Ashridge Strategic Management Centre

Members Meeting

5th March 2020

Minutes of Meeting

In attendance

Philip Meyers	ABF
Alex Manisty	D S Smith
Patrick Scherrer	Helvetia

From Ashridge Strategic Management Centre

Stephen Bungay
Neil Monnery

Neil Monnery: Economic Growth, Corporate Strategy and Value Creation

This meeting was the smallest ever held as a result of members being called away to help deal with the coronavirus pandemic.

Neil has been exploring economic growth for some time, asking why some economies prosper and others stagnate. In late 2019, he published 'A Tale of Two Economies' which compares and contrasts Cuba and Hong Kong. They offer a natural experiment in that they have pursued a stable economic policy for some 60 years, one a pure form of centrally planned socialism and the other a pure form of market capitalism. These policies have resulted in dramatically different results: annual compound growth in GDP per capita of 1% vs 4%, meaning that over 60 years, whilst Cuba has doubled GDP per capita, Hong Kong has multiplied it by 14.

The purpose of the meeting was to consider two questions: whether any lessons could be drawn about managing corporates; and in what ways national economics could affect corporate strategy in the future.

Neil began with a brief summary of the features of the two national policies, and the two architects of them, Che Guevara in Cuba and John Cowperthwaite in Hong Kong. Cowperthwaite applied principles he had learned from Adam Smith, and was very pragmatic, abandoning any policy measure which did not work. Guevara applied principles of central economic planning which many in the West in the 1950's and 60's also believed could create more wealth than free markets, partly because government-sponsored mass production during WWII was seen to create efficiency. The actual results prove otherwise.

Stephen then summarized the two approaches in terms of four variables:

Cuba and Hong Kong: a summary comparison of approach

Variable	Cuba	Hong Kong
Purpose (ultimate goal)	Create economic socialism based on a 'New Man'	Create prosperity
Goal hierarchy (ends and means)	All goals set and controlled by centre; all methods uniquely implied by overall goal	Policy goals create context for pursuit of economic goals of individuals; all methods adopted heuristically
Aggregate power (total available choices)	Restrict aggregate power by using laws to constrain choices (e.g. trading partners, kinds of businesses permitted)	Grow aggregate power by maximising choices within the system (e.g. trading partners, kinds of business that can be started) using laws to set boundary conditions
Power distribution (freedom of economic agents)	All power is vested in the High Priest (*hierarkhia)* and the bureacracy	All economic agents are free to make available choices for themselves

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He then went on to invite comparison with corporate rather than national entities and suggested that those corporates which are closer to the Hong Kong model tend to be more successful, and that following that model requires constant effort against various sources of dysfunction:

Business organisations (firms) as complex adaptive systems

Variable	Features of effectiveness	Sources of dysfunction
Purpose (ultimate goal)	To create value (for owners, customers, employees, society…)	A subordinate goal becomes the ultimate goal; multiple goals; dilution of purpose; lack of realism
Goal hierarchy (ends and means)	Higher level goals set framework for decision-making at lower levels; methods are heuristic	Goals become more detailed; input measures dominate output measures; metric fetishism (BSC)
Aggregate power (total available choices)	Maximise aggregate power within the framework of law and the values of civil society	Processes; goal conflict; agents who can block decisions; established behavioural norms restricting choices
Power distribution (freedom of economic agents)	Clear direction enables individual decision-making by those with the best information at the time; low control	Complex structure; fuzzy accountability; perceived risk leading to high central control; increases in information processing capacity

