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Special Report

Future value and innovation

How to sustain profitable growth

By Toni C. Langlinais and Marco A. Merino

Companies are beginning to look beyond traditional metrics like price-earnings ratio to assess their effectiveness at generating growth through innovation. Determining a company's future-value premium provides a simple but effective way for management to diagnose and understand the complexities of market expectations, as well as the investment community's confidence in the company's long-term outlook.

Analysts and the business and financial press have never been at a loss when it comes to compiling lists of top-performing companies, as measured by one benchmark or another: the best 100, 500, 1,000 or 2,000. But when one turns to companies meeting Accenture's standard for high performance—the ability to outperform industry competitors across business and economic cycles—the numbers dwindle considerably. Indeed, our research shows that only about 5 percent to 20 percent of companies, depending on the industry, are able to sustain top performance over time.

What happens to the rest? Many run aground because they lack a coherent way to measure and plan for growth through profitable and sustainable innovation. Focused primarily on P&L transactions and drivers, com-panies find it easier to look to past performance or to the immediate present—resulting in insights that often account for less than 5 percent of a company's market value.

Every company is after sustainability, of course, because every company wants to achieve profitable growth over the long term. Recent research from Accenture and the Economist Intelligence Unit found, for example, that about two-thirds of the senior executives surveyed expect growth initiatives to take a more prominent place on their company's strategic agenda.

But until now, the desire to perform at high levels into the future has not been accompanied by strategies and operating models that enable those companies to accurately determine how much of their market value is represented by investors' confidence in their long-term outlook.

In our experience, many companies are constrained by an inability to achieve long-term growth through innovation. Their competitive advantage, if they have one, cannot readily be sustained because it is built only on their current enterprise, with insufficient attention paid to the innovations necessary to drive future growth and create future value.

Such companies often have superb financial acumen or sales management. They excel from an operational perspective. But in terms of what Accenture calls a "future-value premium," even some of an industry's most respected names might actually be in the red—meaning the market expects the company's growth to be lower than the GDP growth rate. For example, our analysis shows that during the past decade, the percentage of the publicly listed US companies in the Russell 3000 Index that have a negative future-value premium has increased from about 50 percent to more than 60 percent.

Leadership teams need more sophisticated leading indicators and types of analyses to help them make successful strategic investments in innovations that can accelerate growth beyond the expected performance of their core operations. Future-value premium analysis can quantify the market's expectations of whether a company has a positive or negative growth advantage relative to its peers. By offering that perspective, future-value premium analysis leads companies to consider a portfolio of initiatives *and* the innovation required to build new growth platforms (see sidebar, page 6).

Companies are beginning to look at new kinds of leading indicators, beyond such traditional metrics as price-earnings ratio, to assess their effectiveness at generating growth through innovation. Determining a company's future-value premium provides a simple but effective way for management to diagnose and understand the complexities of market expectations, as well as the investment community's confidence in the company's long-term outlook.

Many CEOs are startled when they see a future-value premium assessment of their companies. Accenture recently performed such an assessment for a highly regarded global financial services institution. The company has a solid track record of delivering strong returns to its shareholders. In fact, however, it actually had a negative future-value premium over the final three years of the analysis period (see chart, page 7).

Short term, long term

Why did the market no longer expect the company to grow faster than the GDP? Like many companies, this firm was more focused on improving current operations and meeting short-term expectations than on sustaining high performance in the long term. It had failed to allocate the resources required to build future-growth platforms. The company lacked the organizational structure and discipline (including dedicated funding) to support an innovation strategy and portfolio, and therefore had not been focused on developing a suite of innovation capabilities for the commercialization of new ideas.

Increasing a company's future-value premium by harnessing innovation more effectively has two major thrusts, parts of what we call a "growth and innovation accelerator" (see chart, page 4). First, what are the sources of growth most important to a particular company? Is the company focused on the right growth opportunities, given its current capabilities, industry realities and customer desires? Second, how can a company unlock its cultural and operational capabilities to accelerate its ability to convert the raw material of ideas into profitable growth?

