

How can you be both the disruptor and the disrupted?

The CEO imperative: in this Transformative Age, seize the upside of disruption or be disrupted



The better the question. The better the answer.
The better the world works.



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Building a better
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Generated by the EY global think tank, EYQ

EYQ is EY's global think tank exploring, "What's after what's next?"

The companies that survive and thrive during seismic disruption are those that quickly sense and best respond to change. The question "What's after what's next?" is key in mastering the tomorrow's demands while strategizing for challenges beyond the horizon.

EYQ is dedicated to ...

- ▶ Convening business leaders, public sector experts, researchers and academics.
- ▶ Creating innovative content and unique experiences to challenge preconceptions, shift perceptions and catalyze innovation.
- ▶ Connecting people and ideas in ways that are thought provoking, barrier breaking and future shaping.

By exploring "What's after what's next?" EYQ helps its audiences anticipate the forces shaping our future – empowering them to seize the upside of disruption and build a better working world.

Learn more at ey.com/EYQ

Executive summary

Caterpillars, chrysalises, butterflies

Based on over 65 hours of survey interviews with Global 5000 CEOs, EY distinguishes three levels of corporate disruption readiness, which we have defined as:

- 1** Caterpillars (the majority of companies, staying the course and exploiting existing success).
- 2** Chrysalises (a smaller group, undertaking transformation to exploit digital and foster a culture of innovation).
- 3** Butterflies (the smallest group, transformed and embracing the ethos of *being disruptive* rather than just *doing innovation*).

A dual path forward

Participating CEOs express the tension between the need to drive the current business and investing in future disruption. This duality – the co-existence of essential but conflicting imperatives – underscores the need for a new approach. In the connected and accelerated digital economy companies must address imperatives not only simultaneously, but together. Every successful business now needs to consider how to become skilled at both initiating and responding to disruption.

An essential dimension of this duality is shifting the organizational mindset from *doing to being*. Rather than treating digital or innovation as discrete strategies, make them part of a holistic business perspective. Recognize that every business process must adapt to be fit for a digital world and adopt “re-strategy” – frequently revisit the plan, re-design the future, and re-pilot concepts.

CEO perception vs. investor reality

CEOs have a perception that institutional investors are averse to any investments that could detract from immediate returns. Yet, our global investor survey shows:

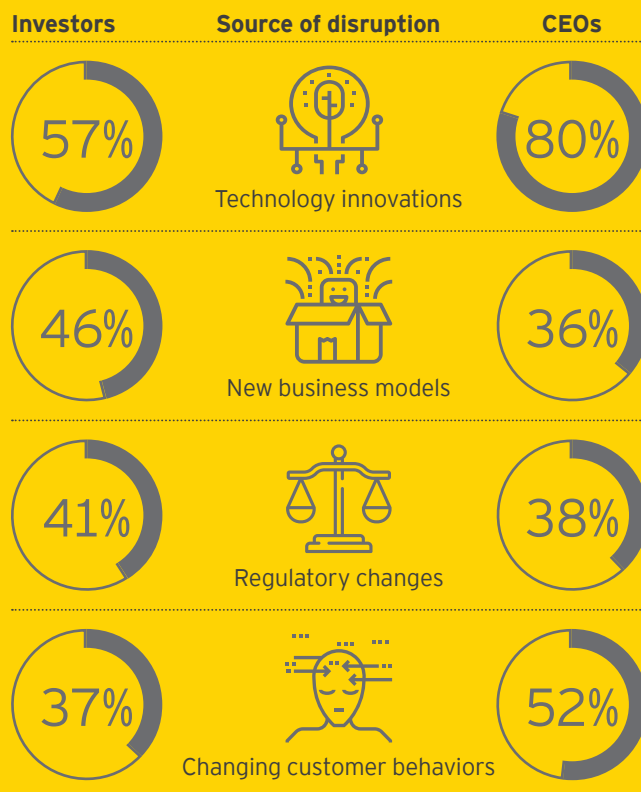
- 55%** of investors say they think companies should invest in exploring potentially disruptive business models.
- 67%** of investors want companies to undertake potentially disruptive innovation projects even if they are risky and may not deliver short-term returns.
- 73%** of investors say that corporate disruption readiness will become a more important investment decision-making factor over the next five years.

