INVESTING TO POWER YOUR WISE PIVOT

Every business takes a distinct path to the New. Determine how, when and where to choose yours.
The late, renowned British physicist Stephen Hawking once said that “Intelligence is the ability to adapt to change.”* This wisdom is echoed by today’s corporate leaders. As our recent survey of 1,440 C-level executives shows, more than 70 percent recognize the need to manage change proactively.

But understanding that stability in the digital age is an illusion, and purposefully preparing an organization for change is different. Companies cannot simply abandon their core business, which is likely to be generating the bulk of their revenues, profits and cash. And the questions of how much and how fast to invest in new business activities are murky if not opaque. Concern about striking the right balance causes many companies to hesitate; premature or late shifts cause many to struggle and some to fail.

At Accenture, we believe there is a way to move confidently and successfully into new businesses—it involves learning how to *pivot wisely*.

What makes a pivot wise? It is all about constantly calibrating investments—not moving too fast (giving up on the core business too early), and not moving too slow (waiting until change is a desperate and reactive move). That means continually assessing the organization’s investment capacity (the resources available to invest) and velocity (the speed at which the company has been moving into new business activities) to inform key decisions for the next pivot.

It is vital to bring the right mindset to the decision-making table. Importantly, our research indicates that the Wise Pivot is not possible without the explicit attention of the CFO, whose position is uniquely suited to helping a company strike a deliberately holistic, effective interplay between investments in old and new business activities.

**The Wise Pivot** requires an investment approach that enables companies to create major new businesses without prematurely abandoning their core.
INVESTING IN THE FUTURE

Companies that master the Wise Pivot are in the best position to drive the most value out of their core business, typically by operating in new ways (such as tires evolving from a product to a sensor-enabled intelligent device that collects data to inform and improve maintenance activities). At the same time, companies are also able to identify, scope, and pursue the most promising new business activities (for example, technology companies that are creating software platforms and artificial intelligence systems to help doctors improve diagnoses and the treatment of illnesses).

If your capital allocation process follows the typical traditional finance route, then you will never get to the New.

Omar Abbosh | Chief Strategy Officer, Accenture
However, according to another Accenture research study of 1,500 organizations, the reality is that large, established companies, collectively, are not accelerating investments at all, in current or new business activities, despite having record levels of cash on their balance sheets. Notably, in the last 10 years, these companies’ total capital investment, relative to revenues, has declined, while research and development has remained stable (see Figure 1).

Leading companies focus on their future, with determination. Surprisingly, only 33 percent have invested aggressively in future businesses, based on our assessment of their investment capacity and investment velocity trends from 2011 to 2016. So, what is holding so many large organizations back?

The overall apparent hesitation is understandable, given the ongoing need to hedge against surprises caused by external factors (such as market volatility, and regulatory changes, related to taxation and trade policies).

But two important internal challenges are also creating a resistance for many large organizations: an inability to replenish investment capacity, and fear of getting investment velocity wrong.

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**Investment trends**

Instead of accelerating investments, most large companies remain (optimistically) cautious

Total investments (CAPEX + R&D) relative to revenue (%)

Total investments (CAPEX + R&D) ($US trillion)

Figure 1.
1. Inability to replenish investment capacity

Consider a company facing slow growth, where investment dollars are hard to find. What should it do? In this situation, many companies double down on their core, investing scarce funds in that business, even though it is decreasing in relevance to customers. New business ventures are starved of the funds they need, and so growth remains elusive—and the spiral continues.

Our research shows that this is a common problem. According to our C-level survey, over 90 percent of large companies that have faced slower growth in recent years do not earmark sufficient investment capacity to scale new businesses and strengthen the core at the same time (see Figure 2).

2. Fear of getting investment velocity wrong

Deciding on the pace of investments and their direction is a constant challenge. For example, a company may lack the commitment to new businesses because its core is currently performing strongly—perhaps due to the tide of the buoyant stock market that has lifted companies’ valuations globally, particularly in recent years.

Our research indicates that companies that are tied to the core business today are often inwardly focused. They are less likely to be acquiring new assets and talent inorganically, and participating in innovation consortia and joint ventures, compared to those that have expanded more aggressively into new businesses (see Figure 3).

