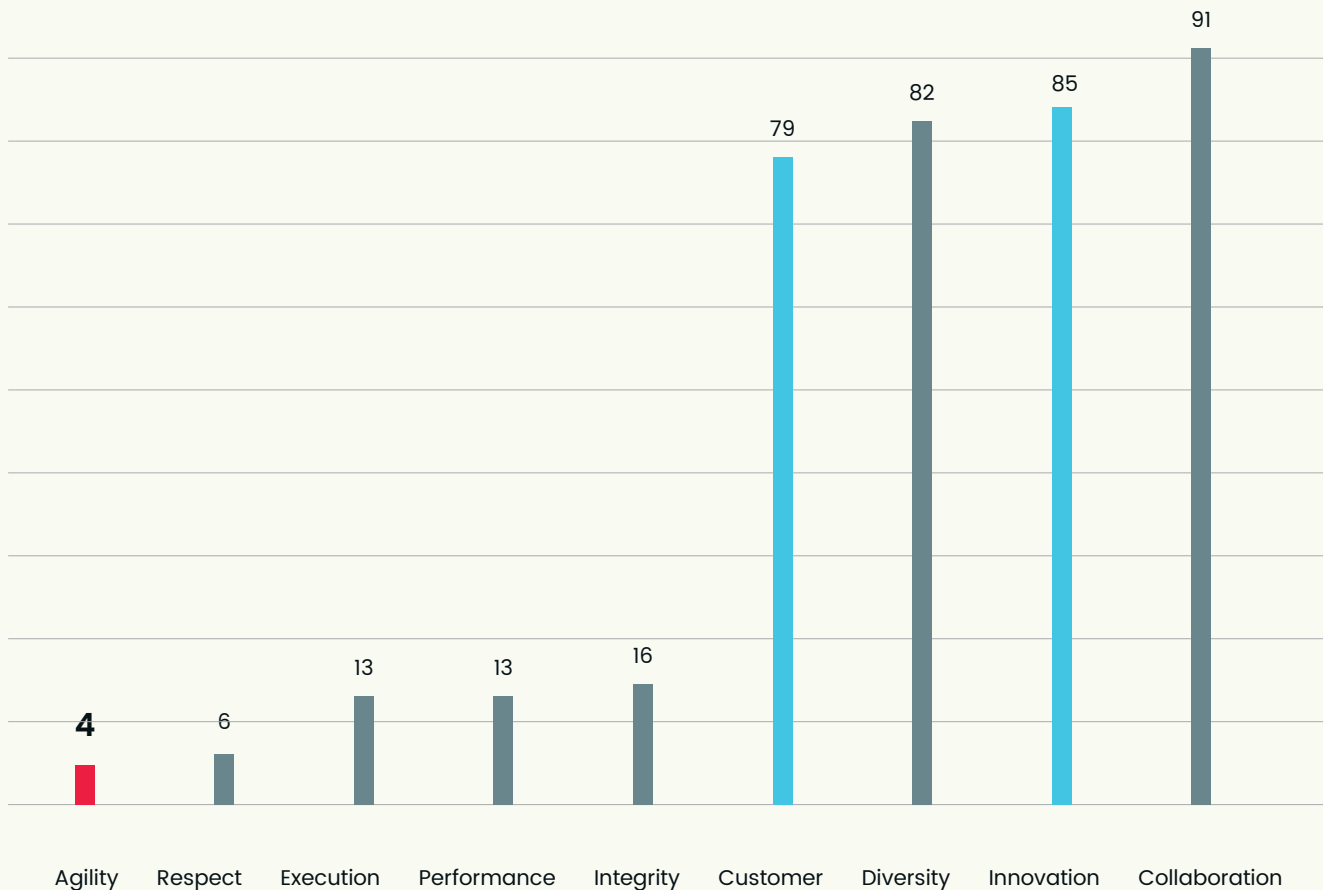
¹ A cultural value is deemed to be prioritised when it is the company's single highest cultural value score.

² Whilst the sample size for Agility in this chart is small, we saw the same pattern at statistically significant number.

2. But companies are worse at being Agile (Adaptable) than any other behaviour

SGI: COUNT OF COMPANIES WITH POSITIVE SENTIMENT SCORES

Segmented by cultural value



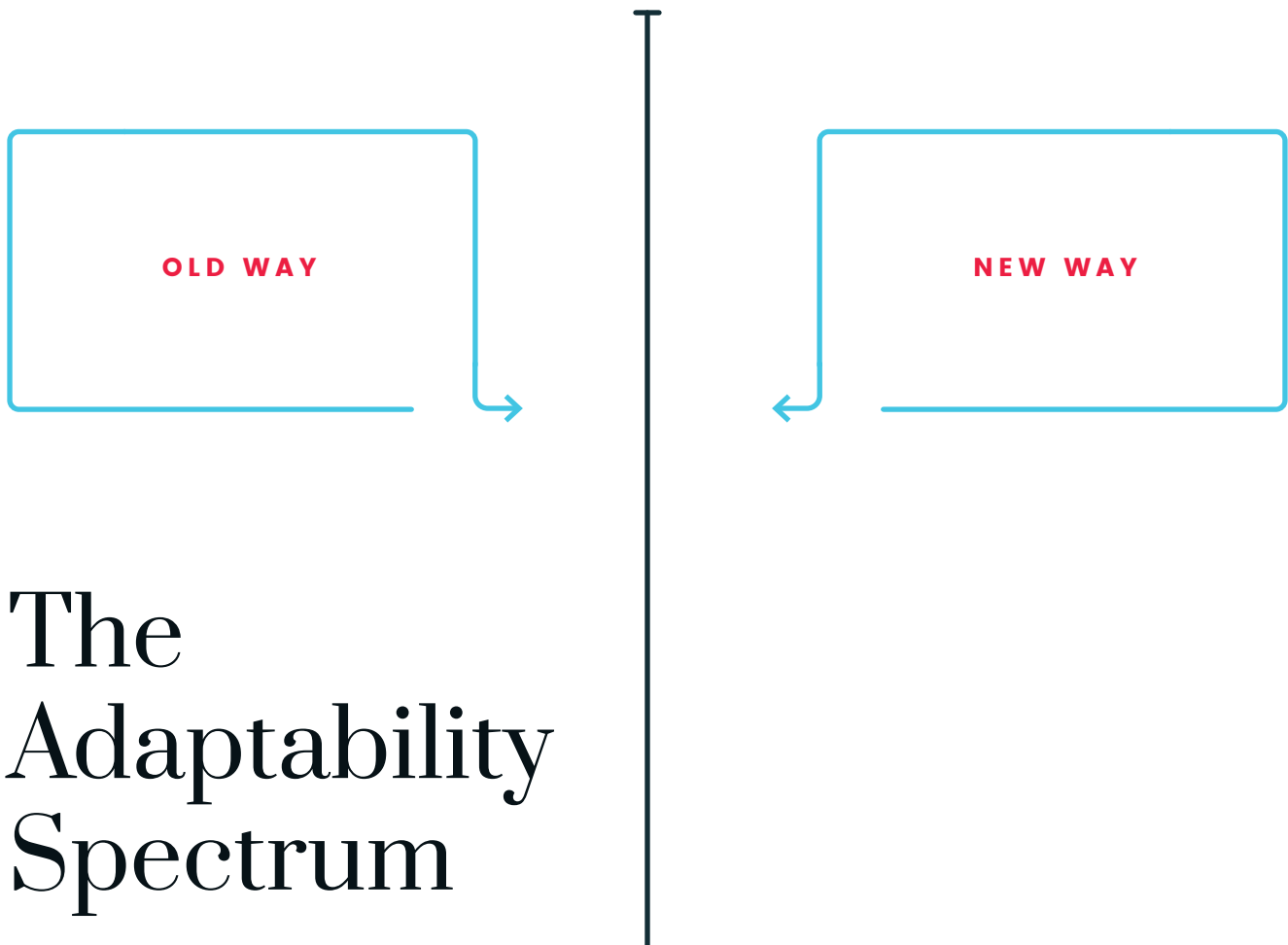
Source: Company Annual Reports (FactSet) & Culture 500

That said, remarkably few companies actually self-assess as adaptable³.

Only 4 companies in the SGI 100 have a positive score on agility, compared to, for example, 91 positive scores for collaboration. In other words, by the admission of their own employees, most of the Sustainable Growth Index companies are not good at adapting quickly and effectively to change. We call this phenomenon the Adaptability Gap:

The ability to adapt is the most important behaviour for long-term growth, but simultaneously the hardest to embed. Due to our revenue size threshold of \$300million, the SGI constituents are for the most part established companies who have grown up in a less volatile era. But if the data's showing that adaptability is today the critical cultural factor (along with Future Focus), where should companies like this look to learn how to close the gap?

³ If all other cultural values are negative, it is possible for a company to prioritise Agility and self-assess negatively in this area.



The Adaptability Spectrum

Silicon Valley is known primarily because of the technical expertise of the companies that grew up there. But it's also rich with learnings from a strategy and ways-of-working perspective too. Since its companies came into existence in the midst of the technological revolution, they have always had to be changing and adaptable. Their marketplace, customers and competitors have been moving quickly for the entirety of their existence. A constant wave of new trends, technologies and behaviours is the defining pattern of their era. As a result, their future is inherently unpredictable and constant change is a necessity for survival (let alone success).

Compare that to the companies that grew up in the wake of the industrial revolution, or at least before the digital age. The rate of change, whilst not insignificant, was considerably slower. Product lifecycles lasted longer and

market leadership positions were more stable, for example. In this context, precision was the order of the day. Improving existing strategies, approaches and processes drove competitive advantage, rather than constant evolution and change.

The Rigid 'Old Way' and the Adaptable 'New Way' represent two models of how a business should be run. The 'Old Way' consists of companies such as Ford, General Electric and Rolls Royce, the 'New Way'; companies like Intuit, Amazon and Alphabet. Between these two extremes a spectrum of adaptability emerges. Our research shows that, whilst the 'Old Way' was wholly appropriate for its context, companies now need to look to the Adaptable 'New Way', and consider which behaviours they should adopt to drive new insight, greater speed and greater flexibility.

THE ADAPTABILITY SPECTRUM

Rigid (the old way)	←	Paradigm	→	Adaptable (the new way)
In a environment of static customer needs and slow technological increase, businesses gained competitive advantage through precision and efficiency.	←	Context	→	In today's less stable market conditions, the adaptability to respond quickly and effectively to unforeseen changes is critical to sustained success.
<ul style="list-style-type: none"> • Fixed strategic choices • 5-year planning cycle 	←	1. Approach to strategy	→	<ul style="list-style-type: none"> • Underlying strategic logic, with the room to flex within it as needed • Frequent refresh of long-term plan (when the environment dictates)
<ul style="list-style-type: none"> • Leaders give orders • Tiered structure • Teams split into functional silos based on individual expertise 	←	2. Ways of working	→	<ul style="list-style-type: none"> • Leaders set visions and design systems • Flat structure • Flexible and cross functional resource allocation
<ul style="list-style-type: none"> • Stage-Gate system: slow innovation process • Top management decisions drive innovation 	←	3. Product creation & innovation process	→	<ul style="list-style-type: none"> • "Lean Startup" methodology: rapid, iterative innovation process • Customer feedback drives innovation
<ul style="list-style-type: none"> • Bias towards the status quo • Reliance on best practices • Uniform thinkers • Supported by data 	←	4. Attitude to knowledge	→	<ul style="list-style-type: none"> • Bias towards continuous evolution • Reinvention of best practices • Diverse, networked, thinkers • Driven by data
<ul style="list-style-type: none"> • Deliver human requests to make us efficient 	←	5. Role of technology	→	<ul style="list-style-type: none"> • Adapt without human intervention to make us effective

To clarify, we believe that the Old Way should look to apply the New Way's learnings only where appropriate, not simply apply all its operating principles with reckless abandon. Some sectors still require a greater extent of rigidity and predictability. Which is exactly why we explored the case of Reckitt Benckiser. The consumer goods conglomerates (of which RB is one) are typically bastions of the old way.

Similarly, RB's strategy and ways of working are less fluid than many tech companies, for example. But it was able to be more adaptable than its direct competitors, and as a result delivered greater sustained performance. Each company needs to find their own point on the spectrum, but here we will overview the North Star: an ideal version of adaptable behaviours to work towards.