These two thrusts, in turn, correspond to five areas of focus.

1. White-space opportunities
Setting a course toward a higher future-value premium requires identifying the right growth opportunities through a purposeful scanning of three important dimensions: customers, competition and context.

One major pharmaceutical company, for example, has recognized the need to generate growth by effectively identifying its white-space opportunities, whether in its traditional business model of new-drug development or in uncharted and completely new businesses. Several years ago, senior management set new five-year growth targets that mandated looking at marketplace opportunities beyond the company's current operations. One element of this exercise was a comprehensive growth assessment for the company that included market research to determine converging trends in the industry, as well as an analysis of the company's current capabilities and operating model.

The project team identified several key areas of focus for innovation, and senior management moved quickly and aggressively to put the operational structures in place to support the exploration and development of those focus areas. Within six months, the company had fully staffed a new innovation capability group and had developed statements of work for six growth platform pilots.

2. Profit pools
An analysis of any company's financial performance reveals that its profits will group, or "pool," around a discrete selection of opportunities within its overall portfolio. Sustaining high performance over the long term depends on a company's ability to develop a clear and real-time understanding of its current profit pools; the impact of emerging trends on those profit pools; and potential profit pools (including their timing, magnitude and possible risks) so that a company is always changing ahead of the curve.

High performers are invariably adept at "seeding, feeding and weeding"—that is, they allocate resources to probe new kinds of opportunities and potential profit pools; they support a handful of such opportunities through the early stages of development; and they know how to identify the winners in a timely manner and cut off support for the non-starters before they become a drain on growth and profits.

Canadian financial services company Scotiabank successfully altered its presence in the marketplace through astute analysis of its current and future profit pools. Because of the maturing of the Canadian banking marketplace and the increasing globalization of the financial services industry, Scotiabank realized it needed to redefine its identity—to change from a Canadian bank with an international presence to a global bank with a Canadian presence.

As part of a three-year global growth agenda, Scotiabank commenced a

Global Trends Report, which included the identification of potential profit pools by country and by financial product. The bank was able to quantify its identified profit pools and estimate their impact on current and future profitability.

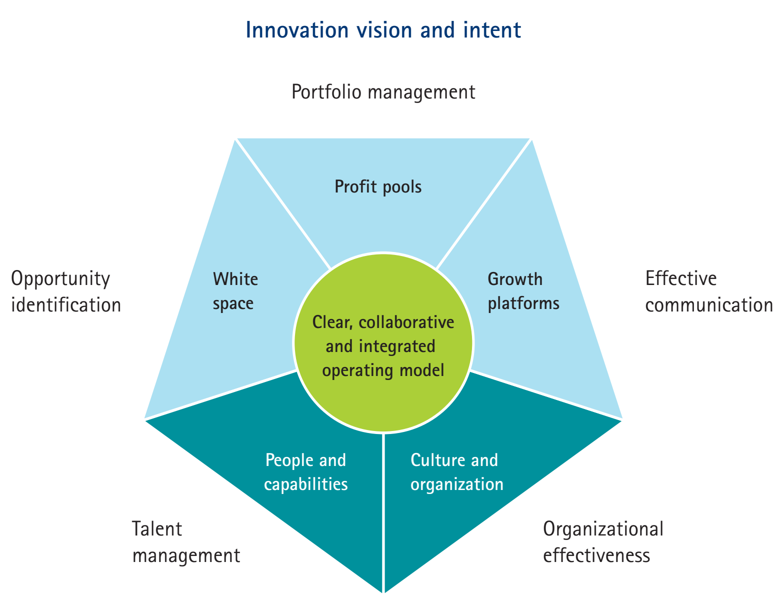
Scotiabank also conducted a competitive positioning analysis in key markets and, most important, determined the key capabilities it would need to establish a presence in those markets that would support profitable growth.

3. Growth platforms
This area of focus refers to the selection, prioritization and communication (both internal and external) of new growth platforms and business concepts that promise to deliver long-term, sustainable competitive advantage. It is here, most especially, that high performers begin separating themselves from the pack by making the strategic distinction between effective innovation in general and the effective *commercialization* of innovation.