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**Figure 2. Investment capacity**

Strong growth trajectory in the past three years underpins the confidence of high-growth companies to earmark sufficient investment capacity for change

<table>
<thead>
<tr>
<th>HIGH-GROWTH COMPANIES</th>
<th>OTHER COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Achieved over 10 percent growth in sales and EBITDA in the past three years)</td>
<td>(Achieved 10 percent or less growth in sales and EBITDA in the past three years)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Definitely sufficient investment capacity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>22%</strong></td>
<td><strong>8%</strong></td>
</tr>
</tbody>
</table>

Source: Accenture C-level Survey, April to May 2017

**Figure 3. Investment priorities (new business expansion)**

Less than one-quarter of companies tied to their core today are expecting to invest in mergers and acquisitions (M&A)

<table>
<thead>
<tr>
<th>Mergers &amp; acquisitions (M&amp;A)</th>
<th>Strategic investments (minority stakes)</th>
<th>Joint ventures/Alliances</th>
<th>Participation in an innovation consortium</th>
</tr>
</thead>
<tbody>
<tr>
<td>43%</td>
<td>-22%</td>
<td>-5%</td>
<td>-15%</td>
</tr>
<tr>
<td>21%</td>
<td>35%</td>
<td>38%</td>
<td>44%</td>
</tr>
<tr>
<td>30%</td>
<td>23%</td>
<td>4%</td>
<td>26%</td>
</tr>
</tbody>
</table>

Source: Accenture C-level Survey, April to May 2017

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Clearly, it is important not to underinvest prematurely in the core business. But it is equally important to undergo the hard, strategic challenge of identifying not only new business opportunities, but also those with the potential to scale rapidly before prioritizing investments.

And they must also be confident they can direct adequate funding at the right time to those new ventures, particularly when seeking to meet the increasing customer demand for innovative products and services, at pace. Tesla, well-known for its bold moves and ambitious targets, found in recent months, that scaling the production for its mass-market car, the Model 3, is not without its challenges. On Tesla’s first-quarter 2018 earnings call, the company highlighted that it continues to “target Model 3 production of approximately 5,000 per week in about two months, although [its] prior experience has demonstrated the difficulty of accurately forecasting specific production rates at specific points in time because of the exponential nature of the ramp.” Model 3 production hit 2,270 per week in April. Tesla’s recent challenges, while high-profile, are not unique to companies in the middle of a pivot. The key is to have the courage to take corrective action, and get focused on the ultimate goal: to scale an innovation ahead of competitors.

The risks are high. Over-investing in new areas to stimulate innovation can mean overstretching financial capacities, while moving too slowly can make companies obsolete. 

Omar Abbosh | Chief Strategy Officer, Accenture
KEEPING AN EYE ON OPPORTUNITIES

Some companies only begin to pivot in response to a disruptive internal or external event (for example, declining profitability or a new competitive threat). Pivoting wisely, however, means knowing when to take advantage of two distinct but perhaps counterintuitive opportunities to accelerate a shift to new businesses.

1. **When things are going well**

Pivoting from a position of strength is, in fact, a best-case scenario, as it enables organizations to take calculated risks with new business activities. For example, consider the Japanese tech giant, SoftBank Group. The conglomerate has been placing bets on the future by investing billions into technology companies since 2001, some of which are not directly related to its core money-making telecommunications businesses. In fiscal 2016, SoftBank Group achieved ¥1 trillion in operating income and reported an average of 44 percent IRR (internal rate of return) on these equity investments over the last 18 years. The group considers investment an important way of seizing growth opportunities ahead of other companies, and has established the SoftBank Vision Fund in 2017 to accelerate efforts in realizing its vision for the future. The fund, with a capital commitment of over US$93 billion, aims to make large-scale, long-term investments in companies and platform businesses that have the potential to spark the next generation of innovations and infrastructure, namely in artificial intelligence and the Internet of Things. It invests not only in communications infrastructure and services, but in a wide variety of sectors that span robotics, rideshare, self-driving, biomedicine, finance, insurance and agriculture. As of December 2017, the fund has already deployed about a third of its capital in 30 companies, such as ride-hailing service Uber, chipmaker NVIDIA and robotics firm Boston Dynamics.

2. **When industry disruption gives rise to possibilities in completely new areas**

Even large technology companies cannot afford to stay on a fixed path and expect growth and future success. Microsoft is a leading platform and productivity company for the mobile-first, cloud-first world, but in the future, could it also be known as a leading healthcare player? This possibility is not so farfetched, considering that the company is co-developing new services such as Microsoft Genomics (a gene-sequencing service that leverages cloud platforms and artificial intelligence) with partners to help improve healthcare. These investments open new markets that could lead to strong financial gains in the near future.
Pivoting wisely also means expecting that, in pursuit of sustained, strong performance, the company’s investment strategy will need to flex. Our research indicates that pivoting wisely takes years, during which an organization balances its efforts to maintain a strong, profitable business—that can meet shareholder expectations—while creating options for future growth.

