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EXECUTIVE BRIEFING // FEBRUARY 2018

2018 Corporate Longevity Forecast: Creative Destruction is Accelerating

S&P 500 lifespans continue to shrink, requiring new strategies for navigating disruption.

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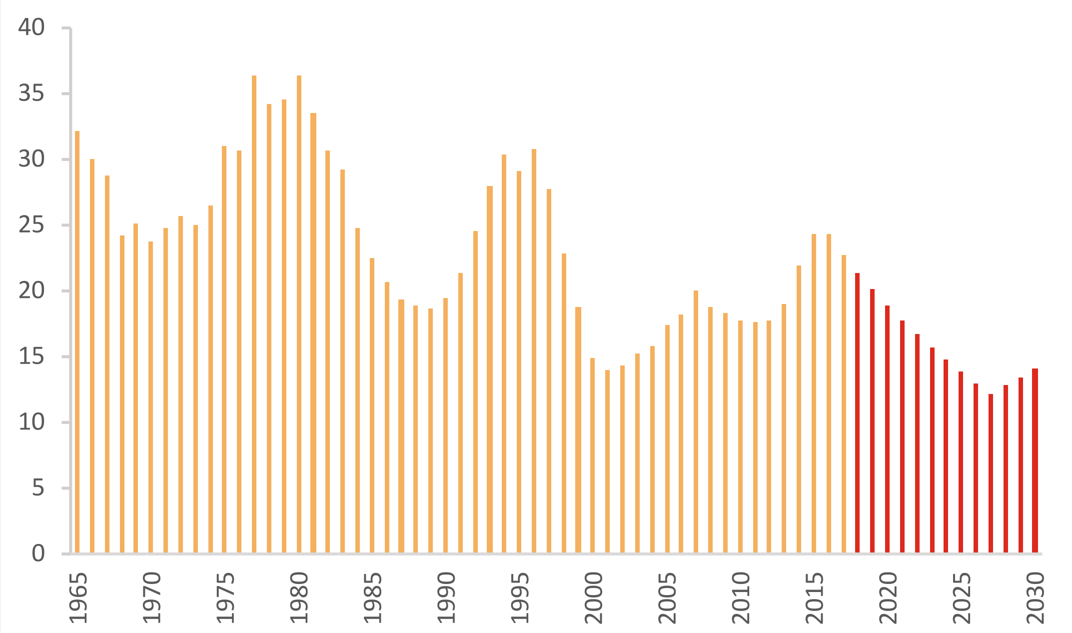
EXECUTIVE SUMMARY

Few companies are immune to the forces of creative destruction. Our corporate longevity forecast of S&P 500 companies anticipates average tenure on the list growing shorter and shorter over the next decade.

Key insights include:

- The 33-year average tenure of companies on the S&P 500 in 1964 narrowed to 24 years by 2016 and is forecast to shrink to just 12 years by 2027 (Chart 1).
- Record private equity activity, a robust M&A market, and the growth of startups with billion-dollar valuations are leading indicators of future turbulence.
- A gale force warning to leaders: at the current churn rate, about half of S&P 500 companies will be replaced over the next ten years.
- Retailers were especially hit hard by disruptive forces, and there are strong signs of restructuring in financial services, healthcare, energy, travel, and real estate.
- The turbulence points to the need for companies to embrace a dual transformation, to focus on changing customer needs, and other strategic interventions.

Chart 1: Average Company Lifespan on S&P 500 Index
Years, rolling 7-year average



Data: Innosight analysis based on public S&P 500 data sources. See endnote on methodology. www.innosight.com

Corporate Longevity Forecast: The Pace of Creative Destruction is Accelerating

Imagine a world in which the average company lasted just 12 years on the S&P 500. That's the reality we could be living in by 2027, according to Innosight's biennial corporate longevity forecast.

Every year, a number of companies drop off the S&P 500 list and are replaced by other firms. In 2017, 26 companies were removed from the S&P 500 and 26 entered the list. This turnover rate of 5.2% is about level with the prior two years, representing the most turbulent three-year period since the recession years a decade ago.