Disruption readiness

The Global 5000 CEO survey results point to three significant disruption readiness issues:

- 1** Half of the 101 CEOs we surveyed suggest that their companies have not implemented an adequate response to disruption, putting market leadership and capitalization at risk – 50% of our CEO respondents indicate that their companies are not well prepared to take advantage of the opportunities that may emerge from disruptive change.
- 2** Real readiness levels are much lower than this overall self-assessment, as measured by specific initiatives undertaken and scores for organizational dimensions in leadership, culture, innovation and external awareness.
- 3** The least disruption-ready companies give themselves the highest overall scores, indicating a lack of awareness of the disruptive challenge. Caterpillar companies, despite trailing the other groups in nearly every metric, score themselves highest in overall readiness.

Top disruptive factors over the next 5 years





The pace and scale of disruption are creating opportunity with unprecedented speed.

New agile, digitally-enabled companies quickly scale and compete effectively with industry incumbents. They enjoy radical growth and competitive advantage in a global digital world. We even have a name for emerging companies that succeed in seizing the upside of disruption – *Unicorns*.

This upside is available not only to start-ups. Incumbents, too, can disrupt their markets. In this study of global corporate disruption readiness, EY identified these companies as *Butterflies*.

Butterfly companies have undergone an enterprise transformation in response to urgent external factors, emerging with new capabilities to drive growth and competitiveness in a digital world.

Chrysalis companies feel the urgency of disruption and have initiated significant transformation steps toward disruption readiness.

Caterpillar companies, in contrast, do not feel the urgency of disruption, trail in readiness metrics and focus on optimizing the success of the current business model.

Market-leading companies face a choice: activate disruption readiness first as chrysalises, then as butterflies, or remain caterpillars, putting both market leadership and market capitalization at risk.

The dynamics of disruption readiness and transformation

In a recent multi-part research study, EYQ, a EY global think tank generating future looking insights with diverse perspectives, explored the dynamics of disruptive challenge and transformation, engaging both leading CEOs and institutional investors globally. We asked two fundamental questions:

1. How ready are the world's largest corporations to seize the upside of disruption?

To gain insight into this question, we spent approximately 67 hours interviewing the CEOs of 101 of the world's 5,000 largest companies ranked by revenue. We probed how well their companies are activating the four organizational dimensions of disruption readiness: empowering leadership, corporate culture, innovation practices and capabilities, and external awareness and collaboration capabilities.¹

2. How do institutional investors value disruption readiness?

Our online survey of 100 senior institutional investors worldwide, representing firms with at least US\$1b of assets under management, tested the conventional wisdom that investors do not support long-term, potentially risky innovation initiatives that may not pay off in the short term.

1. The attributes of disruption readiness incorporated into the survey were generated through a multi-day online collaboration exercise involving 15 senior innovation executives.

Dichotomy between caterpillars and butterflies

We learned through our CEO interviews that there were important distinctions in terms of disruption awareness, sense of urgency and transformation. Our analysis suggests that the companies fall into one of three categories that we've defined as: caterpillars, chrysalises and butterflies.