Our research also indicates that pivoting wisely is a highly individual journey. There is no time when all companies should be pivoting in the same way. Instead, the path that any given company should pursue depends on its particular position, as well as the opportunity that triggers intensified action. There are four different “starting” scenarios to consider, each reflecting a different level of investment capacity and appetite to make decisive moves (see Figure 4).
### Pivot scenarios

**Investment capacity and investment velocity**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Description</th>
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<tbody>
<tr>
<td>Determined</td>
<td>Companies with an aggressive investment strategy supported by high investment capacity (33 percent in our sample) often have a greater propensity to scale new businesses at speed. They have invested in future growth and are better positioned not only to explore options, but also to disrupt other industries (provided they enjoy strong financial performance). Companies in this scenario should consider transferring (at least one of) their proven business models to a new market or industry, with select use of ecosystem partnerships. They must also monitor the performance of new activities closely to avoid overinvesting in areas that do not create business value.</td>
</tr>
<tr>
<td>Compelled</td>
<td>Companies in this scenario aspire to pursue new growth opportunities aggressively but are constrained by low investment capacity (12 percent in our sample). They risk overstretching their finances and damaging the core business through reduced focus. They need to pace themselves as they create additional investment capacity by finding alternative funding sources (for example, through partnerships).</td>
</tr>
<tr>
<td>Reserved</td>
<td>Companies adopted a cautious investment strategy, despite high investment capacity, with laser focus on maintaining a strong current business. They need to pace themselves as they create additional investment capacity by finding alternative funding sources (for example, through partnerships).</td>
</tr>
<tr>
<td>Restrainted</td>
<td>Companies adopted a cautious investment strategy, due to the need to either replenish investment capacity, or to investigate new growth opportunities within limits.</td>
</tr>
</tbody>
</table>

#### What’s Next?

<table>
<thead>
<tr>
<th>Scenario</th>
<th>How to scale new businesses at speed?</th>
<th>Which alternative funding sources can help increase investment capacity?</th>
<th>Which new markets to attack leveraging the current business?</th>
<th>How to reform the current business to replenish investment capacity?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determined</td>
<td>Example: Investments of technology companies in internet satellite networks aimed at bringing fast, cheap access to services globally.</td>
<td>Example: Automakers forming partnerships to co-develop key infrastructure to accelerate adoption of electric vehicles.</td>
<td>Example: Transferring leading-edge technologies such as cloud-based gene-sequencing services to improve healthcare.</td>
<td>Example: Active asset swaps and divestments to create investment capacity and strategic focus, in sectors like pharma and utilities.</td>
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#### Investing to Power Your Wise Pivot

Four Pivot Scenarios, 2016 (1,500 companies from 14 industries)

Source: Accenture Research, Wise Pivot Diagnostic, 2017

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**Merck KGaA**, a leading pharmaceutical and chemical company, began to pivot in 2007 with an 11-year plan to restructure the business and expand into new industry segments. Between 2009 and 2017, the company invested US$21 billion in new business acquisitions to position itself for growth in life sciences and advanced materials. The company has almost tripled its revenues since 2004, and it has delivered strong margins in recent years.

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**Compelled scenario**

Companies in this scenario aspire to pursue new growth opportunities aggressively but are constrained by low investment capacity (12 percent in our sample). They risk overstretching their finances and damaging the core business through reduced focus. They need to pace themselves as they create additional investment capacity by finding alternative funding sources (for example, through partnerships).
Origin Energy, Australia’s leading electricity and gas supplier, has been actively investing in renewable energy for the last decade. Despite delivering strong operational performance, however, Origin’s financials were impacted by declining oil prices and asset write-offs. While the near-term priority is to rebuild the balance sheet and improve shareholder returns, the company continues to make strategic bets in startups to keep abreast of energy innovations. Its leaders recognize that it is uncertain whether these investments will pay dividends in the long run, but they also know that these are necessary moves if the company wants to participate in the transition toward a zero-emissions energy system.

**Reserved scenario**

These companies have a high investment capacity but nonetheless maintain a cautious investment strategy focused on strengthening today’s core business (22 percent in our sample). Companies with strong financial performance can opt to return money to their shareholders; however, they should also be investing in initiatives with strong potential to leverage the strengths of the existing core business and build on those strengths explicitly through new activities.