Table 1: Sample Companies Exiting and Entering the S&P 500 (2013-2017)

EXITED THE S&P 500 (TENURE)	ENTERED THE S&P 500
Yahoo! (18 years)	Facebook
DuPont (50 years)	Incyte Corp
Urban Outfitters (7 years)	Foot Locker
Staples (19 years)	Regency Centers
Dun & Bradstreet (9 years)	Gartner Inc.
Starwood Hotels (16 years)	Hilton Worldwide
DirecTV (9 years)	Dish Network
Auto Nation (14 years)	Alliant Energy
Murphy Oil (12 years)	Under Armor
Transocean (4 years)	PayPal
Ryder Systems (35 years)	Activision Blizzard
Frontier Communications (16 years)	SBA Communcations
Dell Computer (17 years)	Hologic
EMC Corp (20 years)	Regeneron
Alcoa (50 years)	Cadence Design Systems
Safeway (17 years)	Royal Carribean Cruises
Whole Foods (12 years)	MGM Resorts
Bed Bath & Beyond (18 years)	Brighthouse Financial

There are a variety of reasons why companies drop off the list. They can be overtaken by a faster growing company and fall below the market cap size threshold (currently that cutoff is about $6 billion). Or they can enter into a merger, acquisition or buyout deal.
At the current and forecasted turnover rate, the Innosight study shows that nearly 50% of the current S&P 500 will be replaced over the next ten years. This projection is consistent with our previous analysis from 2012 and 2016, which Innosight originally conducted with Creative Destruction author Richard Foster.

Who Exited, Who Entered

Over the past five years alone, the companies that have been displaced from the S&P list include many iconic corporations (Table 1).

By tracking all the additions and deletions from the S&P 500 over the past half century, our study shows that lifespans of companies tend to fluctuate in cycles that often mirror the state of the economy and reflect disruption from technologies, ranging from biotech breakthroughs to social media to cloud computing. Over time, the larger trendline is for average longevity to continue to slope downward. Looking to the future, we expect turbulence to accelerate given factors such as the "unicorn" phenomenon of highly valued disruptive startups such as Uber and Airbnb, as well as intense M&A and private equity activity.

This last driver is even larger than the data show, given that the current churn rate of 5.2% does not include the announced private equity deals and mergers and acquisitions that have yet to close (Table 2). 2017 clocked in as a record year for private equity, with more than $453 billion raised from investors globally, according to industry tracker Preqin. Deals included Panera Bread and Staples being taken private, with both deals valued at about $7 billion. As more companies are acquired or turn private, we are forecasting a decade of greater turnover in the S&P 500.

Table 2: The Top 10 M&A Deals of 2016-2017

ACQUIRING COMPANY	TARGET COMPANY	DEAL VALUE (IN $B)
AT&T	Time Warner	$108 *
Linde AG	Praxair	$80
CVS Health	Aetna	$70 *
Walt Disney Co	21st Century Fox	$52.4 *
Bayer	Monsanto	$66 *
Qualcomm	MPX Semiconductors	$47
ChemChina	Syngenta	$43
Shire	Baxalta	$32
Abbott Labs	St. Jude Medical	$30.5
United Technologies	Rockwell Collins	$30

Data: DEALOGIC. * Deal yet to close or receive approval

Are Corporations Ready for Increased Turbulence?

Viewed as a larger picture, S&P 500 turnover serves as a barometer for marketplace change. Shrinking lifespans of companies on the list are in part driven by a complex combination of technology shifts and economic shocks, some of which are beyond the control of corporate leaders. But frequently, companies miss opportunities to adapt or take advantage of these changes. For example, they continue to apply existing business models to new markets, are slow to respond to disruptive competitors in low-profit segments, or fail to adequately envision and invest in new growth areas which often takes a decade or longer to pay off.

At the same time, we've seen the rise of other companies take their place on the list by creating new products, business models, and serving new customers. Some of the market forces driving these exits and entries include the mass disruption in retail, the rising dominance of digital technology platforms, the downward pressure on energy prices, strength in global travel and real estate, as well as the failure of stock buyback efforts to improve performance.