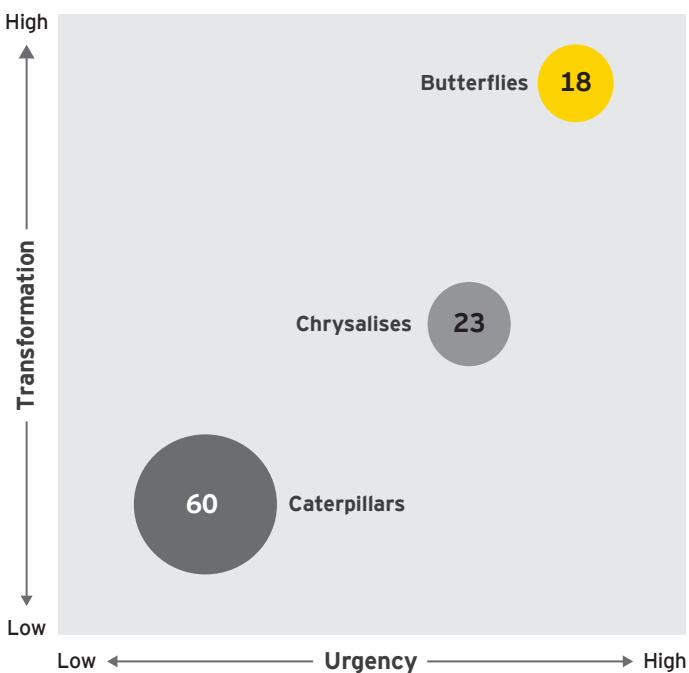
Caterpillars

Sixty companies – the majority – comprise the caterpillar category. They are focused mainly on continuing to exploit the success of their current business model. They express little urgency related to disruption. In some cases, they explicitly discount it.

Many of these companies feel a sense of security because of factors such as lack of prior change, a dominant market position, the regulatory environment and the capital intensity of an industry (e.g., mining, construction, etc.).

Improvement initiatives tend to focus on operational agility, bringing enterprise technology to the current benchmark, incremental innovation and enhancing customer responsiveness.

Figure 1. Urgency/transformation: Caterpillars, Chrysalises, Butterflies



In their CEO's assessment of specific disruption readiness dimensions, Caterpillars trail in 20 of 29 measures. However, they assign their companies the highest scores for overall disruption readiness – a median value of seven. Caterpillar companies are the least ready but the most confident.

Chrysalises

The 23 chrysalis companies are attempting a metamorphosis. Disruption-aware, they are undertaking a transformation, concentrating on creating a culture of innovation, diversifying their talent base and embracing the digital enterprise. Common themes include:

- ▶ Shifting from siloed and hierarchical to matrixed organizational structures to enable agile decision making
- ▶ Overhauling hiring practices to look beyond traditional diversity and toward a diversity in backgrounds as well as an "innovation mindset"
- ▶ Setting up innovation councils to spark employee creativity
- ▶ Developing external awareness capabilities to monitor trends in their respective industries and bring the outside in
- ▶ Exploring emerging disruptive digital technologies
- ▶ Experimenting with and exploring what one CEO described as a "process of accelerated evolution"

The chrysalis group leads or ties in 12 of 29 individual readiness measures and assigns a median overall readiness score of six.