Faced with market saturation, sportswear brand Nike’s plan to outmaneuver the competition and deliver profitable long-term growth involves a “massive transformation,” according to its CEO, Mark Parker. The company expects to reinvest three to four percent of revenue over the next five years to accelerate product innovations, double its speed to market, and strengthen its direct connection to the consumer through overhauled retail and online experiences.

**Restraint scenario**

Thirty-three percent of companies in our sample find themselves in this scenario. Some companies with a highly profitable current business have chosen to return money to shareholders; however, doing so has reduced their investment capacity to grow and expand. These companies should not stop exploring future growth options (while replenishing their investment capacity). For instance, they should consider participating in innovation consortia, and identifying new ideas through crowdsourcing platforms, to name a few options.

Other organizations in this scenario may face low investment capacity due to declining profits in the core business. The priority for this group is to reform and return the current business to growth. Doing so often requires radical actions, such as divesting non-performing parts of the existing business.

For example, consider Verizon Communications. Faced with a saturated mobile market and the slowing down of its wireless business, Verizon decided to build a growth platform in digital media services and the IoT market. The company recognized that a strong balance sheet provides financial flexibility to grow the business. Since 2016, it has divested part of its wireline operations and the data center business in the U.S. and South America to improve its strategic position. This momentum will continue into 2018 with a US$10 billion cost-cutting initiative.

Companies that pivot wisely understand that in today’s world, stability in business should not be a goal. That is why they see the pivot, in a way, as the "new stability": it is their continuous path to the future.
THE CRITICAL ROLE OF THE CFO

Accenture’s experience working with large organizations indicates that CFOs play a crucial role in enabling their companies to pivot wisely.

While their number one priority is to drive maximum cash generation out of existing businesses to create investment capacity, CFOs will also need to actively be involved in supporting the CEO in: committing to new business, finding synergies with the old and managing productive ecosystem partnerships.
1. Creating commitment for new businesses

Recognizing a winning idea is not easy—but committing to it is even harder. The challenge is that new businesses, particularly those that are powered by emerging technologies, often take longer to build and scale but offer significant potential later.\textsuperscript{21} Doing this deliberately is not the same as pursuing a new project. Making a case for a new business often demands multi-year investments in innovation, acquisition of new assets and new skills.

The global energy company ENGIE is accelerating the rotation of its business to focus even more on renewables, grid and energy services. Since 2016, €15 billion raised from divestments was set aside to invest in new assets. According to the company, “low-carbon activities now represent more than 90 percent of earnings before interest, taxation and amortization, ahead of target.”\textsuperscript{22} ENGIE recovered from the contraction phase of its three-year transformation plan (when investments in new assets have not yet replaced earnings from assets sold) to deliver a five percent core earnings gain in 2017.\textsuperscript{23, 24}

The new generation of CFOs needs to:

- Support and collaborate with other business leaders to define and architect their own “businesses of the future” from the inside, even though the core business may not be under imminent pressure.
- Define the economic profile of “new businesses of the future,” and success metrics that are relevant for each “new business” case (for example, target growth expectations within the first few years, relative to the core).
- Rotate and prioritize capital allocation to support the growth of new businesses, so that these do not have to compete with the typically larger core business.
- Support the capability to drive experimentation in the New, with appropriate gating mechanisms and “new business” case orientation.
2. Being transparent about synergies

As companies pursue new growth opportunities, they should be proactive about seeking synergies across the core and new businesses—in terms of products, channels, customers, operational efficiencies and talent.

NVIDIA, the inventor of the Graphics Processing Unit (GPU), has taken its predominantly gaming-oriented graphics technology and applied it to high-performance computing in the form of GPUs which can be used in a variety of electronic devices. NVIDIA’s CFO articulated its transition to a platform growth strategy in 2014, with the aim of scaling its offerings across four platforms: gaming, professional visualization, data center and automotive. This investment approach is delivering profitable growth; in FY17, the company reported a record US$6.91 billion in revenues, up 38 percent from a year earlier, and expanded its gross margin by 270 basis points to hit 58.8 percent.

The new generation of CFOs needs to:

- **Bundle/repurpose relevant core assets** to create oxygen for growth; for example, spin off the most future-relevant assets from the core business and establish a new operating entity.
- **Create management incentives** to ensure the core business unit leads to leverage the embryonic new/digital capabilities (e.g., those coming out of their own innovation studios/accelerators) and also create management accounting incentives to bring innovation back into the core.
- **Encourage a gradual but systematic transition of finance talent (including senior leaders)** with the right skills from the old parts to new parts of the business.
- **Develop a compelling yet manageable strategic and financial story** for the investor community; the objective is to increase investor confidence in the company’s ability to realize the synergies between the existing and new businesses.
3. Growing through ecosystem partnerships

Leveraging partnerships across ecosystems within and beyond industry boundaries can enable a company to exploit and scale new, but often riskier commercial opportunities, much faster than they would be able to otherwise.