In our 2017 survey measuring the strategic readiness of corporations, executives showed great awareness of the implications of these disruptive trends, with 80% of respondents indicating they believe their companies recognize the need to transform (Chart 2).

However, we also uncovered blind spots, in that most leaders see future competition coming from existing players, rather than new competitors. One hallmark of transformation is that entering new markets requires you to serve new customers and go up against an entirely new set of rivals (Chart 3).

Chart 2: Most Executives Say They Need to Transform

To what degree do you agree or disagree with this statement: "Our company recognizes the need to transform—that is, to change our core offerings or business model—in response to rapidly changing markets and disruption."

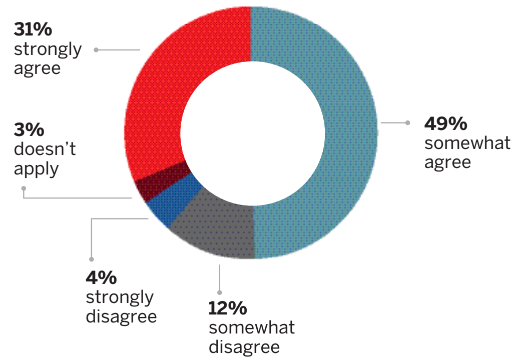
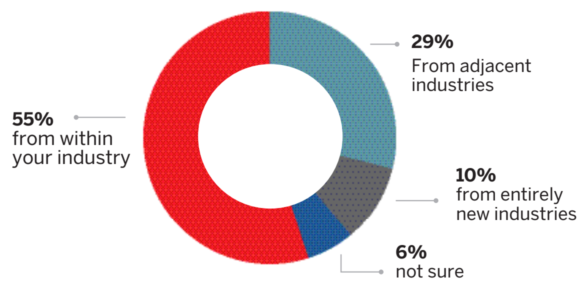


Chart 3: Most Executives Expect Competitors to Remain the Same

Where do you see the greatest competition coming from in the next five years?



Data: 2017 Innosight survey of 300+ executives at firms with $2B+ in revenues

Due to blind spots like these, our survey pointed to what we called a "confidence bubble," in which leaders expressed high degrees of confidence they could transform but at the same seemed to underestimate specific threats and opportunities. For instance, only 29% percent reported investing heavily in digital technologies. For the full survey, see: Are Business Leaders Caught in a Confidence Bubble?

Five Trends Driving Market Turbulence

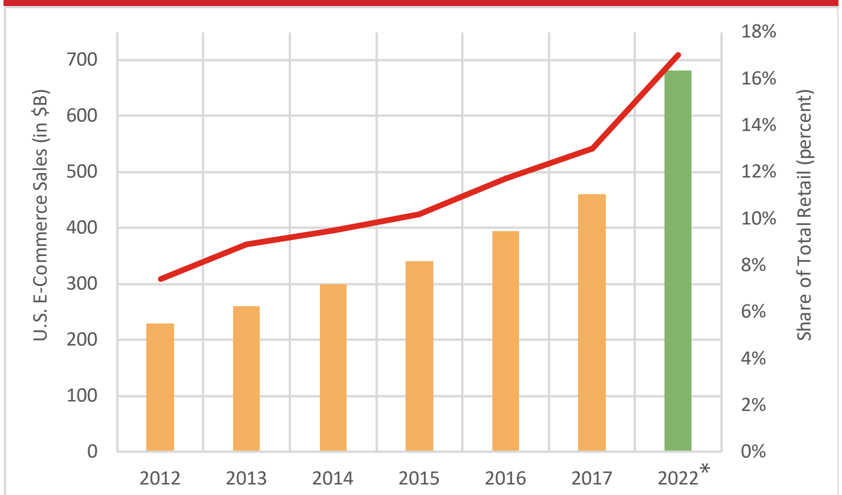
In recent years, the changing makeup of the S&P 500 has been shaped by megatrends that have triggered more turbulence in some industries rather than others. The takeaway lessons from these five forces, however, are not just confined to certain sectors, as the strategic responses of companies are instructive for all leaders.