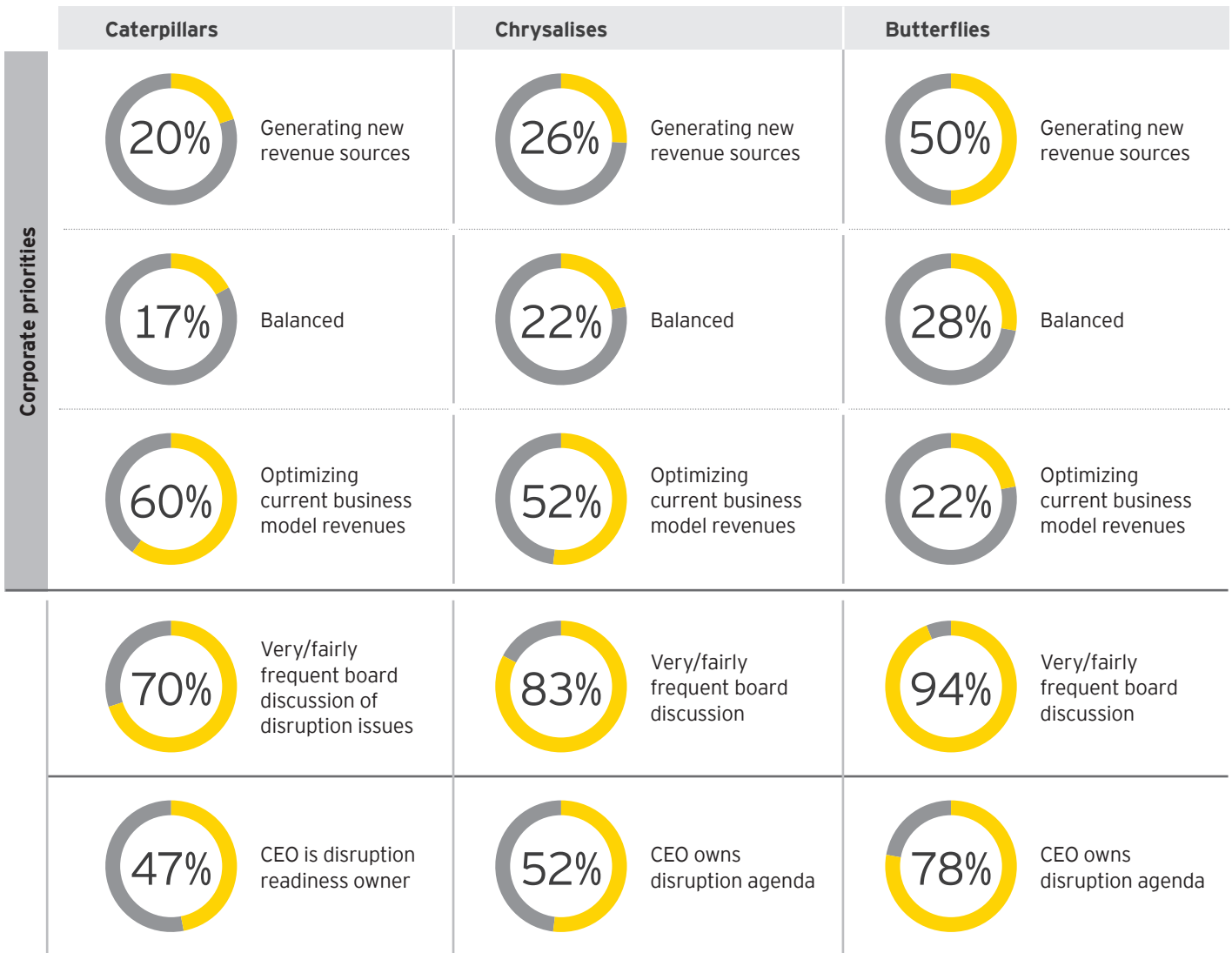
Butterflies

Eighteen companies fit into the butterfly category. They have internalized the urgency of disruption and overcome the inertia of current success to transform their businesses with the goal of seizing the upsides.

Butterfly companies display a set of characteristics and behaviors that set them apart. Their underlying difference is an ethos of *being disruptive* rather than just *doing innovation*. They do this by:

- ▶ Shifting their product and service portfolios and/or overhauling incumbent business models
- ▶ Creating a culture of being first-mover and seeking to disrupt
- ▶ Looking beyond their sector to fostering cross-industry and cross-sector partnerships
- ▶ Transforming the talent model, hiring across industries for cognitive diversity and entrepreneurialism
- ▶ Creating dedicated innovation units with enabling governance and senior sponsorship

Figure 2.



The ambitions of Butterfly organizations go beyond incremental innovation. The leaders of these companies challenge themselves and their teams to become disrupters. As one CEO put it, “Use “first principle” thinking, rather than “comparative thinking”, to guide research and innovation, with a view to eventually achieve disruptive, fundamental breakthroughs.”

Butterflies lead or tie in 20 of 29 specific disruption readiness measures with a median overall readiness score of six. Despite taking greater readiness measures – or perhaps because of it – Butterflies are more humble as they assess their response to the challenge of disruption.

Embrace the concept of duality

In the *The Innovator's Dilemma*, Harvard professor Clayton Christensen looks at the ways successful companies can seemingly do everything "right" and still somehow lose market leadership – or disappear altogether – in a landscape of fierce competition from new and unexpected market players.