1. Approach to Strategy

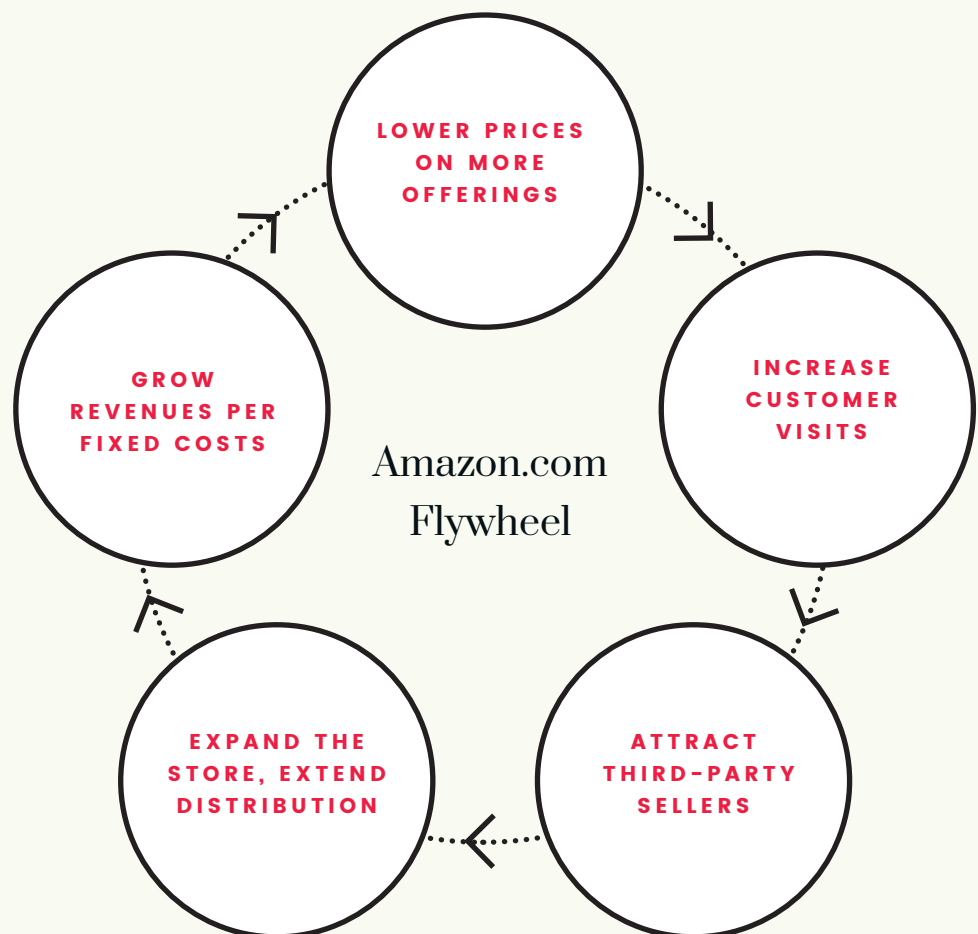
As mentioned, Adaptability is not a substitute for Future Focus – companies need to embed both capabilities into their planning. Future Focus is to act on what you can foresee, Adaptability – in addition – to respond to what you cannot. Reckitt Benckiser’s Powerbrand strategy treaded this balance perfectly. Whilst the overarching strategy remained fixed, the actual list of brands that benefited from the investment was constantly evolving, dependent on the environment at any given time. The underlying logic for value creation remained the same, but it was continually adapted to the needs of the hour.

The ‘Flywheel Concept’, coined by management thinker Jim Collins, touches on a similar point. The success stories of his famous book *Good to Great* (and other companies that he has studied since) were not because of a single strategy year after year. Rather, these companies identified the underlying strategic drivers of their business, constantly adapting how this manifested. Below are two of Collins’ examples, both of which are also Sustainable Growth Index companies³⁶.

AMAZON

Amazon has generated and sustained a phenomenal competitive advantage by adherence to a handful of principles, each empowering and enabling the next. But the way they have delivered against each is in constant adaptation and expansion based on the needs of the day (from internet retail to cloud-based web services, for example).

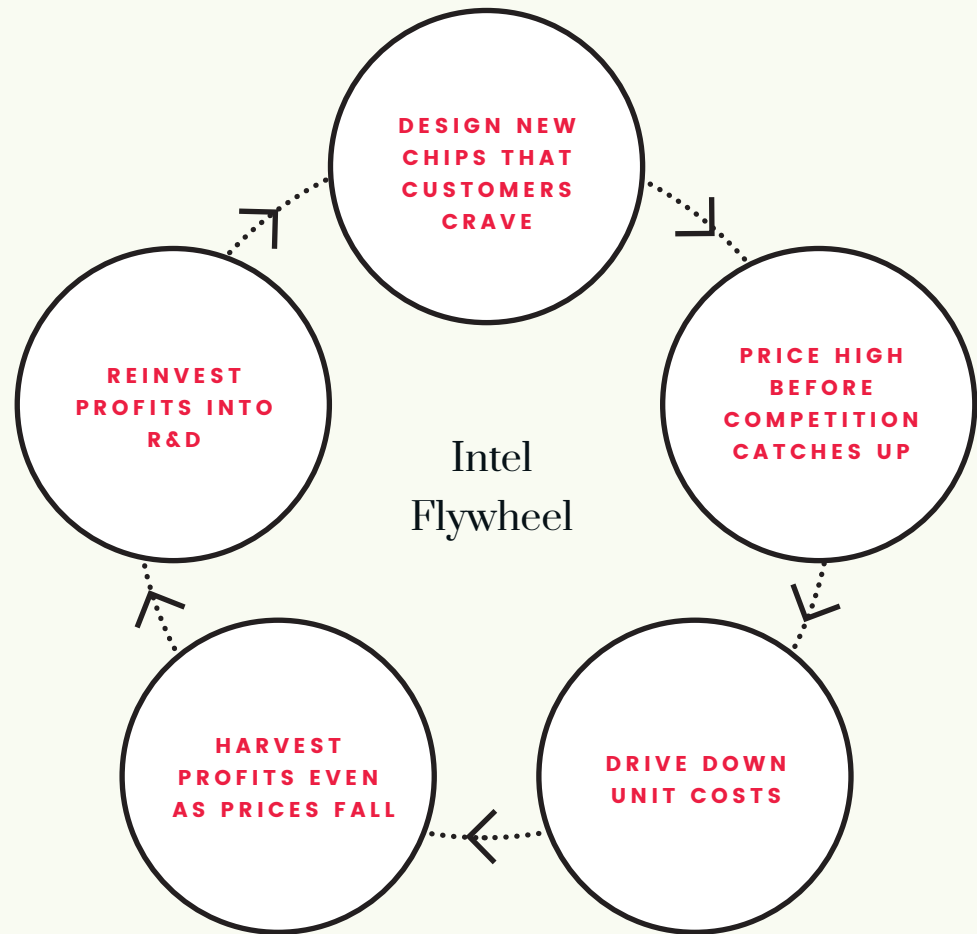
Source: Collins, *Turning the Flywheel*



INTEL

Andy Grove's strategic shift to microprocessor chips (introduced in Dilemma 2) was a bold strategic move. Certainly, it was a radical change of direction from the company that at the time had more than half of their revenue in memory chips. But seen in the light of their underlying 'flywheel' logic, the move should be seen as an adaptation of an existing approach, rather than a wholesale change of tack.

Source: Collins, *Turning the Flywheel*



So how should a business set about refreshing its strategic direction once it has laid it out? Let us be clear: a company should absolutely not simply "stick with" a strategy once it's been locked down. Even if all goes 'to plan', the strategic direction will require constant course correction as the external environment changes. Thankfully, most companies are more adaptable than this approach. RB, for example, is in the majority in its process for strategic planning: A 5-year plan refreshed every year. Whilst this might sound counterintuitive: it's absolutely necessary. Each plan should be able to demonstrate the long-term value that its initiatives can create, but the key assumptions will need to be revisited at least annually, and the resulting plan altered as par for course.

Better still is a less seen approach: building strategies of undefined time. Here the mindset is different – the strategy

needs to be seen less as a list of actions to match up with a 5-year financial commitment, but as a set of actions to drive greater value for the business. When the assumptions (about the market) underpinning the strategy are no longer true, plan out how to adapt the business' resulting approach. This could be six months or six years, but the key point is that the needs of the marketplace should drive the strategy, not the time of year.

Businesses tend to be reluctant to adopt this planning approach. They like the consistency and predictability of updating a strategic plan every autumn. Or they may need to plan out the additional resource requirements to conduct the analysis and planning well in advance, for example. If this is the reason for retaining a fixed planning cycle, then our next point will be highly relevant: building adaptability into ways of working can open up new possibilities.

2. Ways of working

Agile ways-of-working has been a particularly notable addition to management concepts in recent years. With it has come a seemingly endless array of sporting and biological metaphors ('sprints', 'scrums', 'organisms', etc.). Our take, based on the Sustainable Growth Index data and case studies from the top performers, is that at its heart 'agile ways-of-working' is an important concept. The challenge that the agile 'tribe' face, however, is in speaking a language that decision makers in businesses understand. One of our recent strategy engagements with the management team of a global consumer goods company's key market underlined that point. One of the discussion points was implementing a globally led ways-of-working change to 'Agile'. The challenge however, was, that nobody was really sure exactly what Global meant when they said 'agile'.

From our research, the subject can be simplified. There are four core elements to change your operating behaviours to become more adaptable, and be in a better position to respond to change as a result.

Leaders design systems. Traditionally, leaders led by making decisions and giving orders. This approach works in a static or simple environment, where only a few decisions need to be made. But in a more complex world, a leader simply cannot have a handle on all the issues across the organisation. Monopolizing decision making not only slows things down, it means worse decisions are made. **An Adaptable Leader spends their time designing systems and setting goals, giving their team the guidance they need and letting them reach the answer themselves.**

Flat and open hierarchy. When a leader gives orders, she can only manage a handful of people. But when she is focused on designing systems and setting goals, her span of control can broaden, and she can oversee a much larger team. The result is that much fewer levels of hierarchy between executives and those closest to the customer are needed. Information does not have to be passed up and down a chain, and actions can be taken more quickly. **Adaptable Teams have fewer levels of hierarchy and bureaucracy.**

Flexible resource allocation. As the world around us continues to evolve exponentially, we need to acknowledge that exact resource requirements are unknowable. As demands and priorities shift week by week, traditional organisations are caught out of balance, with too many employees in one team and not enough in others. But if employees are better connected with other departments, the size and composition of teams can be shifted more rapidly to deliver what the business needs. You cannot respond to change effectively if specialist teams sit in silos with pre-defined work flows. All the creative marketeers, for example, should not sit in one team – they should be spread across the organisation, allocated to specific projects based on specific needs. **At its heart, an adaptable resourcing model is outcome driven, not process driven, and as a result is inherently malleable to the situation.**

Adaptable resourcing also unlocks efficiency. When locked into static teams with immovable structures for long enough, everyone becomes busy. Work expands to fill the time available, and processes become over-bureaucratized. An adaptable resourcing model forces teams and their leaders to constantly reprioritise; to allocate work to the areas that matter, and to put their time and energy to the activities that make a difference.

Faster iterations, and more of them. The world is inherently more complex than we think it is, and we are all wrong more than we think we are³⁷. **Adaptable teams acknowledge this challenge by adopting a continuous learning mindset.** No decision is ever final and can always be improved, and they are constantly iterating to challenge their assumptions and reach a better outcome.



In recent months, the need for an adaptable people and organisation model has become even more pertinent. As 2019 drew to a close, companies were mapping out their strategic plans, budgets and resourcing requirements for the following year. Not one could have predicted the all-encompassing disruption and rapid shifts of priorities that the Coronavirus would cause. Whilst some sectors are facing challenges inherently more severe than others, those with adaptable ways of working were better positioned to respond more quickly and effectively, to the benefit and safety of their stakeholders. Michelle Peluso, IBM Chief Marketing Officer was reflecting on the role of agile working in helping IBM react to the crisis.

“Agile teams are really good at prioritisation at thinking about the outcomes they have to drive and every day prioritising what matters. That is very, very valuable right now (during the Coronavirus Crisis)³⁸.”

It is too early to identify winners and losers from the crisis, but our expectation is that the companies with the habit of Adaptability will manage the turbulence better than their peers.

So, whilst not every company will adopt each element of adaptable ways-of-working in its 'purist' form, there is real value in beginning to move in that direction. RB, for example, during its years of continued Powerbrand success, was not using fully 'agile' ways of working. It did, however, have a flatter hierarchy and empower employee decision making more than its competitors, driving greater speed and flexibility as a result. We would encourage leaders and teams to do the same.

3. Product creation and innovation process

As we have seen, both 'Agility' and 'Innovation' are fueling growth in many companies on the Sustainable Growth Index. Our view is that the two are inherently linked; greater speed and responsiveness drives better innovation. And it is here that we see, both anecdotally and through an assessment of the Sustainable Growth Index, a critical example of the capability gap when it comes to adapting quickly. The product creation machine at a number of established companies is slow and onerous; driving tangible outcomes has often been forgotten and the process remains as king. To illustrate we will highlight the two extremes of innovation speed, and how RB outperformed the consumer goods industry, which typically sits towards the slow end of the spectrum.

The Slow Way – Stage Gate Processes⁴.

Based on an intelligent premise, a Stage Gate process is designed to optimise investment in innovation. Rather than injecting all the cash at the beginning of a process, companies create defined checkpoints ("Gates") at which decision makers decide whether to continue investing behind a new product or initiative. Typically, the Stage Gate process starts at market analysis, moving through to product scoping, to business case development, to market pilots, and finally to product launch. Often, this throws up two problems for businesses trying to innovate. Firstly, the numerous Stage Gates each take time, preparation and logistics. When all of this adds up, by the time the innovation is ready, the opportunity has gone, or at the very least is crowded by other competitors. Secondly, at each 'Gate', the process relies on the expertise of a decision-maker

– typically a senior body within the company. But this individual is not necessarily in the best place to make the decision. Regardless of their experience or quality, they are unlikely to have spent the time required on the key activity: observing customers and their unmet, unarticulated needs. (This point is doubly true if the Gate decision maker is managing many different initiatives through the pipeline).