Accelerating growth through innovation requires becoming more disciplined at identifying a company's innovation "center," as it were. For some companies, such as Apple, innovation generally flows from its products and services. Other companies, such as Wal-Mart, fuel growth through operational innovations. Business model innovation has helped drive companies such as eBay and Skype.

Growth and innovation accelerator

Accenture defines "innovation" as the creation and implementation of strategies, processes, technologies, organizational structures and culture that accelerate and sustain new idea generation, selection, development and commercialization. The accelerator helps a company look at what the important sources of growth will be and how the company can unlock its cultural and operational capabilities to turn ideas into profitable growth.



Source: Accenture analysis

Companies must manage growth from that innovation center, rather than from the periphery. Part of that commitment to innovation involves embracing new and disruptive ideas. Another important aspect is leveraging open innovation and open sourcing methods that bring together suppliers, partners, employees and management.

Companies that effectively commercialize innovation also develop more risk tolerance when scanning for opportunities outside their immediate business environment. They become more willing to cannibalize products and services when investigating new growth platforms. They become more adept at the operational requirements of their winning concepts, leveraging current partners, networks, assets and distinctive capabilities to help drive growth through innovation (see "Leading by imitation," *Outlook*, January 2007).

Finally, these companies know how to communicate their growth and innovation strategy, both within their company and to the marketplace. Like the old story of the tree falling in a deserted forest, future value that is not communicated effectively to the marketplace doesn't make any noise.

4. Culture and organization
Accelerating growth through innovation means treating innovation as a discipline, not simply as a personality trait. High performers know how to apply operational excellence to innovation: the discipline and organizational infrastructure that enable capabilities and assets to support idea generation, and then the inventory and screening of those ideas. They are also more disciplined at proactively creating the kind of culture that values and rewards innovation. Such discipline enables companies to accelerate the generation of business value by selecting and testing innovative ideas.

Consider Wells Fargo & Company. As the financial services industry and its products have become more complex, companies like Wells Fargo can struggle to deliver a consistent and high-quality customer experience. To meet this challenge, the bank launched an enterprisewide program to identify solutions and strategic change ideas to improve the customer experience and, in the end, ensure customer loyalty and retention.

Wells Fargo created an "innovation network"—a means of connecting and tapping into the insights of the bank's employees to identify and address the main threats to customer loyalty. An organization can accomplish more by mobilizing this type of broad horizontal network of participants than it can by leveraging a small group of experts such as corporate development or strategy.

The success of Wells Fargo's innovation network was twofold. First, it generated a pipeline of more than 50 ideas highlighting specific product and process issues, as well as ideas for improving the end-to-end customer experience. Second, implementing the innovation network fostered higher levels of employee engagement and awareness for the customer loyalty program. More than 250 Wells Fargo employees—representing more than 21 US states and 90 job titles—submitted substantive ideas, resulting in seven high-quality innovations for the company.

Following this initial success, Wells Fargo is creating ongoing, collaborative networks as part of a broader innovation capability that will support the transformational and cultural changes needed for the company to achieve sustained high performance.

5. People and capabilities
Accelerating growth through innovation comes down, ultimately, to the

(Continued on page 7)