Our CEO interviews suggest that the horns of this dilemma remain razor sharp. CEOs struggle to balance the need to pursue sustaining innovations (doing everything right in the near term in existing markets) that drive current revenues rather than investments in disruptive innovations that could lay the foundation for long-term survival and a new phase of growth.

As one CEO remarked, "The challenge is that the company has been very successful with the current portfolio. So there is going to be a fair amount of inertia ... why should we change when we have this great history of success?"

The CEOs' answer to this question is the urgency of disruption. "People think they have two to three years to prepare for this but disruption is here and now," a CEO respondent warned.

Or as another CEO puts it, "I think that you are deluding yourself if you think that your industry is immune from change. There will be disrupters out there and if you don't react to them or ideally take a decision prior to your own industry being disrupted then I think that you will suffer as a result."

Strategy can be neither long-term nor short-term

Addressing the tension of the Innovator's Dilemma requires embracing duality.

Duality is the co-existence of imperatives that are in contrast or conflict with each other but together make up two essential parts of the total system or outcome. In the connected and accelerated digital economy we must address imperatives not only simultaneously, but together.

As a result strategy can be neither long-term nor short-term; an organization's strategy must encompass both, and the interactions in between.



A participating CEO explained duality as: "We look at this as a 'here and now' and a 'tomorrow into the future.' And the trade-offs for the short-term and the long-term have to live together. It's not an 'either or.' It is necessary to be able to do both at the same time."

"We have a middle as well as long-term plan which is connected to a strategy process, so that we can keep an eye on the complexity of the whole," another respondent explained.

For another company, the bridge between now and next was scenario planning connected to a purpose-driven strategy: "We have instituted a process of formal scenario planning looking out into the future ... It has been hugely informative to the development of our purpose-driven strategy, which is what we are looking to use to combat or prepare for the (disruptive) changes."

Thinking and operating in duality can lead to transformative collisions that allow business leaders both respond to disruption and initiate it.



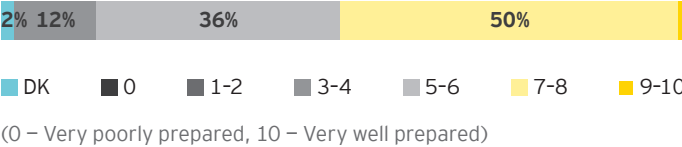
Ready? Not ready

Our study's substantive CEO interviews, approximately 67 hours in total, gathered both quantitative assessments of organizational attributes in the form of ratings, as well as qualitative verbatim inputs.

The interviews explored overall readiness to take advantage of opportunities arising from disruptive change as well as detailed dimensions of leadership, culture, innovation practices and external awareness.

What we learned is that in terms of overall readiness, half of the CEO respondents thought that their companies were prepared or very prepared to take advantage of the opportunities that may emerge from disruptive change. However, that leaves half who are not.

Figure 3. Overall readiness to take advantage of opportunities from disruptive change



This overall 50/50 split in disruption readiness begins to unravel as we probe specific aspects of readiness in four organizational dimensions: enabling leadership, corporate culture, innovation practices and capabilities, and external awareness and collaboration.

“People, by nature, don’t like change because it brings with it uncertainty, so really the biggest challenge is taking people with you along this process.”