So whilst the logic behind the process is sound – conserve cash until we're sure the innovation will work – the process has commandeered the outcome. The resulting speed of innovation is harmed³⁹. In an era of low change (before the digital revolution had affected almost every industry), the Stage Gate process brought rigour and precision. But today, when applied incorrectly, it stifles innovation and speed.

The Fast Way – Lean Startup Methodology.

Thankfully, there is now an alternative to the Stage Gate system, which legacy corporations can hold up as a mirror to reflect on their own approach. In 2011, Eric Ries' bestselling book, "The Lean Startup", introduced a new approach to innovation for startups and legacy businesses alike. The governing principle is actually the same as the Stage Gate system: that companies can do more innovation with less waste, if they manage their resources efficiently. But the resulting process is very different. It looks something like this⁴⁰ (with a real-world example: the creation of Intuit's SnapTax).

⁴ Some companies refer to this as a 'Phase Gate' or 'Waterfall' process

Step	Intuit example
<p>1 Build your hypothesis</p> <p>Identify a potential product / innovation, and the associated assumptions as to why you think it will succeed. It's critical that you list these assumptions clearly and fully.</p>	<p>In 2010, engineers proposed that filing taxes through TurboTax (Intuit's existing tax-filing software) could be simpler. What if customers could take a photo of a tax form through a mobile app, and automatically update their tax forms? The question formed the basis of a new innovation concept, of which the critical assumption was this: customers are willing to pay more to do their taxes faster.</p>
<p>2 Create an MVP (Minimum Viable Product) as quickly as possible</p> <p>Rather than further analysis, assessment, research and meetings, build your product as cheaply as possible and to as small a scale as possible. Repurpose an old product or other materials if needed: it does not have to be perfect, just viable.</p>	<p>The MVP in this case, was mockups of the product functionality rendered on paper. Although these were rudimentary in nature, it meant that the idea could be shared almost immediately with a small set of customers, who provided feedback on the quality of the idea. They validated the critical hypothesis: they would be willing to pay more to speed up filing taxes⁴¹. In this way, without expending any considerable resources, the innovators were able to gain confidence through external customer support. All without launching a product or committing to coding and design.</p>
<p>3 Iterate based on customer feedback and responses to your MVP</p> <p>Check back to see whether your initial assumptions still stand, or whether you need to adjust the offering or scrap it all together. Ries calls this phase Build-Measure-Learn; reaching new MVPs as quickly as possible to test your latest assumptions.</p>	<p>The initial feedback propelled the next phase of innovation, with SnapTax being beta-tested in late 2010 with a group of customers in California. This allowed Intuit to understand the nuances of specific use cases, such as using SnapTax to complete insurance claims for hospital expenses⁴². With fresh insight, the engineers set to work, tweaking the efficacy and user experience of the app.</p>
<p>4 Pivot or persevere</p> <p>Every few months, the innovation team to check in on their direction; at such moments further investment can be given to scale the innovation, or park it if necessary. Crucially, these decisions need to be driven by customer feedback. Are your hypotheses at step 1 still valid?</p>	<p>The rapid customer feedback prompted further investment from Intuit's CEO fund (Venture Capital-style money used to seed new innovations). They began to scale the product beyond initial customers, and with further success eventually integrated the product into the TurboTax product.</p>

A key difference between the two processes is that in the Stage Gate, all the information is gathered up front. You define the size of the opportunity, the business case, the spec of the product, all before the product has been launched. The Lean Startup Methodology prioritises speed of learning. You build a product as quickly and cheaply as possible, and then define how big and effective it can be (alongside constantly iterating and improving it). The result (when well executed) is products that meet customer needs more effectively, whilst getting to the market more quickly.

RB, again, was somewhere between the two extremes. It used a Stage Gate system during the period of our study, but the process was characterized by empowerment and accountability. Product development did not need to be approved by senior executives. The product creators were granted greater ownership and decisions could be taken more quickly. Its successful case illustrates that whilst all businesses might not move fully to rapid prototyping and iteration, they should at least challenge their innovation process in two ways: how can we learn faster and how can we create quicker?

4. Attitude to knowledge

Just as the best products are created by constant testing and iteration, we believe that the best organisations develop through constant learning and evolution. But here, most organisations face a fundamental barrier – an invisible wall that blocks new insight and adaptation: confirmation bias. Human beings have a natural inclination to selectively sift through all the information they encounter, push out the points that challenge their beliefs and welcome in the points that support them. We approve the information that confirm our worldview, ignoring or de-legitimising the rest. Organisations are (typically) much the same. The ‘old way’ rigid organisation pays attention to new information only when it reinforces the status quo. A company-wide blindness can emerge, where from the outside it is clear what needs to change, but the protagonists on the inside miss what is right in front of them. (UK High Street retailers not wanting to build online businesses come to mind here).

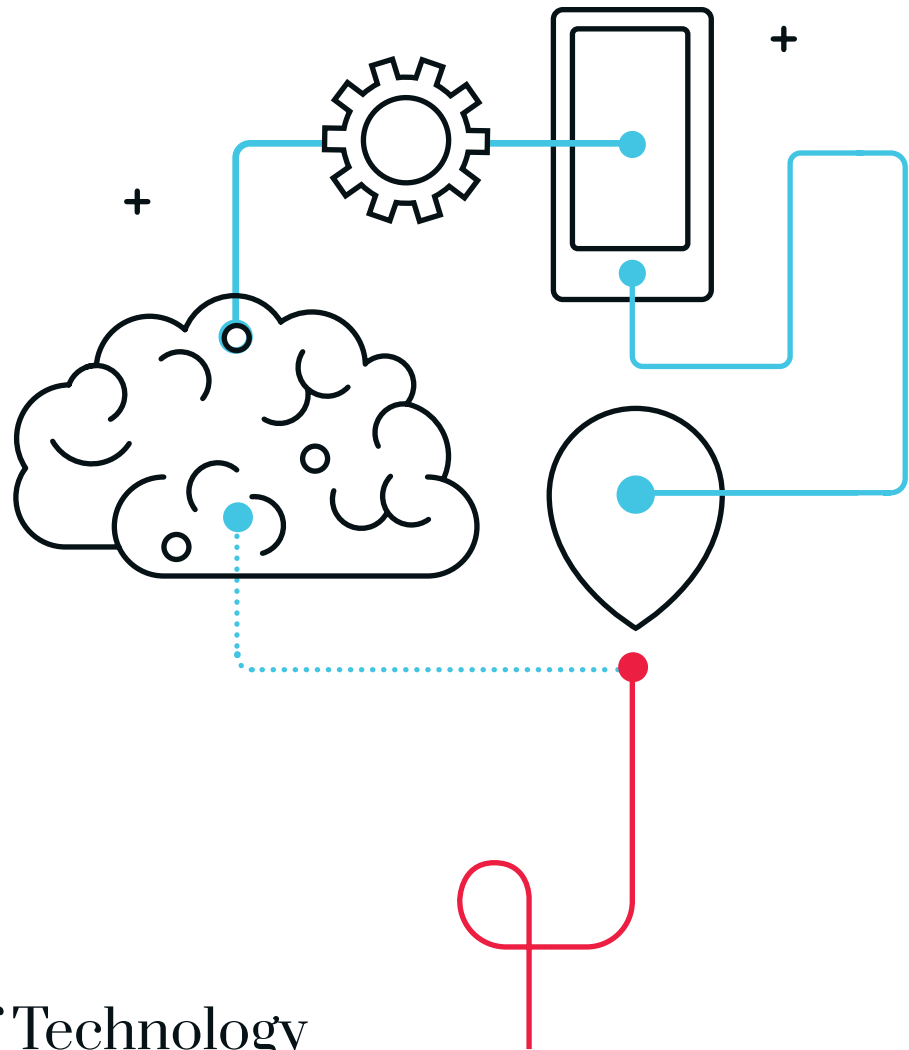
Thankfully, we see three practical questions that leaders can ask of their organisations. Many of our top-performing Sustainable Growth Index companies used these questions (or similar) to build cultures of intellectual curiosity and honesty, the basis for continuous adaptation.

Are we challenging our best practices? In a volatile environment, successful businesses are in some ways more at risk than their counterparts. The risk is in one dangerous assumption: that what worked yesterday will work tomorrow. ‘Best practices’ are a useful insight, but when they are left to rest stale without fresh challenge and perspectives, they lose their value. RB’s culture of ‘creative conflict’ captures the essence of our point here. Challenging the status quo is inherently out of the business’ comfort zone, but it is also necessary for progress. What really differentiated RB is the source of the creative conflict. It was actually the junior employees – those who lived within the company’s processes and systems – who were encouraged to challenge the status quo, and ultimately make things better.

Do we bring diverse ideas to the table? Socrates, the father of Western philosophy, is widely considered a genius. But why? Sociologist Randall Collins identifies the root cause of Socrates’ brilliance (along with that of many other notable philosophers). Socrates was powered not only by the strength of his intellect, but by the size and diversity of his network⁴². Businesses can learn from Socrates to challenge and sharpen their own ideas in two key ways. Firstly, they should build teams of diversity: both demographic diversity (e.g. gender, ethnicity, socio-economic status, sexuality) and cognitive diversity (e.g. people-driven, logic-driven, creativity-driven). Secondly, leaders should encourage and empower teams to network beyond their organisation. To hear new approaches and new possibilities of how things could be, not just how they are today. In both instances, the insights are richer, broader and will help break down the tendency to confirmation bias.

Do we use data to shape new stories? Most of today’s organisations have data that affords them rich possibilities to breakthrough insight. And whilst data-gathering capability is in itself important to strategic advantage (as we will explore in the following chapter on Customer Centricity), the questions that you ask of the data are more important. Combined with a confirmation bias, data does not add value; it just perpetuates orthodoxies. Businesses should use data when they are genuinely exploring new possibilities. If using data solely to explain what you will do anyway, then a lot of analysis time can be saved by jumping straight to the answer. When combined with a mindset of challenging the status quo, however, new insights can be unlocked.

Constantly asking these three questions can unlock a culture of intellectual curiosity. The company will see new insight more clearly and more quickly than competitors. But there is a second equally important benefit, which again we saw in RB’s culture of creative conflict. Employees want a culture where they can change, amend and improve the processes they work within. For RB, the culture unlocked an ownership mentality, and with it a commitment to the firm’s continued success.



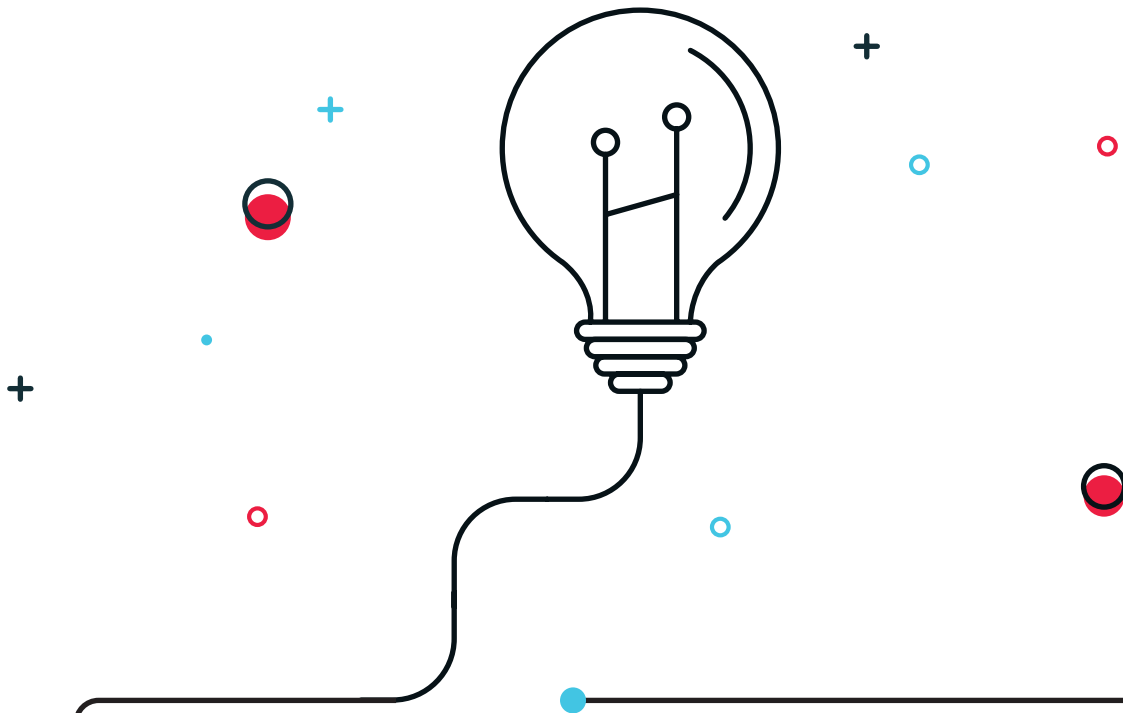
5. The Role of Technology

The mandate to adapt need not only refer to employees. As machine learning opens up new possibilities, businesses should consider how they can set up their technology to enable the organisation to adapt and evolve even before human intervention is required.