1) The digital disruption in retail heightens the imperative of dual transformation.

Retail has become one of the most volatile sectors in the S&P 500, with physical chains such as Bed, Bath & Beyond and Urban Outfitters dropping off the list due to declines in market valuation, while grocer Safeway was acquired by Albertsons only to see the combined company cancel its IPO due to weak demand among investors. Firms such as Sears, Radio Shack, and J.C. Penney dropped off earlier.

At least 21 U.S. retailers filed for bankruptcy protection in 2017, according to Retail Drive, including chains such as Toys R Us, The Limited, Payless, and Gymboree. That tops the previous record year of 2008.

Chart 4: Digital Disruption in Retail



Data: U.S. Dept. of Commerce; Forrester Research, * Forecast

The move to digital channels has been steady and relentless. U.S. online sales now account for about 13% of the $3.56 trillion in total retail sales, according to Forrester Research. That is forecast to rise to 17% by 2022 (Chart 4).

Many brick-and-mortar retailers have adapted and responded to the online opportunity with their own digital channels, and many have transformed by integrating physical and digital commerce around customer experiences. However, such efforts are rarely enough.

The predicament faced by Staples shows why. Since the late 1990s, the office supplies leader has long been devoting resources to online sales and delivery, especially for commercial customers. In 2016, e-commerce accounted for more than 60% of its $18.2 billion in sales.

The complication is that competition in those spaces is much fiercer than in its brick-and-mortar channels—so much so that replacing declining store revenue with online sales is not a recipe for overall growth. Instead, Staples has been steadily shrinking and closing underperforming stores since 2011, when its revenue had reached its height of $24.7 billion.

Staples is an example of the need for dual transformation, an approach for making the core business more resilient while at the same time pursuing a strategy to create tomorrow's growth engines.

While by most measures the company was successful at repositioning its core business of selling office supplies—what we call its Transformation A—what Staples has been lacking is a strong strategy for its Transformation B, a new growth plan that could leverage its strengths. Whereas Amazon has built its Amazon Web Services venture into a $10 billion new growth business, Staples had not ventured much beyond its core. With its share price in decline, it agreed to a private equity deal with Sycamore Partners which meant delisting Staples as public company. Explore more about Dual Transformation about here.

2) The rising dominance of digital technology platforms continues to shift massive market value.

A glance at the list of the companies with the largest market capitalizations reveals a megatrend that has been playing out over the past two decades. In 2000, the top four companies by market value were industry leaders General Electric, ExxonMobil, Pfizer, and Citigroup. Now, the top four are digital platform companies Apple, Alphabet/Google, Microsoft, and Amazon (Table 3).

Newer global platform companies that have made the list include Alibaba and Tencent. Facebook also made the ranks, with its platform now reaching 2 billion people worldwide, enabling it to add new features and revenue streams at a furious pace.

What these firms all have in common are powerful digital platforms that provide the scale and scope to expand into new growth markets and geographies at speeds never before possible.

One less obvious case study of how this is playing out comes from PayPal, which was added to the S&P 500 after its spin-out from eBay in 2015. Since then, PayPal has moved from a company that sells specific products and services to one that provides a secure platform for all kinds of commerce—physical, online, and mobile—turning former foes such as MasterCard and Visa into partners so it could better compete against newer rivals Apple and Square. As a result, PayPal's market value has risen to nearly $100 billion, more than double its former parent.

Table 3: A Dramatically Different Top 12

TOP 12 IN 2018	MARKET CAP ($B)	TOP 12 IN 2015	MARKET CAP ($B)	TOP 12 IN 2000	MARKET CAP ($B)
Apple	$896	Apple	$710	General Electric	$474
Alphabet/Google	$782	Alphabet/Google	$449	ExxonMobil	$302
Microsoft	$682	Microsoft	$368	Pfizer	$290
Amazon	$629	ExxonMobil	$334	Citigroup	$287
Tencent	$540	Wells Fargo	$297	Cisco	$275
Facebook	$521	Johnson & Johnson	$274	Wal-Mart Stores	$287
Berkshire Hathaway	$519	Facebook	$272	Microsoft	$231
Alibaba	$467	General Electric	$259	AIG	$229
Johnson & Johnson	$395	JP Morgan Chase	$255	Merck	$216
JP Morgan Chase	$389	Amazon	$247	Intel	$202
Exxon Mobil	$371	Wal-Mart Stores	$230	Johnson & Johnson	$181
Wal-Mart Stores	$310	Procter & Gamble	$218	Coca-Cola	$164

Data: Bloomberg; 2018 valuations as of 1/18/18

3) Disruptive change across industries highlights the importance of continual business model innovation.