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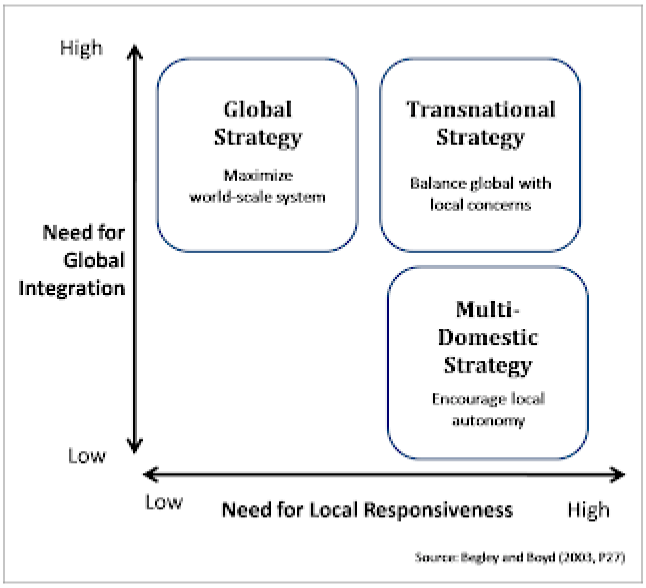
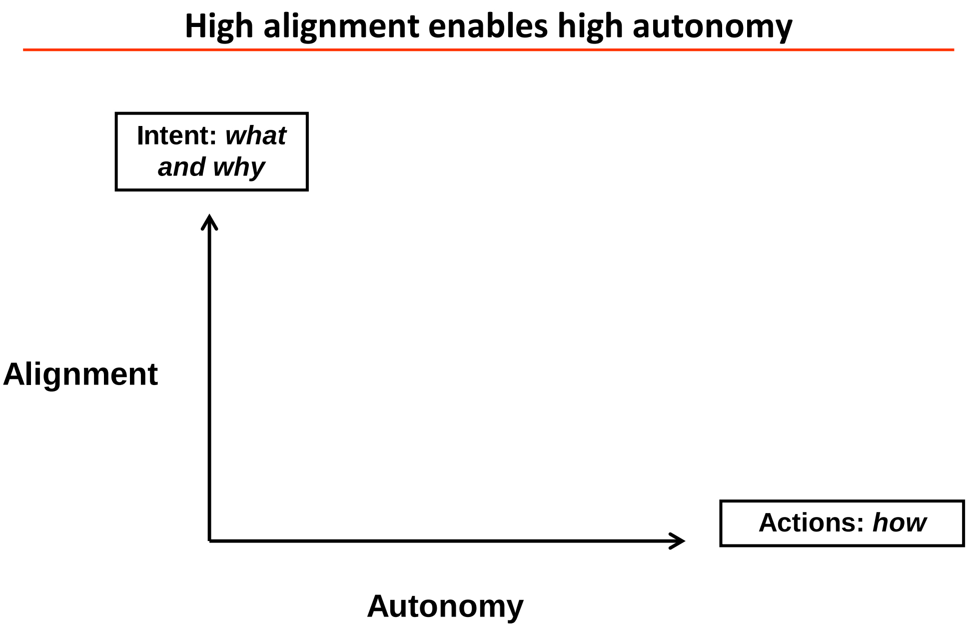
One member commented that their organization used to be highly devolved but that led to chaos, and they have since imposed universal production methods and centralised buying. Another member is highly centralised, and is now trying to push functions out to business units. Another drew attention to the matrix used by Bartlett and Ghoshal:



A company like Apple would be in the top left. Their own food business is bottom right. The top right is an interesting area.

Stephen suggested that this matrix frames the issue as one of choices in organizational structure, but it could be viewed in a slightly different way which broadens the issue:



All companies need alignment. Centralisation of functions and standardisation of methods is one way of achieving it, but there are others. Where operational decisions are devolved there is still a need for alignment around strategy, expressed as in intent (what to achieve and why). Organisations that do not distribute any decision-rights become inflexible, find it hard to innovate and cannot adapt. The question then is how much autonomy to grant people in which areas.

The rule implied by the Hong Kong model is that decision-rights should be given to whoever has the best information at the time, and that control over how should be replaced by alignment around what and why. Cowperthwaite did not delegate any decisions about economic policy, but took them all in the centre. He was, however, very careful not to take decisions he thought others should take, such as what businesses to be in. Guevara, in contrast, had a list of forbidden businesses and another of ones that were permitted.

Similarly, corporations need to be careful about where to exercise control by, for example, standardising product processes, and where they should delegate decision-making (e.g. over production planning), and align by giving guidance, e.g. 'minimise finished goods inventory with the constraint that orders must be fulfilled within 48 hours'.