Nike, for example, is Number 25 on the SGI and is using AI to drive greater personalisation and an enhanced customer experience. Through its recent acquisitions of data science companies Zodiac and Celect, Nike is now a leader in processing its customers' data, gained first hand through its suite of mobile apps and growing Direct-to-Consumer model. With these added data-science capabilities, it is now able to deliver fully personalised products – “twenty thousand different shoes rather than one shoe twenty thousand times”. For Nike, Technology is fuelling an entirely new level of adaptability.

Although Nike is a leader in its use of AI, it is no longer an outlier. IT consultancy Gartner's annual “hype-cycle” plots several technological innovations, providing insight on both the maturity of technologies as well as their likelihood of adoption. Notably, there is no mention of artificial intelligence on the latest release. Instead, there is a separate release for all technologies that are currently in development under the AI umbrella. This comes as no surprise, as there is already widespread support and adoption of AI technologies. Research from Gartner also shows that in 2019, 14% of businesses were deploying AI, compared to only 4% the year before⁴⁴.

As AI moves further into the mainstream in the coming years, we will see the bar raised again for how quickly and flexibly companies can respond to external change.



Adaptability: Closing Thoughts

Businesses will need to find their own way to becoming more adaptable. Fully agile ways of working, a lean startup product creation approach and an AI-driven operating model will seem certainly seem unfeasible to many readers' companies. But a move in that direction is possible, provided it is not a set of individual initiatives. Organisations become more adaptable when they embrace all five elements

in tandem. An adaptable resourcing model, for example, empowers a more flexible approach to refreshing strategy. A culture of intellectual honesty helps you through the product testing and iterations in a lean innovation process. When each of the five areas is activated in tandem, organisations can improve efficiency, adapt faster and sustain performance for longer.

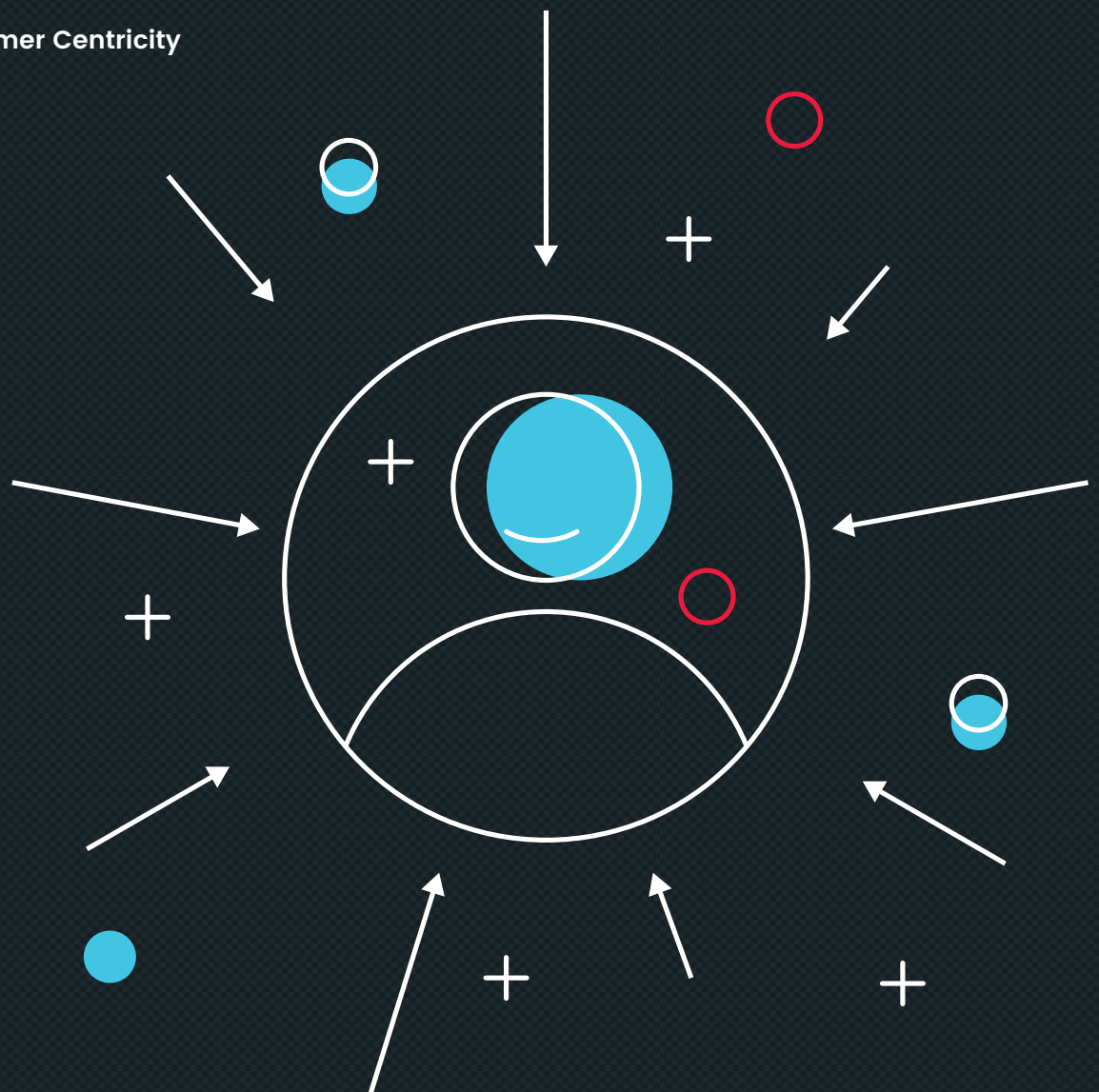
Chapter 5

Customer centricity

p.62 Summary

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Critical to Improvement

p.66 The Customer Centricity
Spectrum



Summary:

- An ability to identify and prioritise customer needs is the single biggest behavioural contributor to **improving** financial performance over the long term.
- Most companies believe they do this well – they invest in market research and track what customers think of their brands – but in reality they do not start with an understanding of customer needs. We call these companies 'Product Centric'.
- 'Customer Centric' companies operate with a different mindset. They are able to **anticipate** customers' unmet (and often unarticulated) needs, and they use customer insight as a basis for action across the entire organisation.
- They embed a customer orientation through organisational structure, process and data & technology.

Over the course of our study, Estee Lauder Companies has been a pioneer. Its brands and propositions are timeless, to this day imbued with the passion for creativity, beauty and individuality of its founder, Estee Lauder herself. But alongside its values and its history, the company has shown a consistent ability to lead the way, to adopt new habits and seize new opportunities before its competitors. Specifically, we see four strategic decisions that have driven Estee Lauder's recent value creation:

- 1 **Acquiring and prioritising** the growth of small and mid-sized brands, such as Bobbi Brown, MAC Cosmetics, and Smashbox Beauty Cosmetics
- 2 **Driving a digital transformation** at both the front and back end of their business
- 3 **Shifting from third party sellers** to owned-retail stores and direct-to-consumer (DTC) channels
- 4 **Unlocking new growth** in emerging markets, particularly China

As a result, the company ranks 16 on the SGI and outperforms its competitors in all three areas: growth, profitability, and market valuation. It also ranks as the 5th most improved company on the SGI (an assessment which we unpack below).

So what enabled its foresight, and above all its accurate decision making? Why was Estee Lauder able to get it right more than its competitors? The common theme, uniting each of the four threads was a deep understanding and empathy for customer needs. Estee Lauder developed clarity not only on what customers wanted today, but on how their demands and priorities were shifting over time. Discussing the move to digital in particular, a former VP of Marketing at Estee Lauder put it simply:

“As she (the consumer) moves, we move with her. At every level of the organisation, everyone is focused on the consumer. Everyone”.

The explanation of ‘we focused on our customers’ is obvious, to some extent, but no less true or valuable for being so. Estee Lauder's success (and the decisions underpinning it) illustrates our third key behaviour to sit alongside Future Focus and Adaptability: companies that identify and elevate their customers' needs perform better over the long run. Every company implicitly knows this to be true, but we will explore that in many instances companies are product-driven, not customer-driven. They figure out what to sell and then who will buy it, as opposed to understanding customers' problems, needs and wants, and then considering how the product can fit into their life. By ‘customer’, in our context, we are referring to the ultimate buyer or user of the product, as opposed to a ‘middle man’ or distributor. Whilst both are important, ultimately it is the person (or entity) who uses the product or service that generates growth and value for a company. As a consequence, their needs should be a constant priority that shapes how the business thinks and operates.

First, we will look at the empirical evidence: Do the customer-driven companies create more value? Next, we will explore how to do be customer centric: what are the common traps that organisations can fall into, and how can they avoid these pitfalls to be more customer-driven and deliver better and more sustained performance as a result?

Customer Centricity is Critical to Improvement

As a whole, the SGI ranking system asks one simple question: What differentiates companies that sustainably **outperform** the competition? But many of these top performing companies simply have always had exceptional results. Netflix (SGI_#1), for example, has more than doubled its revenue every 3 years across its entire existence. But what about the companies who are underperforming today? Which Sustainable Growth Index companies should they look to for insight?

Such questions led us to looking at the SGI through another lens. As well as the SGI ranking, which is based on category outperformance over a 15-year horizon, we built the Improvement Rankings:

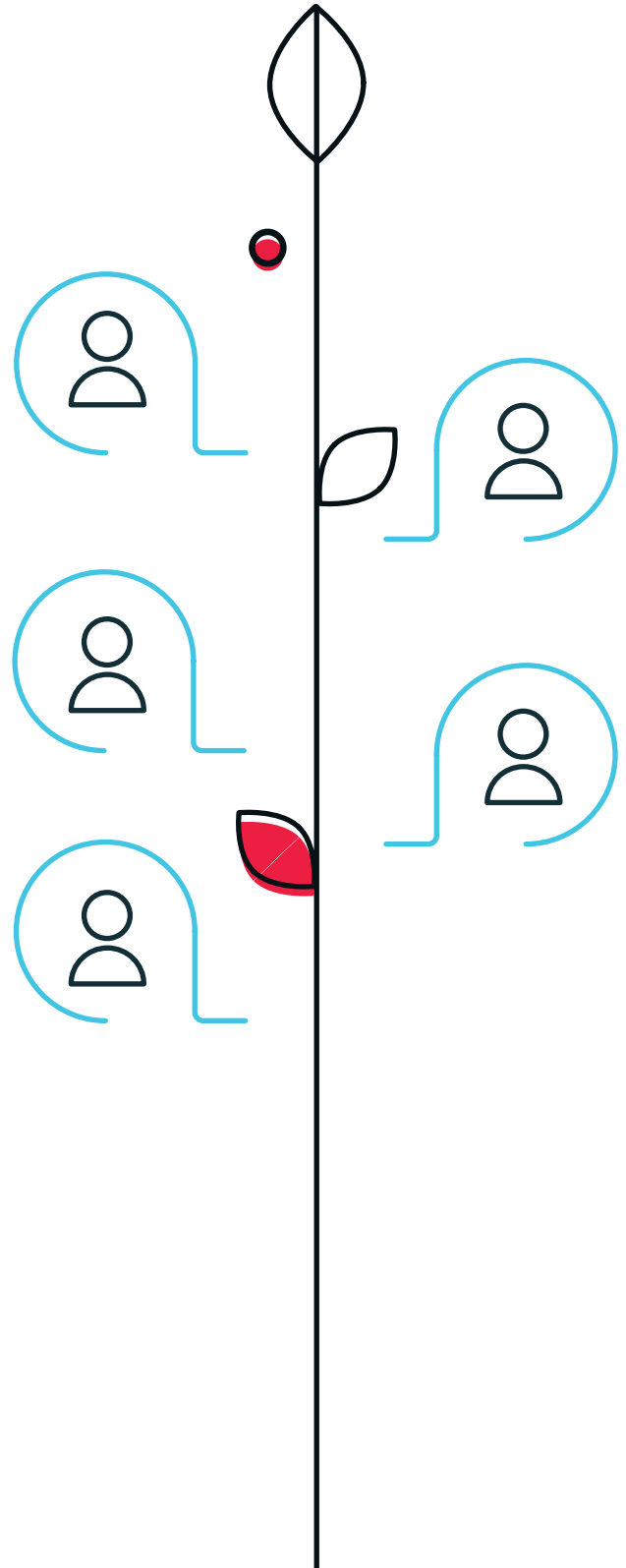
SGI rankings

Based on outperformance of competitive set

Improvement rankings

Based on outperformance of the company's prior results

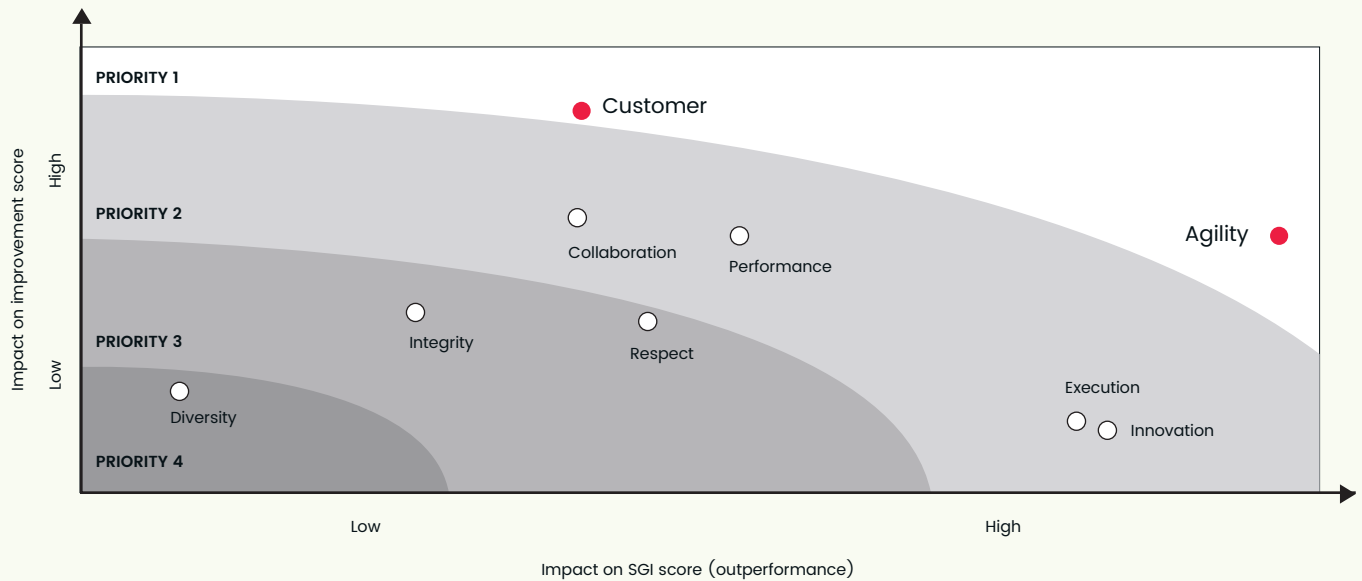
It is in this context that we found the importance of Customer Centricity. Leveraging the same MIT Sloan Culture Study as seen in Chapter 4 on Adaptability, we tested the correlation of the different cultural variables with both the SGI score and the Improvement Score.



CUSTOMER CENTRICITY EVIDENCE

Cultural Values:

Relationship with the Sustainable Growth Index



Source: Company Annual Reports (FactSet) & Culture 500

Two points are particularly noteworthy:

First, Agility has the strongest correlation of any variable with SGI score, corresponding with our earlier findings: that Adaptability powers both growth and profitability.

Secondly, although Customer – defined as “Employees put customers at the centre of everything they do, listening to them and prioritising their needs” – is towards the middle in terms of its relationship with outperformance, it is the clear leader in terms of contribution to improvement.

In other words, it is a focus on the customer more than any other behaviour that is propelling companies away from the plight of average performance, and helping them sustain greater results over a 15-year time frame.

The Customer Centricity Spectrum

The relationship between a customer orientation and improved financial results is not exactly surprising. After all, customers (and no one else) bring the cash into your business; so those who understand them best will be the most successful. But that is about where the simplicity ends.

As the volume of a cube increases, the ratio of surface area to volume decreases in proportion. The same is true of organisations. As companies grow, they begin to lose the breadth and depth of their connections with customers. Their 'surface area' is proportionately smaller and they become more inwardly-focused. Many senior positions, for example, may become separated from their customers by layers of hierarchy. They interact with customers only through intermediaries: an agency speaks to customers and packages up their findings for the Customer Insight Team, who then re-package the findings, and only then do the leadership see the customer. By this stage, the message has often become distorted and twisted to suit the preferences of the stakeholders along the chain.

Companies can guard against the inherent tension between scale and customer centricity, but it requires dedicated attention and effort. Alongside stripping back hierarchy and bureaucracy (explored in our previous chapter on Adaptability), it also requires thinking about the customer in a different way. Typically, we find that companies do view themselves as customer driven. They cite the following behaviours as evidence:

- “We conduct **market research** on things we've done (initiatives, product launches, ad campaigns, etc.).”
- “We gather **customer feedback** on things we're developing.”
- “**We respond** to customer feedback, altering our brands and products as a result.”
- “We have a high Net Promoter Score (an indicator of how many **customers would recommend** the product).”



Companies should continue with these behaviours and continue gathering these data. They are all a worthwhile means to understanding your customers better. But they do not represent genuine, value-creating, customer-centricity alone. They fit into the category of what we call 'product-centricity': the product drives insight and decision making, as opposed to the needs of the customer.

Product-centric' companies fall short of their customer-centric counterparts in four areas, constraining their performance over the long term as a result.

THE CUSTOMER CENTRICITY SPECTRUM

Product-centric	←	Paradigm	→	Customer-centric
Most businesses engage with customers through a product-first lens. Customers are consulted, but their unmet, unarticulated needs do not drive the company and what it does.	←	Description	→	Some businesses start with the customer, across all elements of their business. They elevate their unmet (and often unarticulated) needs as the basis for decision making.
<ul style="list-style-type: none"> • Product forward mindset • Gather reported attitudes • Response to past / present needs 	←	1. Underlying mindset	→	<ul style="list-style-type: none"> • Customer back mindset • Observe behaviours; translate into insights • Anticipation of future customer needs
<ul style="list-style-type: none"> • Customer drives commercial execution only • Commercials drive the planning process • No room for Adaptability 	←	2. Processes	→	<ul style="list-style-type: none"> • Customer drives entire value chain • Customer drives the planning process • Customer drives continuous iteration
<ul style="list-style-type: none"> • Customer capability sits in silos, with little influence or impact on the organisation • Customer needs disconnected with People agenda 	←	3. Structure & people	→	<ul style="list-style-type: none"> • Customer is owned and valued across the organisation • Designated customer champion at the top table • Training and development as core capability • The customer is central to evaluation, reward and progress
<ul style="list-style-type: none"> • Syndicated data • Isolated reports and pockets of information 	←	4. Technology	→	<ul style="list-style-type: none"> • Proprietary data as competitive advantage • Open IT infrastructure

1. Underlying Mindset

“If I had asked people what they wanted, they would have asked for faster horses,” said Henry Ford according to common business lore. The quotation is often used as a defence against the need for customer-centricity: “we understand our category better than our customers, so why waste time and money listening to them?”. But to us it illuminates a different point: that the way in which we engage customers is all-critical, not just the mere fact of engaging them.

Customer-centricity, as we define it, is not about merely asking people to report what they want (in the form of a survey or focus group). At its best, it is patiently and frequently observing customers in their natural environment, and inferring their needs, wants, motives and pain points. In other words, Ford’s quote is right: customers would not have articulated that they wanted a car, but by observing their habits and challenges, Ford deduced that a car was exactly what they needed. In this example, there are two important points which it’s worth unpacking separately.

Customer insight needs to come from observed behaviours, instead of reported attitudes.

A series of studies over the past few decades by brain scientists Roger Sperry and Michael Gazzaniga (the former of which is a Nobel Prize-winner) should shape how we think about trying to understand and influence our customers. Their research, in simplistic terms, has identified that there is a fundamental schism in how the brain works. The right hemisphere, which processes information non-verbally, governs the world that we perceive through our senses and our immediate actions. The left, which processes information verbally, then makes sense of that world, providing a narrative to accompany what we see and do. The point made by Gazzaniga, however, is that the two hemispheres do not interact as freely one might expect. In other words, we do things (based on reasons we don’t comprehend) and then make up why we did them, what drove our decision making, etc. This is not lying, it is just a part of the human condition: we make up stories that make sense of what we do, but which do not accurately explain why we do it⁴⁵.

When it comes to market research, then, we cannot simply ask customers why they chose that brand of cereal. The narration concocted by the left brain (“it’s healthier”) is unlikely to represent the actual driver of choice in the more immediate, non-verbal right brain (“the bright colours attracted by attention”), and will therefore lead us down a false path of insight. To overcome this challenge, companies need to find ways of observing customers for themselves. Only by observing customers and making inferences ourselves can we hope to identify motivations; if we are led entirely by the narrating left brains of our customers, then we cannot have confidence in the eventual insight.

Customer insight should be the basis for anticipating future needs, as well as just responding to the present-day.

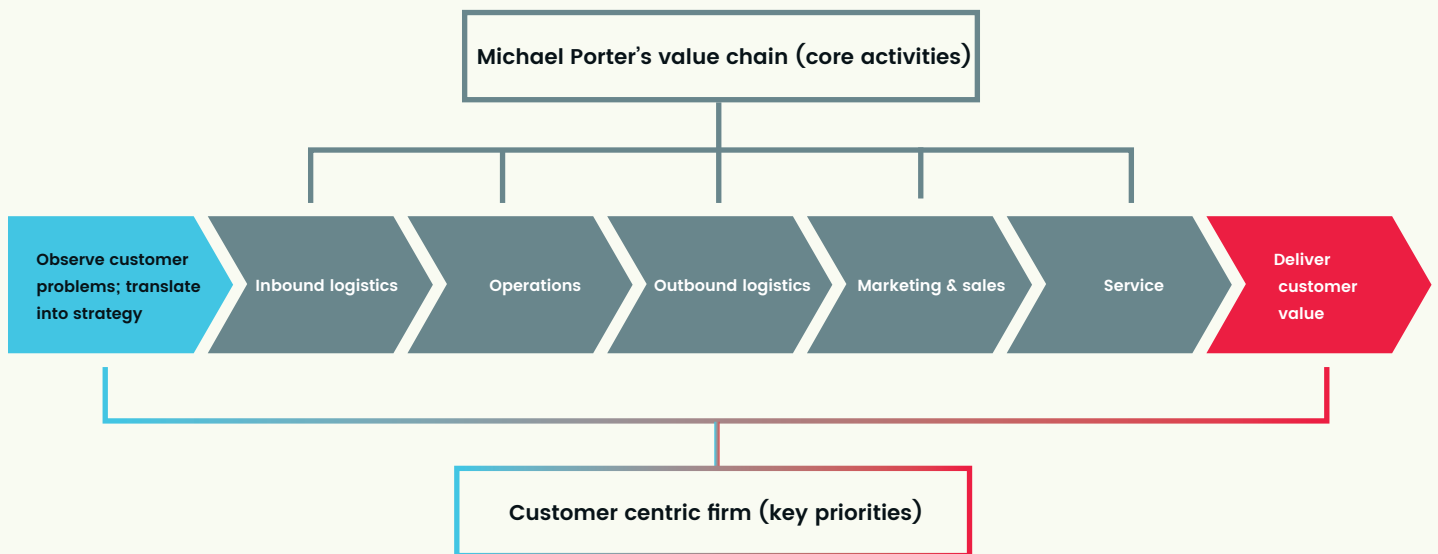
Examining customer behaviour works most effectively when it is paired with a forward-looking orientation. As we explored in the previous Chapter on Adaptability, plans expire when the assumptions that underpin them are no longer valid. To compensate, companies should look at customers through a dynamic lens, as opposed to static – to understand what they need in the future and deliver against those needs. Estee Lauder’s mentality of “as she moves, we move with her” is exemplary. It is no coincidence that they launched their e-commerce offering in 1996, long before other companies in the sector⁴⁶.

Anticipation of future needs is dependent on a deep understanding of customer behaviours. Observing a customer behaviour will give you one insight – namely, that specific behaviour – which will expire as the context around customers changes. Understanding why a customer behaves the way they do, however, gives multiple insights, that do not expire in a new environment and can therefore provide the basis for foresight.

So at its heart, customer centricity is about observing the problems of your customers, inferring their needs, and then figuring out how your company can improve their lives (both today and tomorrow). With this conceptual centrepiece in mind, we will now focus on the practical elements: what needs to be true to get an organisation to make and execute decisions based on their customers’ unmet, unarticulated needs?