CEO survey respondent

Leaders have trouble walking the talk

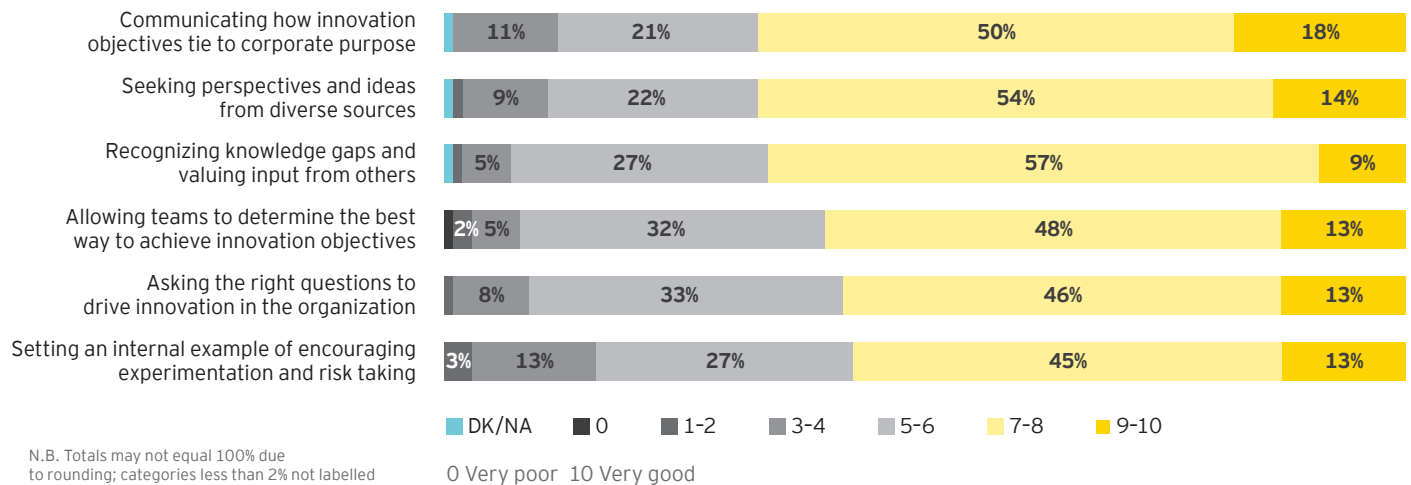
CEOs score leadership attributes most highly. In areas related to communication, openness, and listening – close to 70% of respondents assign their companies’ a good or very good rating (see Figure 4). CEOs assign the lowest scores for setting an internal example of encouraging experimentation and risk taking. This “walking the talk” is most difficult because leaders live the tension between balancing revenues with innovation that will drive real change and achieve the right business outcomes.

Old operating models no longer apply and one could argue neither does the old management model. Today’s management teams need to be open to “new thinkers” who understand where their organizations fit within the ecosystem that is driven by customer expectation for frictionless service and experiences.

“Everyone is watching to see if we are serious about this, so they will watch our actions and our words to see what we do when things go wrong, where we invest and what our attitude is.”

CEO survey respondent

Figure 4. Empowering leadership





Gap between cultural values and real risk-taking

In assessing specific dimensions of their corporate culture, CEOs assign mostly high scores (see Figure 5). CEOs surveyed indicate that culture is top of mind and that they are devoting considerable effort to shift culture.

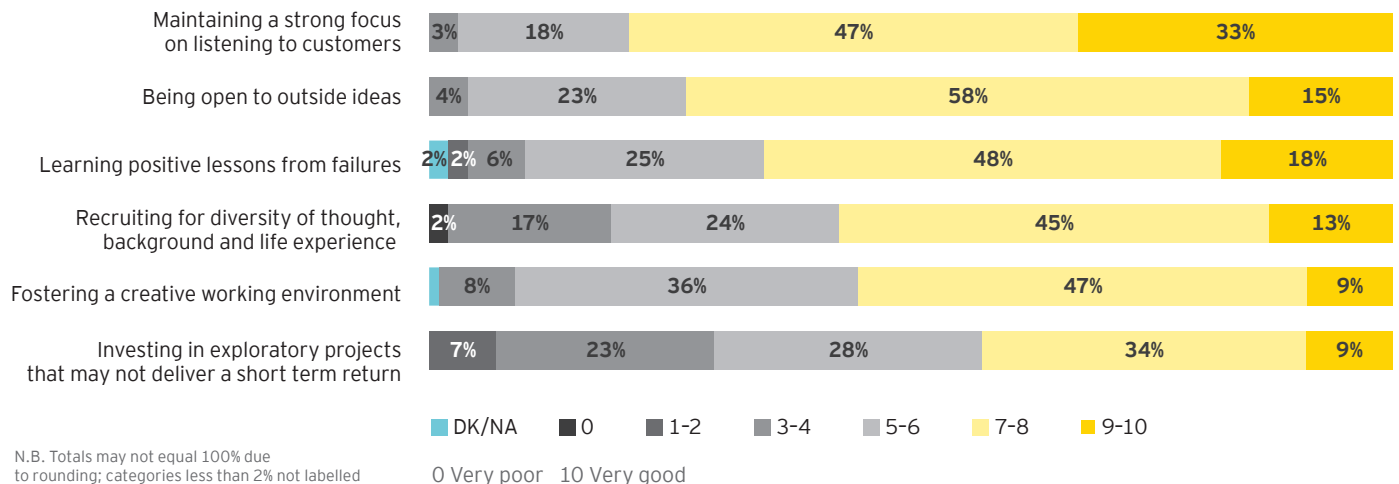
A key part of cultural transformation is developing a culture of yes that enables agile decision-making – can a great idea be moved forward as the result of a 30-minute meeting? So is being customer obsessed and understanding what is working for their customers and what’s not. Companies need to know each segment (millennial, baby boomers, etc.), both for B2C and B2B. Inherent in this customer obsession is focusing on end to end experiences, driving new capabilities and technology decisions based on creating better experiences for customers.