Traditional capital funding sources (for example, reinvestment of profits, cash reserves, borrowing or raising equity) remain the dominant choice for most large companies. However, using network-funded sources such as partnerships, joint ventures or crowdfunding, is gaining increased traction. Partnerships can help to create optionality for future revenue streams and financing power, while enabling companies to share any risks involved.

For example, GlaxoSmithKline (GSK) and Alphabet’s life sciences unit (Verily) created a new company in 2016, Galvani Bioelectronics, that is dedicated to the development of bioelectronic medicines. Galvani is focused on miniaturized, implantable devices that can modify electrical nerve signals, as a way of treating certain chronic conditions, including diabetes, arthritis and asthma. A joint investment of US$715 million will help both companies tap into the potential of the bioelectronics market—and even shape the future of medical science.27 28

The new generation of CFOs needs to:

- Develop a clear commercial ecosystem strategy that enables them to not only identify, but also commercialize new opportunities or ideas.
- Create a financial mechanism to lock in innovation from the ecosystem (e.g., by making commitments to small startups; making value sharing and intellectual property sharing arrangements with partners, etc.) and adopt a new investor or “outside-in” mindset.29
- Know when to walk away from partnerships that limit growth potential to seek more strategic—or more profitable—opportunities.
Companies that aspire to lead in the future need to focus on creating major new businesses without prematurely abandoning the core—in short, they need to learn to pivot, wisely.

And although each company’s pivot will be different, success for each will depend ultimately on the willingness of business leaders, and CFOs especially, to commit to a future direction, create synergies between new business activities and existing operations, and replenish and redirect investment capacity continuously, making the best use of both internal and external funding sources.
The research includes two separate analyses: first, the results of a diagnostic model to evaluate the pivot intensity of companies and second, a global online survey. These are explained in more detail below.

**Accenture Wise Pivot diagnostic model**

A financial and investment analysis of 1,500 non-financial services companies from 14 industries was conducted using Accenture’s proprietary Wise Pivot diagnostic model. The model assesses the pivot intensity of companies using two measures: investment capacity and investment velocity over a five-year period.

**Investment capacity** is a function of liquidity, cash replenishment capability and access to financing. We combine the following three factors to determine an index score:

- **Liquidity**
  Measured by cash over revenue (five-year average) with a weighting of 40 percent.

- **Cash replenishment**
  Measured by operating cash flow over revenue (five-year average) with a weighting of 40 percent.

- **Access to financing**
  Measured by cash from financing over invested capital (five-year average) with a weighting of 20 percent.
Accenture C-level Survey

Accenture conducted a global online survey in April and May of 2017 with 1,440 C-level executives from companies with revenues exceeding US$500 million, across 11 industries and 12 countries, examining how large companies prepare to respond to disruptive change, both in terms of transforming their well-established legacy (or core) business, and expanding into new, scalable businesses. By using the term legacy business, we are referring to the main revenue-generating business activities that have been in operation for more than five years. When we use the term new businesses, we are referring to business activities, investments and ventures into unexplored markets and offerings, where the company has not previously participated at scale.

Respondents in our primary research included Chief Innovation Officer, Chief Operating Officer, Chief Strategy Officer or equivalent roles, or direct reports to these positions. More than one-half (51 percent) had occupied their position for more than five years. The sample provides a balanced view between mature and emerging economies and a wide spectrum of industries.

**Investment velocity** is a combination of the direction and rate of investment. The direction of investment is about the shift of investment into future businesses. The rate of investment is about how fast investments are allocated in comparison to competitors. We determine an index score using the following measures with equal weightings.

**Investment direction**
Measured by increasing share of R&D in (R&D + capital expenditures), increasing share of marketing and sales in operational expenditures and increasing share of intangibles in (tangibles + intangibles) over a five-year period.

**Investment rate**
Measured by increase of R&D (R&D over revenue), CAPEX (CAPEX over revenue), and the sum of intangibles, PP&E (property, plant & equipment) and goodwill (total sum over revenue), each in comparison to competitors over a five-year period.
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Paul Nunes, Amy Chng, David Light, Himanshu Patney
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