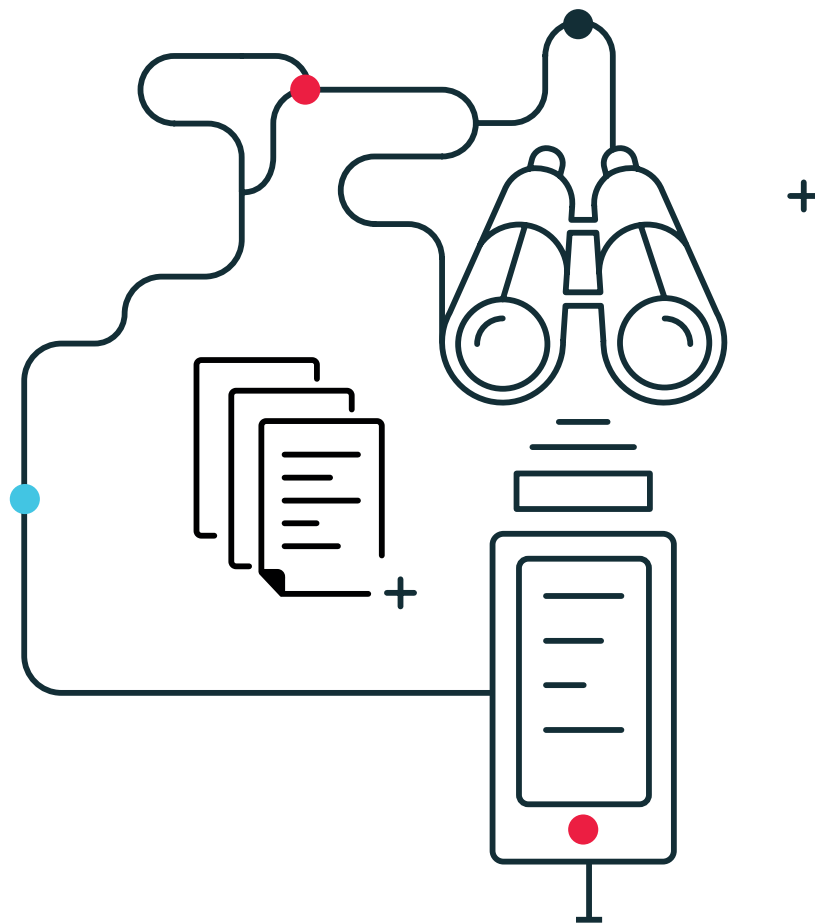
2. Processes

CUSTOMER CENTRICITY ACROSS THE VALUE CHAIN



In product-centric companies, we find that the customer drives how the company executes. Marketing assets, for example, are finalised based on customer preference. But customer-centric companies go a step further, input from the customer drives what they do (the strategy) and how they do things (the execution). In other words, the customer should drive a company's entire value chain, not just the final step.

This means putting customer insight at the start of your strategy-making process. From our experience, companies can often approach this the wrong way round: they define the scope of specific projects, and then gather customer data from the insights team to fill gaps and validate hypotheses. In this order, the impact of customer insight is diminished; it helps deliver a pre-defined strategic agenda, but it does not shape a strategy. Confirmation bias is also a danger. The plan is already set in stone, so you find the facts to fit your beliefs rather than building a plan based off what customers actually need.



Intuit is a leader in this regard. Just as Scott Cook started the company by observing the challenges that he and his wife faced balancing check books in their own homes, he instituted this approach to planning and innovation across the company. He mandated the “follow me home” concept, in which employees literally go to customers’ houses and watch them using their products and services. Employees then return with ideas aplenty for how the company can improve to solve customer problems better or differently. The key point is that the information on the customer is a basis for planning, rather than an afterthought. It is also pervasive across the organisation, to the extent that Chief Financial Officer Neil Williams is one of its leading advocates⁴⁷.

A customer-driven strategy should tell a joined-up narrative: between the financial targets and the customer behaviour changes driving them. Typically in financial planning, the first assertion is around revenue growth – often depicted with the deceptive certainty of a waterfall chart. “Our revenue will increase at 10% a year for the next three years.” Strategy-

builders and decision makers alike should make sure the ‘why’ is clearly demonstrated. If you cannot explain your top line forecasts in terms of the customer insights you’ve identified, the customer behaviour changes you are looking to drive, and the customer value you will deliver, the chances are the assumption is invalid.

In this way, by starting strategy-making with inputs from the customer and by explaining plans in the terms of their behaviour, companies can pair customer-centricity with our first principle of sustainable growth: Future Focus. They can use customer insight as a means of proactively driving change in the business. But, as we explored in the previous chapter on Adaptability, processes need to be inherently flexible. Unforeseen changes will inevitably occur, and companies have to respond quickly. Insight and information from the customer should enable this constant journey of learning, iteration and change.

3. Structure & People

So how, from an organisation design perspective, do you put the customer at the start of the value chain, as well as the end? Evidence from the Sustainable Growth Index

and experience from beyond it highlight the need for four organisational elements that turn the theory and the process into reality.

Customer Centric Organisation	Best-in-Class Example: Walt Disney
<p>The customer should be owned and valued throughout the organisation. Whilst each organisation or business unit is likely to have a focal point where information and insights on customers sits (i.e. Customer/Market Insights function), a focus on the customer must permeate more broadly. The customer should drive the work of all functions, not just those that are ostensibly customer facing. Here, an adaptable resourcing model is a key enabler – so that access to customer insight capabilities can be accessed by different parts of the business based on need at that time.</p>	<p>At the Walt Disney Company, the founders' notion that "people can feel perfection" drives the core of the customer agenda⁴⁸. At present, customer data is collected at all perceivable touch points, at Disney's parks and resorts as well as through reviews & feedback their media subsidiaries such as ESPN & Disney+. The insights generated from these sources help create "an organisational common purpose" with customer-centricity at its foundation⁴⁹. As such, the ecosystem of customer data is open and available to use: from optimising park logistics with MagicBands through to film production and testing market fit⁵⁰. The insights, in turn, feed into training and development, enabling Disney to further optimise their propositions.</p>
<p>The top table needs a 'Customer Champion'. Customer-centric behaviours are most effective when they have a clear leader; someone who can influence senior leadership and set the organisation-wide agenda on how customer needs and problems can be elevated across the business. This is equally relevant for an Executive top team as for a specific business unit or function. Without people whose job it is to make the organisation more customer-driven, it will be difficult to shake off the limitations of product centric habits.</p>	<p>Championing the customer is at the heart of all strategic decisions made by the Walt Disney Company, and as a result it has clear representation on both the executive and business unit levels. Most recently, this has driven the acquisition of Marvel Studios and the launch of Disney+. These have been informed by the "cradle to grave" strategy which aims to deliver magical memorable moments through all stages of customers' lives.</p>
<p>Training and development priorities need to be customer-driven. To create a common language that the organisation understands and buys into, customer-centricity needs to be an essential part of training and development initiatives. Individuals should understand how their specific function seeks to create value for customers, building up an organisation-wide expertise and alignment.</p>	<p>The leaders at Disney understand the interrelation of EX (employee experience) with CX (customer experience)⁵¹. The key priority for all Disney employees is to provide a great Guest experience. As a result, the training and development fosters behaviours that support a healthy work environment, as well as driving business outcomes. Entry-level staff complete a 6-week training course, learning about an experience mentality rather than a task mentality⁵². The Disney Institute, a centre of excellence for customer centricity, also provides both internal and external training for staff on an ongoing basis.</p>
<p>The customer should drive reward and recognition. As with Future Focus, incentives should reflect the outcomes you want to drive. And as such customer-driven metrics (e.g. Brand Health, customer satisfaction, NPS) should not only be measured, they should form a part on individuals' incentives, both financial and non-financial.</p>	<p>Recognition at the Walt Disney Company ranges from zero cost social media mentions, all the way up to glamorous awards nights for high performing employees who are presented a Legacy award: Disney's highest honour⁵³. Customer-centricity plays a key role in this, as all employees are held accountable for delivering great Guest experiences and providing magical moments. Customers are encouraged to give feedback to drive the recognition process, and in turn, employees that have over-delivered are championed both internally and with customers through mentions and unique badges.⁵⁴</p>

4. Data & Technology

To this point, we've looked at the mindset needed to reach perceptive insight on customers, and how to embed that mindset into the business process and structure. But there is one key point still to cover: that the outputs are only as good as the inputs. It is possible to deliver on points 1-3 perfectly – for the entire organisation to dig deep into customer behaviours by way of habit – but ultimately if your starting data is worse than competitors', then the disadvantage will be hard to overcome in the long term.

Historically, the world of data was relatively egalitarian. In most industries, data was not a core competency and data generation would be outsourced to one of a few market research providers. As a result, you knew your company's data was just about as good as your competitors'. Today the landscape is different: A quick look at the Top 10 of the Sustainable Growth Index and it's clear to see that a number of companies have used data as competitive advantage: Netflix (#1), salesforce (#4) and Amazon (#9), to name three obvious examples. (It's worth restating that these companies rank highly not because of their industries, but because they have outperformed their respective industries.) In each instance, the companies have a wealth of proprietary data about what their customers like, dislike, watch and buy. Netflix, for example, made the move into original content with House of Cards in 2013⁵⁵. Given that it did so with a wealth of data about what its viewers would enjoy, the success that followed is little surprise.

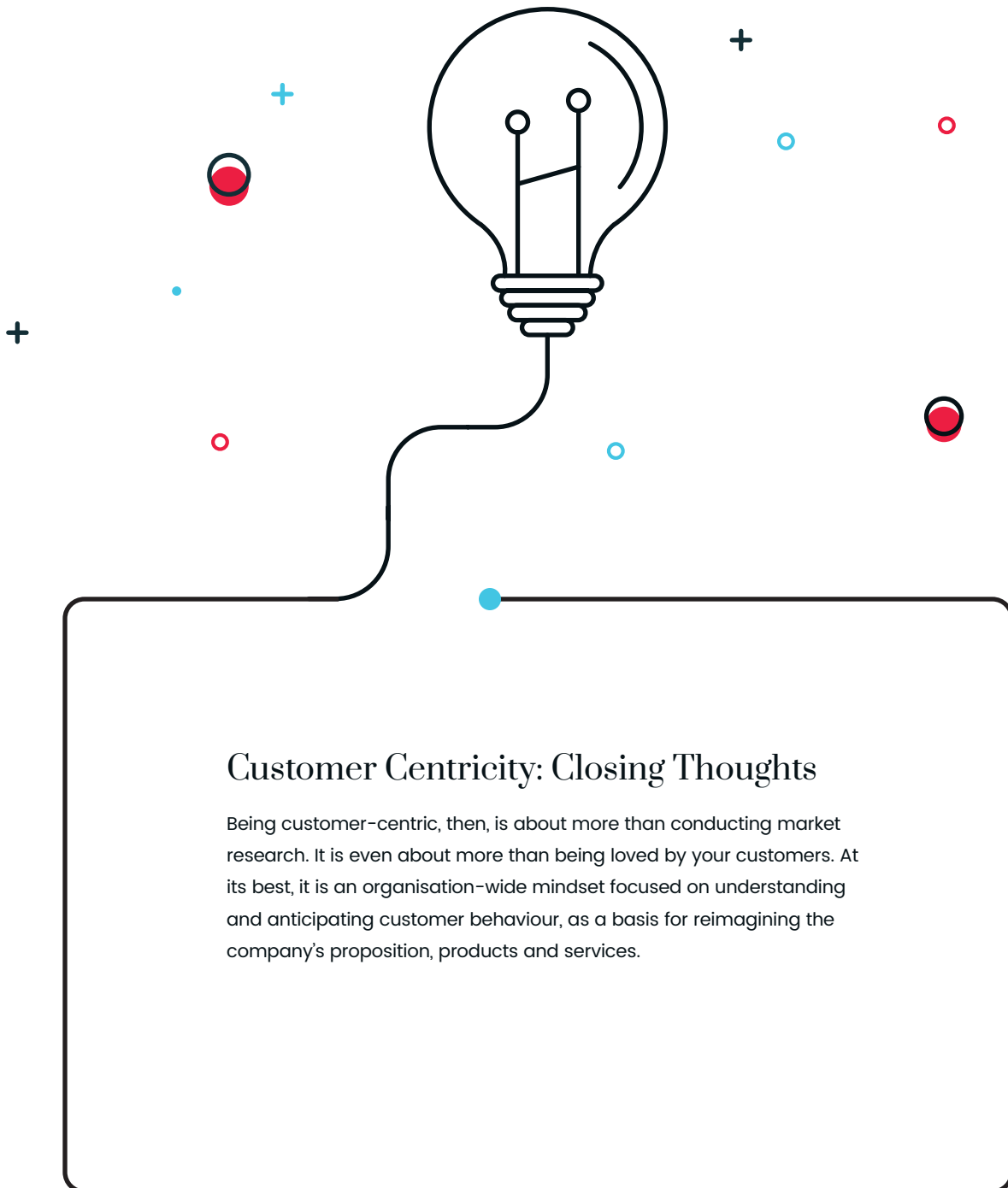
So the role of customer data to an organisation has changed. It used to be a level playing field, no firm's data was significantly better or worse than the other's. Today, however, data on customers is a source of competitive advantage (provided companies have the capabilities to draw out insights). With this fundamental shift, companies should look to generate their own proprietary data, as a basis for new insights that can differentiate them from

competitors. Now in every case this not possible: cost and capability may make it a better option to outsource data needs. If this is the case, companies should think deeply about the reports and data that they buy in. Market research is a necessity, and when selectively chosen it can add real value. But companies should beware of two potential stumbling blocks that will at best dampen, and at worst destroy the quality of their insight generation:

When the market research relies too heavily on self-reported attitudes (through the form of surveys), and not observed behaviours. As we have seen, there is a limit to how much we can trust the 'narrating' left hemisphere of our customers' brains. To unpack motivations, we need data on what customers actually do.

When the market research is unanimously used across the industry, or comes in too 'packaged' a form. Again, the key principle here is competitive advantage. If all of the other players in the beer market, for example, are reading the same report that beer/lemonade shandies are a 'white space' within the category, then they will all flock there simultaneously. The customer need may be there, but if the space is already over-supplied it's unlikely to deliver financial success.