The notable exceptions are the scores for investing in exploratory, long-term ROI projects that may not deliver a short-term return – only 43% give themselves a good or better rating in this disruption readiness attribute. This suggests that despite the work underway on culture change, there is still a gap in translating innovation cultural values into real risk taking and change from business as usual.

“I don’t see how you have a sustainable platform for growth if you don’t have a culture that is open and receptive to the challenge in front of you.”

CEO survey respondent

Figure 5. Corporate culture



Innovation activation falters with practices requiring organizational change

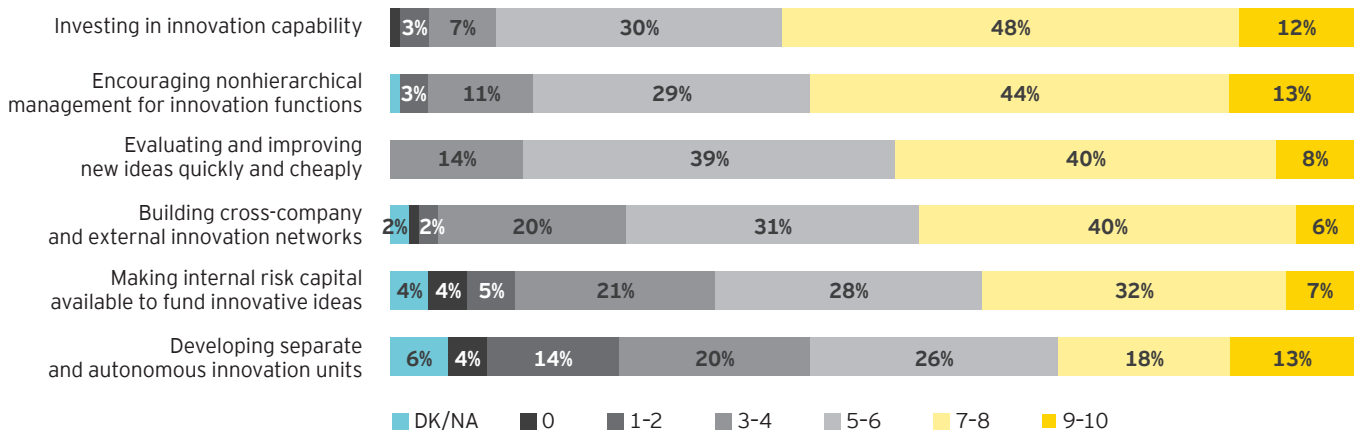
Activating disruptive innovation attributes requires acquiring the right talent, establishing an enabling governance structure and making real organizational change. Innovation leverages technology to create new operating models, products and services, while taking into account the associated process changes, the financial and tax implications as well as the people and culture implications.