Neil then moved on to the second question of the ways in which national economics could affect corporate strategy in the future.

He began with a caveat about measures of economic growth. People are most familiar with measures using nominal or real GDP as a numerator and the population or some subset of it as a denominator. Though reliable numbers are hard to find, the best measure of prosperity would be 'consumption per hour worked'. In practice the most reliable compromise is GDP per capita, but its limitations should be borne in mind.

By that measure, since WWII corporates have been operating in an economic golden age. The G7 countries plus India and China have grown by 3.8% since 1950, and 82% of world GDP has been concentrated in only 10 countries. There has therefore been little need for corporations to understand the specific nature of the economic environment as it was similar in most of the countries in which most GDP was generated, and it was benign.

However, that has changed. The top 10 countries now account for only 62% of GDP, and whereas in 1960 there were 27 countries of over 5m people with a GDP per capita of >$3,000, there are now 90. This means that today there are a large number of investment opportunities across the world and the environments vary greatly. So the choices corporates make about where to invest will have a significant impact.

Members have had widely varying experiences when investing outside of the familiar developed capitalist economies. One made a lot of money in Poland when it opened up. Another avoids the highly competitive large economies in its brewing activity and locates it in middling ones, such as Peru and Argentina where its operations are very successful. Another member company however, would never invest in Argentina, and another has also avoided moving outside of the developed world because the markets are financially unstable and demand for insurance only occurs at a late stage of economic development.

Globalisation has been a powerful force, with the opening of China having a transformational effect. GATT covers 98% of world trade with average tariffs falling from around 20% in 1950 to 5% in 2000. This has allowed specialisation and the optimisation of supply chains.

However, there are now signs that the positive impact of an economically benign global order will slow down. There are already moves to localise supply chains, which the coronavirus pandemic may well reinforce. Open borders are closing, tariffs being re-introduced, populist nationalism is on the rise and military tension between the US and China is adding to the risk of confrontations in Asia to add to the endemic conflicts in Africa and the Middle East. Demographic trends which fueled growth are changing and diverging sharply, with some developed countries facing population decline and others growing rapidly. As the effects of climate change are actually starting to be felt, in many countries the public are forcing governments and businesses to take it more seriously.

This is resulting in a rift in some societies between the young, who want action now, and voters, who are not willing to go much further than stopping the use of plastic straws. Idealism is clashing with reality. One member company needs to spend $1.5bn on a market cap of $5bn to cut emissions by 50%. The net result will be an increase in unpredictability.

However, one thing which is predictable is demographics. Neil took us through some of the more dramatic changes which will occur during this century.

Most of the world will see a static population, a declining workforce and therefore a higher dependency ratio as the population ages. Some countries, such as Japan and Italy, will see steep declines in the size of the population and workforce. The Italian workforce will halve by 2021, which implies the need for 1.3% compound productivity growth just to hold GDP constant. Since 2000 Japan's GDP has not grown at all, but consumption per hour worked has risen, so most Japanese are in fact better off. Japan is making up for the lack of human workers by investing very heavily in robots, many to help care for the elderly.

Population growth in Asia will peak and then decline. The two Asian giants, China and India, make up 36% of the world's population today, but by 2100 their share will have declined to 23%.

The continent to see the highest growth will be Africa. Nigeria will be the third most populous country on earth and half of the 20 largest nations will be African. Most of the growth will take place in countries which today rank amongst the most corrupt and least economically free, which raises the question of whether Africa will be a huge basket case or another China. China is investing in Africa, but the experience of western companies is mixed: Heineken has a great business there, but International Paper exited.

(Note: A Special Report published by The Economist in the March 28th edition suggests reasons for some optimism, but the continent has deep problems to confront and it could go either way.)

As the demographics of countries diverge, so too could their economic policy, either mitigating or exacerbating the wide differences in prosperity they currently experience.