Estee Lauder has built its information advantage through its strategic focus on Direct-to-Consumer. MAC, which it acquired in 1998, has led in this regard. By ownership of its route to market, MAC is able to generate more meaningful data from point-of-sale, in-store and online interactions with consumers. The power in these data is that they are unique and differentiated, MAC has reliable information that its competitors do not. Combined with the ability to draw out insights from the data, MAC's products and experiences are sharper and more relevant as a result.



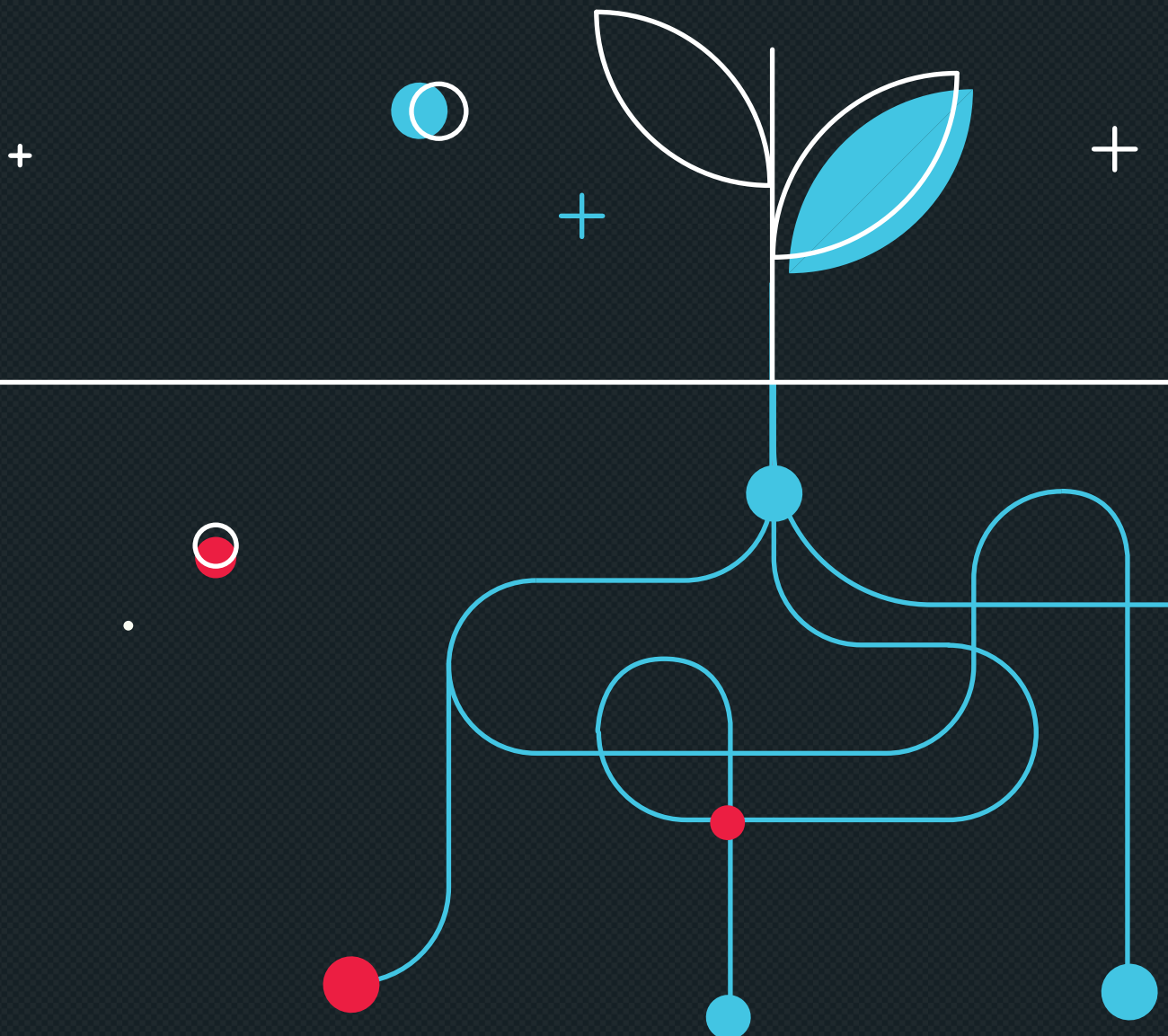
Chapter 6

Purpose

p.75 Summary

p.77 The 4 principles of sustainable growth
(and how they interrelate)

p.78 Lululemon: Illustrating the role of Purpose



Summary:

- Future Focus, Adaptability and Customer Centricity should be the key drivers of change within an organisation, to keep it relevant in a fast-evolving environment.
- But without a coherent and consistent narrative to guide this constant change, organisations can lack focus, clarity and alignment.
- In this context, the best of the Sustainable Growth Index have used Purpose – a company’s reason for existence – as a guiding hand of change. Purpose can provide an overarching coherence and shared understanding, enabling constant progress and sustainable growth.

We have discussed three concepts so far, each of which help to unlock sustainable growth. Businesses need to retain a constant focus on the long-term horizon, they need to build adaptability into the fabric of their operations, and they need to do both these things with an attention on the ever-evolving problems of their customers. At their heart, each of these three concepts is about change. Dilemma 1 showed us that exponential patterns of change are inevitable in our society and our economy. As with the Coronavirus Crisis, Climate Change and computer processing power, change does not happen in little-by-little increments. It happens in rushing waves, as each step perpetuates the possibility for yet larger steps. As computers became more efficient time after time, we saw in Dilemma 1 that they opened up even more expansive possibilities for the next generation of technology.

Lou Gerstner, CEO of IBM from 1993 to 2002, inherited a loss-making company at the brink of extinction. Over his tenure, he nurtured it back to survival and success, overseeing a rise in its market capitalisation of over \$180 billion⁵⁶. His view on corporate longevity is telling; that change is the essence of survival.

“Remember that the enduring companies we see are not really companies that have lasted for 100 years. They’ve changed 25 times or 5 times or 4 times over that 100 years, and they aren’t the same companies as they were. If they hadn’t changed, they wouldn’t have survived⁵⁷.”

The Sustainable Growth Index has shown us that Future Focus, Adaptability and Customer-Centricity are the critical mechanisms for change, with which to propel a company forwards and re-ensure its relevance. The problem with change, however, is that it is destabilising. With every decision to tweak, alter or reinvent, there is a danger of unhinging what makes the company successful in the first place. There is a risk of straying too far from the core competency, the formula that works, and ultimately destroying value.

On the surface, the potential pitfall of making change is about decision-making and execution. “Will this initiative make our company stronger, better, more profitable?”, etc. But change is also inherently tied up with identity.

Ancient Greek historian Plutarch explores the issue, with a philosophical paradox known as ‘The Ship of Theseus’. The mythological ship is continually restored and repaired part-by-part over one thousand years, to the point where no original part of the ship remains, but the ship itself goes by the same name and identity⁵⁸.

Plutarch uses the story as a means to exploring personal identity. Am I, the seventy-year-old the same person as I was when I was seven? What is the common thread that connects those two people with different interests and appearances, beyond a name? In a business context, however, the paradox forces us to think about the implications of change. If a company (like Gerstner’s IBM) changes all its parts, plans and products, then what makes it the same company as before? What focal point or common objective is there for employees to identify with, and to guide decisions around change in the first place?

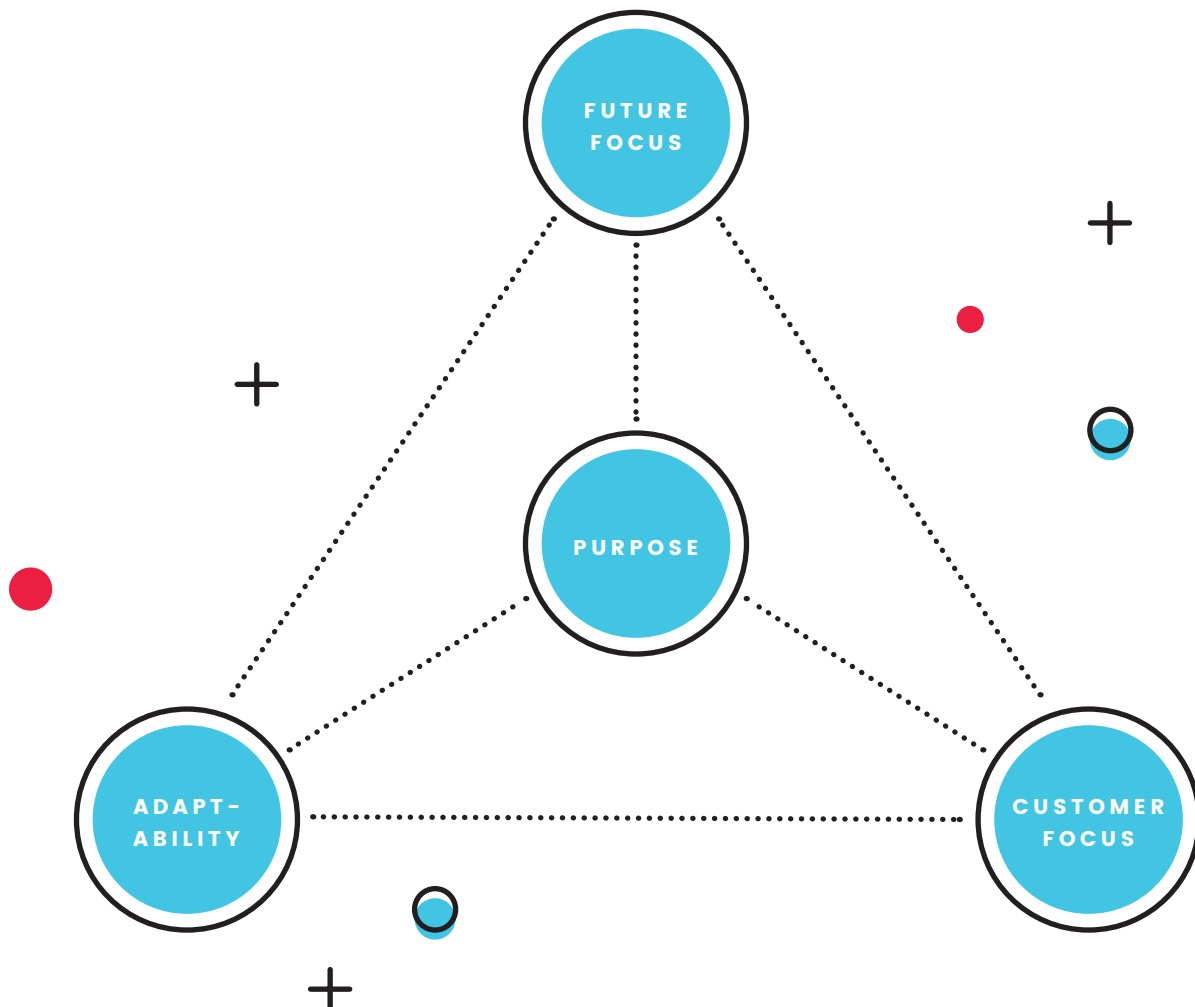
Economist Milton Friedman, as we saw in Dilemma 3, would have said that the shareholder gives a business a common objective. It is the shareholder, and management’s responsibility to make money on their behalf, that unites the business and its goals. Whilst still a basic truism – businesses need to make money for their shareholders (and indeed this study has assessed them based on their ability to do so), on its own, a shareholder focus is no longer a sufficient answer. We have seen that requirements are shifting, that businesses are increasingly recognising that a single-minded focus on shareholder value is counterproductive; it will often create less value in the long run. In an age of increasing information transparency and social need, businesses need to create value for a broader set of stakeholders (including employees, customers, communities). And by meeting all these disparate demands, the shareholder will be superiorly rewarded in the long run.

Within this context – the need for a common business identity, paired with a more complex web of stakeholders to serve – we can locate the importance of Purpose. Constant change is inevitable, and so businesses need a common definition and ultimate objective, to create coherence amongst the disruption. Over the past two decades, Purpose has moved from a fringe idea to the business mainstream. But from our experience and research, it is often not fully understood and underutilised as a result. Purpose can create financial value for businesses by serving as a light to guide the constant change created by customer centricity, future focus and adaptability.

The 4 Principles of Sustainable Growth

(and how they inter-relate)

In this way, Purpose sits at the center of a three-cornered structure, which is a metaphor for our own principles of sustainable growth. Future Focus, Adaptability and Customer Centricity (the three change-agents) sit at the perimeters of the structure. They require an organisation to look outwards, to constantly evolve based on the external environment. Purpose, on the other hand, sits at the center, connecting each of the otherwise disparate initiatives into a coherent organisation.



Lululemon: Illustrating the role of Purpose in Sustainable Growth

Number 2 on our Sustainable Growth Index, apparel and retail company Lululemon shows us what a Purpose can do in guiding and controlling change. Founded in 1998 by Chip Wilson, the company has matured from a fast-growing startup to a sustainably growing PLC in the timeframe of our study. It has outperformed its industry in terms of growth, value creation and market valuation, overcoming some critical challenges along the way: product quality issues in 2013 and the decline of retail in its home market the USA, for example. But these setbacks serve to reinforce its qualities of longevity; each time the company has been set back it has continued to evolve and progress.