Industries such as financial services, healthcare, telecom, travel and real estate have seen some of the highest rates of churn among members of the S&P 500. The $7.6 trillion global travel & tourism sector is a case in point, as it has seen a pronounced shift in its business model, partly as a result of disruptors such as Airbnb and Uber.

Whereas Uber is now booking more than 40 million rides per month and Airbnb is booking more than 100 million room nights per year, exactly who these players are disrupting remains open for debate.

There has been widespread impact from the move to "asset-lite" business models of companies like Airbnb and Uber.

As recently as 2015, the leaders of most of the major hotel companies were quoted as saying that the sharing economy had yet to take a measurable chunk of its business away. However, even if that were the case, there has been a widespread, if indirect, impact from the move to "asset-lite" business models of companies like Airbnb and Uber which don't own real estate or vehicles.

Starwood Hotels & Resorts, in particular, owned a higher percentage of its properties than most other hotel companies, and this was deemed a drag on its market value, helping to force its $13.6 billion merger with Marriott in 2016. Since then, the combined company has been divesting real estate and moving toward a more asset-lite approach while also investing heavily in digital to improve the customer experience versus new rivals.

4) Cleantech and the downward pressure on energy prices has created new winners and losers in one of the world's biggest industries.

With $1.7 trillion in global investment, the energy sector is also among the world's largest industries facing disruption and transformation.

The massive shift of investment to renewables has finally reached critical mass, with investment in solar, wind and related grid capacity now surpassing total investment in new fossil fuel resources for the first time, according to the International Energy Agency.

Solar and wind are now either the same price or cheaper than new fossil fuel capacity in more than 30 countries, according to the World Economic Forum. In the U.S., jobs in solar are growing at 17X the rate of the economy and are more than double the number of coal jobs.

The market reflected these shifts. The S&P Global Clean energy index posted an 18% rise in 2017 (roughly in line with the 19.5% gain of the S&P 500 index for the year). In comparison, the fossil-fuel based S&P Global Energy Index posted performance of about 7%, and the domestic S&P Energy Index was at 3%.

This lagging performance of traditional energy companies is a direct result of extreme downward pressure on the prices of fossil fuels, crippling many of the profit models of leading players, leading to bankruptcies and consolidation.

Among the oil and gas companies dropping off the S&P 500 over the past two years are Transocean, Southwest Energy, Murphy Oil, and Diamond Offshore Drilling (do to drops in market cap), as well as Spectra Energy, TECO Energy, and Columbia Pipeline (due to acquisitions).

It's why many incumbent energy companies are massively investing in renewables, which requires new business models, new growth strategies, and new organizational capabilities.

5) The explosion of private "decacorn" companies signals accelerating turbulence in the years ahead.

The term unicorn was created five years ago to describe privately-held startups with valuations of $1 billion or more. The idea was that such beasts were rare. Not anymore. While there were 82 such companies as recently as 2015, there are now more than 275, according to Crunchbase.

Indeed, the term "decacorns" has been invented to describe companies with private valuations now above $10 billion. Such valuations put them comfortably above the threshold for making the S&P 500. And as we've seen with Alibaba, many non-U.S. firms are seeking to go public on American stock markets.

It's a good bet that today's multi-billion-dollar startups will continually disrupt incumbent leaders across industries for years to come. Those industries range from transportation (Uber and Lyft), financial services (ANT Financial and SoFi), aerospace (Space-X), real estate (We Work), healthcare (Outcome Health), energy (Bloom Energy) as well as everything in the technology space.