Calculating your future-value premium

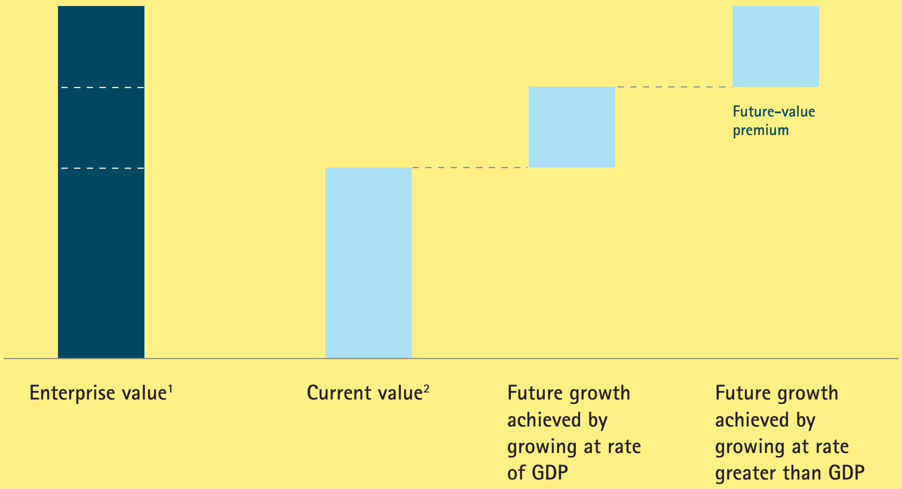
Corporate executives are increasingly dissatisfied with their limited ability to measure and track meaningful performance data that can help them plan for future growth. Their frustration is well founded: Most performance metrics are, in fact, based on accounting transaction information that delivers insights into only *current* value. The corporate asset base has changed dramatically, but today's accounting management systems ignore and undermanage intellectual capital assets that are value creating and that indicate a company's ability to achieve future growth. (For a related article, see "Future value: The $7 trillion challenge," *Outlook*, February 2004.)

Future-value premium, a relatively new performance metric, can help to identify which companies have what we call a "growth advantage"—a perception by the market that the company will be growing faster over time than the overall gross domestic product. As shown in the figure below, future-value premium can be calculated by beginning with a company's enterprise value—the total market value of debt and equity less excess cash—and subtracting its current value and expected economic growth.

Some of the remaining difference can be attributed to simple expected economic growth. In other words, investors have already figured any likely growth in a nation's GDP into the share price. Future-value premium, therefore, represents the incremental value the market expects the company to create, beyond the value delivered by its current operations and expected GDP growth.

High-performance businesses, by Accenture's definition, are those that outperform their peers through sustained economic cycles. A future-value premium analysis can provide the critical forward-looking financial information to guide companies as they leverage innovation in the pursuit of growth and long-term success.

Future-value premium: Which companies have a "growth advantage"?

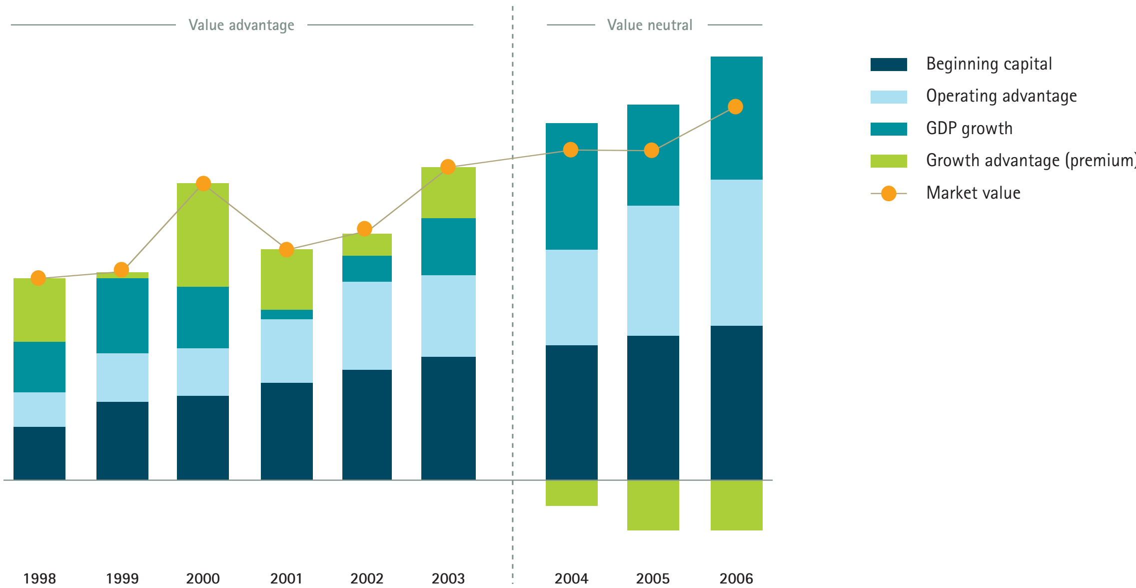


1. Enterprise value equals market value of debt and equity less excess cash.
2. Current value is defined as net operating profit less adjusted taxes divided by weighted average cost of capital. It represents the present value of current operations in perpetuity.
Source: John Ballow, Anthony Relvas and Sarah Maloney, "Taking Measure of Your Stock's Future Value Premium," Accenture Research Note, August 2005; Accenture analysis