At the heart of this progression is its purpose⁵, which is written on Annual Reports and the like as: “to be the experiential brand that ignites a community of people living the sweatlife through sweat, grow and connect”. As ever with statements like this, it requires unpacking, both to understand what the language means and to understand how (and indeed whether) it is embodied within the company. Upon speaking to employees, we learnt that – whilst different people articulated it in different ways, the underlying concept was well represented through the three closing words of the statement.

Sweat: Helping customers exercise and be healthy

Grow: Empowering customers to develop into their best selves

Connect: Showing the way that we can achieve more together than alone

These ideas, we will show, have empowered each of our three ‘corners’, the critical change-agents required for sustainable growth.



Purpose & Customer Centricity

When working effectively, a Purpose should be an aspiration for how you add value to customers’ lives. As with Lululemon, it is important that it goes deeper than the particular product or service of the day, but to something that a business can continually aspire towards even as trends come and go. ‘Sweat, grow, connect’ is a powerful concept because it reaches into three insights about the human condition: our need to stay and be healthy, our individual desire for progress and the importance of community and friendship. The insights are timeless, and as such Lululemon has a clear and consistent start-point from which to build its value proposition.

Sweat, Grow, Connect also provides the basis for how Lululemon learns about customers. It drives them to learn more about customer behaviours, for example, through its loyalty program “sweat collective”. By watching and caring about these behaviours over time, it can understand what drives their motivations and needs, whether or not these are articulated. Out of these insights came its unique grassroots ambassador program. Whereas other athleisure companies are increasingly investing in top-level sponsorship deals (Nike partners with Cristiano Ronaldo, LeBron James and the like), Lululemon is doing the opposite. Based on the importance of community, both from a company purpose and a consumer need perspective, Lululemon focuses on a Grassroots model, partnering with a number of local ambassadors – for example yoga teachers – who do not have high reach, but who are present and influential within their own communities. The approach is truly authentic to Lululemon’s commitment to ‘connecting’ its stakeholders. The purpose allows it to create a customer experience that is genuinely distinctive.

⁵ Lululemon actually uses the word “vision”, but the basic concept is the same.



Purpose & Future Focus

As we have seen in Chapter 3 on Future Focus, companies should look to identify their future opportunities, and then assess their level of adjacency to the core business (using the Value Pool Matrix). The theory is that the markets you are in today may not be the best place for your business tomorrow. We saw that Intuit reinvented its business model based on this approach, moving from a desktop based product to a cloud based platform, and the financial results followed.

But how, in the first place, do you define what constitutes an opportunity for your business? How do you decide what needs to be plotted on the value pool matrix? A purpose, when working effectively should enable this clarity. Lululemon, for example, through 'sweat, grow, connect' was clear on the reason it existed, and therefore which opportunities were within its remit. Making computers or phones or chocolate bars were all, from the outset, out of scope. None of them help customers sweat, grow and connect. But moving into footwear, expanding beyond the USA, selling their athleisure products online – all strategic moves which Lululemon has made in the past decade – were permitted by purpose. Each initiative, expansion and innovation propels them further into helping more people 'sweat, grow and connect' more of the time.

A purpose is a powerful strategic tool in two ways. First, it sets your limits. It gives a conceptual core competency: a space in which a company should not go beyond and in which it can build up credibility, expertise and uniqueness over time. But, when functioning properly, a purpose is also an imperative to act, providing permission to change and broaden the company's horizons. A company can never have completed its purpose. Lululemon – no matter how well it performs – can always get better at helping its customers sweat, grow and connect. Considered in these terms, a purpose should never be reduced to a product: selling milk or televisions or taxi rides. The purpose should not only give a company space to explore and evolve over time, it should also be a clear mandate to change, improve and bring the purpose to life.



Purpose & Adaptability

At its heart, Adaptability is about rapid and continuous prioritisation. We looked at this from a number of perspectives in Chapter 4: cultural, strategic, ways-of-working, product creation. But across each is the same base idea: that what was important yesterday may not be as important tomorrow, so we need to keep on reassessing and reprioritising based on new evidence. But without a guiding force and common set of objectives, constant adaptation – and its requirement for more decisions to be made every day – could lead to chaos.

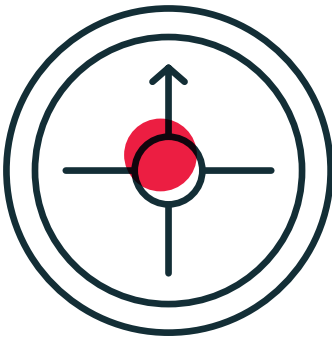
The adaptable resourcing model, for example, encourages that functions and individuals should no longer be siloed to a specific step in the business process. Rather, people's time should flex project by project to where it is needed at that given moment. The potential benefits are significant: a faster, more focused and more efficient organisation. But the downside could be significant too, if employees misinterpret what is important and therefore mis-prioritise their time.

Herein lies the beauty of a guiding purpose. It provides a common language, motivation and set of objectives that mean layers of bureaucracy can be torn down. Rather than making employees do what the leadership needs by extensive task-lists, workflows and Stage Gate check-ins, the Purpose leads them there autonomously. At its best, it acts as a stake in the ground – a constant stability around which rapid decisions can be taken with confidence and with common language.

Lululemon, we learnt from a former Global Operations Director, was unique in the extent to which it empowered its store managers. Typically these were men and women in their mid-twenties managing what were in essence \$2-3 million businesses. Whilst they were guided by more senior management, ultimately they had the freedom to showcase and run their store how they thought it best. Consequently, they were able to make decisions quickly for the business' benefit, without needing the approval from higher up the business that would slow them down. But the culture of speed, flexibility and empowerment only works if both store managers and senior leadership are pulling in the same direction and committed to the same vision. In Lululemon's case, "sweat, grow, connect" as a guiding principle.

A purpose, then, should be the glue that holds a state of constant progress and evolution together.

It can shape our three catalysts of change into a coherent story, as opposed to a number of different ideas driving disparate initiatives. To make the connections that we've outlined with Future Focus, Adaptability and Customer-Centricity meaningful, however, there are four litmus tests to what a good purpose looks like. Any work on purpose-development should keep these thoughts (alongside the desired outcomes outlined above) top of mind.



Authentic but challenging

An effective purpose is true to what you sell, but not limited by it. Businesses should look to define the higher-order benefit that they bring to customers lives at their best. In this way, it should be something to stretch the organisation, to strive towards day after day.

Unlocks motivation and belief

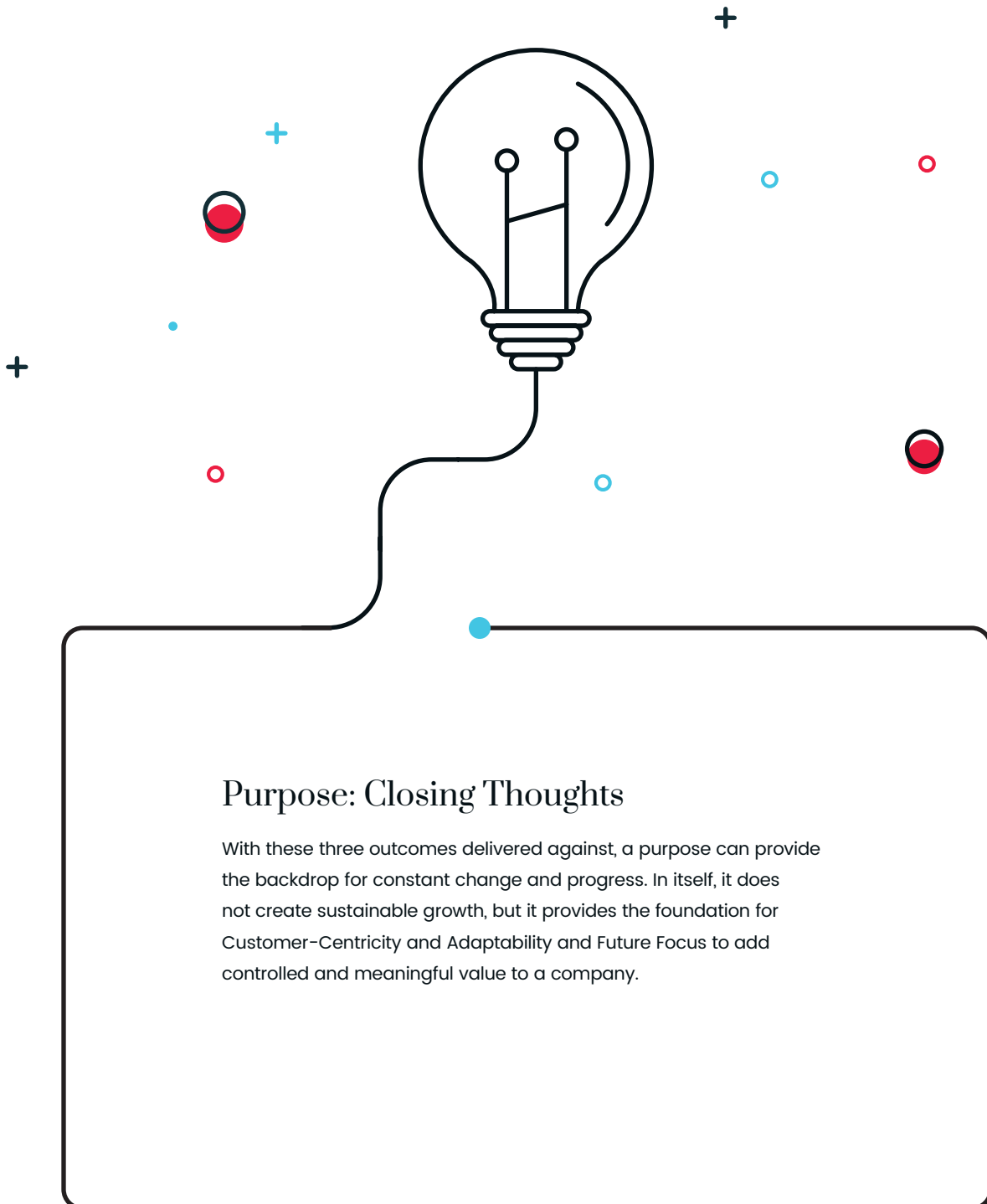
A purpose, ultimately, needs to resonate with the employees that are tasked with delivering it. It should ignite clarity and belief in what the organisation is doing. It should interlink with a personal sense of purpose for individuals. The litmus test of a strong purpose can be seen in two measures: employee engagement and employee churn. When the former is high and the latter low, the chances are this is driven by purpose.

Lived and breathed throughout the organisation

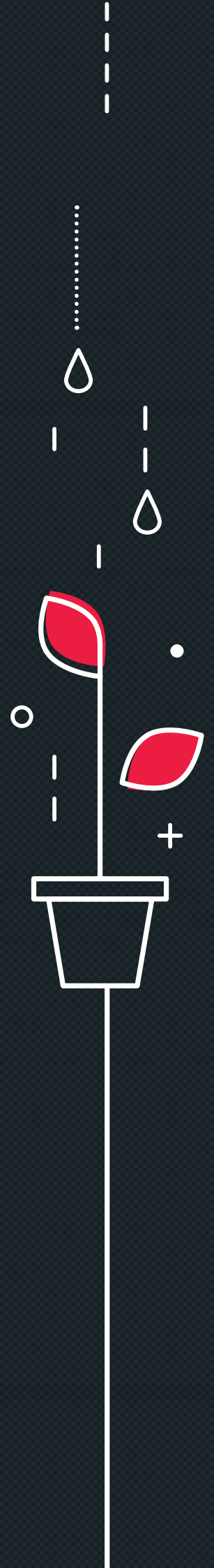
A purpose is not a quotation or statement that sits on investor presentations and careers website pages. Nike is a famously purpose-driven company, but for most of its history it never boiled its purpose down to a single phrase or tagline. Lululemon, too, has only recently started articulating 'sweat, grow, connect' in those specific terms (although the principle has always been present). A purpose is made real through behaviours, their consistency and their pervasiveness, not through words on a page.

Shapes value proposition(s)

A corporate purpose should not only be an internal tool, it should shape and be visible in the company's products and services. Often this is already inherent in single-brand companies (like Apple, for example) but we believe it is equally important in companies with portfolios of brands. Find the common thread that connects a diverse portfolio and embodies why you are different.



The Final Word



The findings outlined in this study are not an exhaustive list. Other behaviours will continue to be important to the health and success of businesses, and others will appear in the coming years that are not included in the scope of this study. We chose, however, to focus on Future Focus, Adaptability, Customer-centricity and Purpose because we believe that these are the areas of greatest urgency. As society continues to move with accelerating speed, it is in these areas that business management needs to evolve and improve more than any.

Our final request, if these findings have been of interest, is that you bring them to life in your business. This is not a theoretical guide, or a manual for only CEOs. It is a manifesto for change-makers wherever you sit or whatever you do.

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