Table 4: The Rise of the Decacorns (Top 10)

COMPANY	POST MONEY VALUE (IN $B)	COUNTRY	MARKET
Uber	$69	USA	Transportation
ANT Financial	$60	China	Financial Services
Didi Chuxing	$56	China	Consumer Internet
Xiaomi	$54	China	Hardware
Airbnb	$31	USA	Consumer Internet
Meituan-Dianping	$30	China	Consumer Internet
SpaceX	$21	USA	Aerospace and Defense
Palantir Technologies	$20	USA	Software
WeWork	$20	USA	Real Estate
Toutiao	$20	China	Consumer Internet

Data: Crunchbase, January 4, 2018

TAKEAWAY STRATEGIES FOR HARNESSING DISRUPTIVE CHANGE

Leaders across every industry need not only to take note of these trends of rising turbulence but to devote time and resources towards harnessing them for their own future growth. We recommend five takeaways:

1. **Spend time at the periphery:** A good place to start would be the emerging unicorns list. But spending time online or in physical spaces experiencing new products and services is essential as well. These are just some of the ways to spot early warning signs and opportunities that could cause massive shifts in value.

2. **Focus on changing customer behaviors:** Early warning signs of disruptive change can also be found by observing customer habits and behavior patterns. Large hotel players, for instance, can observe whether they are overshooting customer needs by providing amenities most people don't use—just as new entrants are solving essential jobs-to-be-done at cheaper rates.

3. **Make sure your strategy isn't trapped by yesterday's assumptions:** Traditional strategy tends to be data-driven and present-forward – extrapolating from today to predict tomorrow. But in dynamic environments, this approach constrains strategic choices and can limit a company to simply extending the current model.

   A future-back strategy, on the other hand, begins with the assumption that tomorrow may not resemble today. It involves looking at powerful trends that hold transformational potential, coming to consensus about the future environment, developing shared aspirations about the company's future state, and then making "stepping stone" investments to turn that aspiration into an achievable reality.

4. **Embrace dual transformation:** As we've seen, companies often make the mistake of believing that transforming their core business is enough to sustain growth. We strongly advocate a dual approach. As the digital platform companies have shown, those that discover new growth opportunities outside the core—and govern them separately while resourcing them adequately—are able to continually reinvent themselves by changing faster than the market.

5. **Assess the cost of inaction:** Leadership teams often squabble over allocating scarce resources—including capital and talent—among current demands and future opportunities, with new growth ideas often pushed to the back burner. But instead of looking only at the cost of new actions, it helps to also estimate a price tag for inaction. Many of the firms exiting the S&P 500 due to drops in market value can serve not just as cautionary tales but as guideposts for measuring the impact of lost opportunities.

About the authors

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About the methodology

The S&P 500 turnover analysis is based on data compiled from public sources and is inspired by research conducted by former Innosight director Richard Foster. "Churn" is calculated by dividing the number of constituent changes each year by 500. For instance, 2017 had 26 constituent changes; 2017 Churn = 5.2% (= 26 / 500). Next, "seven-year rolling compound annual growth rate" (7yrCAGR) in "Churn" is calculated to smooth year-on-year volatility and capture long-term trends. Average Company Lifespan is calculated by the reciprocal of 7yrCAGR (= 1 / 7yrCAGR). The resulting Lifespan history is plotted and reveals cyclical pattern in long-term decline. Note: Lifespan begins in the mid-1960s and reflects the move from 90 to 500 constituents in 1957. Forecast Lifespan reflects historical Peak-to-Peak and Trough-to-Trough trends. Forecast "Channel" is created in Peak and Trough patterns based on historical trend and cycle duration to 2030. This "Channel" serves as guide for forecast trend line to 2030.

About Innosight

The strategy and innovation practice of global professional services firm Huron, Innosight helps organizations own the future, instead of being disrupted by it. The leading authority on disruptive innovation and strategic transformation, the firm collaborates with clients across a range of industries to identify new growth opportunities, build new ventures and capabilities, and accelerate organizational change. Visit us at www.innosight.com.