Companies therefore need to have economic as well as business acuity in a way they did not in the relatively homogeneous and benign environments they have been used to doing business in. Competitive advantage may result from knowing where and how to invest and being able to operate successfully in more challenging countries. If some geographic choices are forced on businesses by customers, advantage will become more a function of being able to operate effectively in a wider range of circumstances. Though since the industrial revolution the world economy has been driven by Europe and the US and is now set to be driven by Asia, in the future it could be more multi-valent.

Corporate strategy therefore looks set to become more complex, requiring a way to identify benign environments. These could involve a range of variables which have hitherto only attracted marginal attention: immigration, populism, trade barriers, workforce size and structure and the changing importance of different parts of the world.

Round the table comments

- As an insurer, a lot of this comes naturally to us. However, although we look at new countries every year, we always stick to the familiar ones where we know the culture because we can manage that. Our investors are very conservative. Some even ask why we have risks in the US;

- Sino-American rivalry is a big issue for us. It is affecting our supply chain. We rushed in to single sourcing but are now regretting it. We are also seeing big social changes in the workplace here. Young people hate making telephone calls and seeing other people. They will sit in the same office and text each other. We set up a web business for small customers but find younger generation people at Unilever and Nestlé use it. These changes are a bigger concern than country differences.

- We buy businesses that are already operating in several countries. We have an Ovaltine business in Nigeria and use it to learn. I think that is the way to go, conducting small trials which are not material enough to spook shareholders.

Future meetings

As you might expect, we are re-working the schedule for Members' Meetings and seminars.

The next Members' Meeting was due to be held on 4th June. We are now looking to postpone it to September and to push back the dates of the subsequent ones.

Similarly, our next seminar was due to take place on 9th June, but we will also be postponing this till September.

We will let you know the details about the new dates and venues as soon as we are able.

However, our **Strategy Bootcamp** will run again as planned from October 5th – 8th, and bookings are now open. Places booked before 14th June will benefit from an early bird discount.

This year for the first time we are introducing a new **Innovation Bootcamp**, which will take place from 1st – 3rd December.

Details about both Bootcamps are below:

ASMC Strategy Bootcamp 2020

When: October 5 – 8 2020
Where: The Grand Connaught Rooms, Covent Garden.

Who: Members of your strategy team (new members, members who want a booster, senior leaders rotating into a more strategic role)

What: 4 day focused content on strategy, value creation, corporate strategy, and approaching strategic decisions in uncertainty. Specifically, the Bootcamp covers the following areas:

- Strategy, value creation and competitive advantage, and the key pieces of a strategy story
- Strategic analysis, the tools, frameworks, and analytical approaches to strategy
- Framing of strategic options, choices, and prioritising strategic issues
- Strategy, finance, and creating a business case
- Communicating strategy and the first steps of implementation
- Corporate-level and portfolio strategy
- Strategy under uncertainty

Costs: : The standard fee for this four-day programme is £5,000 plus VAT (£4,000 for ASMC members). Places booked by 10 July 2020 qualify for an early bird discount and are available up to then for only £3,500 plus VAT

Next steps: Contact Angela to book places at angela.munro@ashridge.hult.edu. Questions, contact Rebecca at Rebecca@homkes.com

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NEW - ASMC CORPORATE INNOVATION BOOTCAMP

When: December 1-3 2020
Where: London, TBD

Who: Members of your strategy, innovation, RD, teams or leaders rotating into a more strategic role.

What: 2.5-day focused content on overcoming the challenges to innovation and execution on innovation. Topics include preparing for innovation, learning better lessons from entrepreneurs, accelerating your innovation pipeline, and executing on the innovation pipeline. Other topics including building open innovation ecosystems, current trends in Corporate Innovation Centers (CICs) and Corporate Venture Capital (CVCs), and how to be a successful corporate partner.

Note the focus is not on the motivation for innovation or ideation/ design thinking but rather how these topics interact with corporate strategy and how established company leaders can drive better results from innovation initiatives.

Includes interactive lectures, case studies, mini workshop'ing, guest speakers from the entrepreneur and corporate innovation space, and panel discussions.

Next steps: Contact Angela to book places at angela.munro@ashridge.hult.edu.

Questions, contact Rebecca at Rebecca@homkes.com