Comparing current and future value

A major financial services company had a future-value premium up until 2003. However, its senior leadership was surprised to learn that from 2004 to 2006, the market did not have positive growth expectations for the company and that its future-value premium was negative.

Drivers of value, 1998–2006



Source: Capital IQ; Accenture analysis

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performance of a company's people. Optimizing that performance, however, depends on a unique and diverse pool of talented contributors, both internal and external, supported by assets, technologies, know-how and brands, deployed to enable the growth platforms.

For example, over the past decade, a leading US retailer has consistently outperformed its peers in terms of innovation that delivers sustainable and profitable growth. A great deal of the company's success is attributable to its culture and people, and to the organizational structures it has put in place to enlist employees at all levels in the ongoing success of the company.

Never content to rest on its laurels, the retailer recently determined that, although there were multiple avenues in place to enable the discussion of issues and ideas throughout the company, there was no central vehicle or process that could filter, select and execute the ideas coming from across the organization. Over time, management knew, the absence of such a process could lead to good ideas being overlooked, or to the failure to commercialize ideas due to lack of support.

To address that concern, the retailer is building an "employee collaboration network," an enterprisewide, innovation-enabling functionality. The network's stated goal is to support faster speed to market of ideas through cross-functional collaboration and visibility, driving growth and shareholder value.

In addition, this innovation-generating initiative is explicitly linked to creating the kind of culture—and the sourcing and selection of the right kinds of employees—that can drive innovation and growth in the long term. The company believes that the employee collaboration network will improve the engagement of its workforce and, by extension, the ability of the company to retain its best-performing workers.

The promise of growth

Most companies, especially those enjoying success in the current market place, will already be focused on these five key areas that are critical to achieving and sustaining success through innovation. Fewer of these companies, however, will have integrated those efforts effectively, or will have the right combination of factors that can bring more discipline to their innovations in support of sustained growth.

Here are some things executives can do to create a more effective innovation capability.

Articulate high-value opportunities. Accenture research has shown that high performers are unique in their ability to change ahead of the curve (see "Changing ahead of the curve," *Outlook*, January 2007). Many successful companies are unable to sustain that success because they wait too long to identify new growth platforms and profit pools. High performers, by contrast, change before they must, knowing that the best way to transform is from a position of strength. Change should not be crisis driven but opportunity driven.

Identify critical barriers and drivers. Part of the new rigor and discipline of innovation involves an assessment of where a company falls short in its current capabilities. Companies must identify the symptoms and get to the root causes of the challenges they face in harnessing innovation in support of growth. Several causes may be at work.

- Weak portfolios and pipelines for growth and value-creating initiatives.
- The inability to convert growth and value-creation ideas into robust concepts, businesses and service offerings.
- Disappointing impact due to the inability to market and communicate innovations that can drive growth.

Put in place an innovation "seeding, feeding and weeding" process. As seen with such innovators as Wells Fargo, companies should create formal organizational structures to identify promising ideas. They should also establish funding mechanisms to support the development of ideas to predetermined stages and then give these nascent projects the latitude needed to explore their commercial potential. The companies also must have the rigor and courage to separate the sheep from the goats—identifying both projects worthy of further development and those where the idea does not match the commercial reality.

Develop an innovation communications capability
Finally, companies must begin developing the communications and relationship-building capabilities needed to promote their growth platforms. They have to make sure that the "tree" makes a noise when it hits the marketplace. High performers succeed not only because of their commercialized ideas but also because they are adept at exciting the right parts of the overall value chain about those ideas.

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