Yet, making internal risk capital available and developing autonomous innovation units represent the weakest areas in terms of activating innovation readiness, with only 39% and 31% of CEOs, respectively, assigning a good or better rating. This is perhaps to be expected, since risk capital allocations need to be cleared with the board and explained to investors. Creating autonomous innovation units requires adjusting the landscape of the many functions and business units that own some dimension of innovation.

“We have consciously targeted people from organizations that have already changed with disruption. Advantages and results: there is no history that people will take into account when developing new ideas.”

CEO survey respondent

Figure 6. Innovation practices and capabilities



N.B. Totals may not equal 100% due to rounding; categories less than 2% not labelled

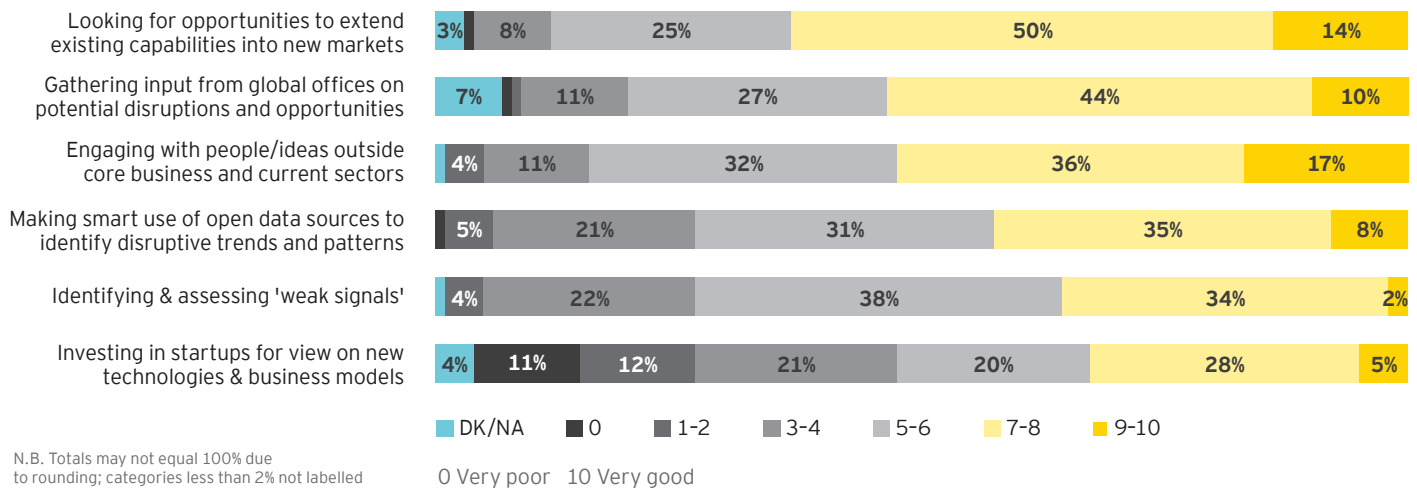
0 Very poor 10 Very good

External awareness and collaboration capabilities need a boost

The external awareness and collaboration attributes – bringing the outside in – receive some of the lowest CEO ratings. This dimension of disruption readiness demands that CEOs reach beyond the boundaries of the organization and their comfort zone. It also requires a significant investment in time and resources to look ahead toward an uncertain future when most organizations are focused on activities with certain and immediate returns.

Only 36% of CEOs give themselves a good or better rating for identifying and assessing weak signals that could serve as signs of new trends. And only 33% gave their companies a good or better rating for investing in start-ups to gain a view of new technologies and business models.

Figure 7. External sensing and collaboration



Theater of innovation

The pressure to demonstrate a response to disruptive factors, and to pursue related goals such as attracting and retaining talent, sometimes gives rise to the “theater of innovation” – creating high visibility initiatives without making them part of a comprehensive enterprise-wide innovation strategy.

We found this tension at play when we queried CEOs on 12 indicators of disruption readiness activation. Uptake is highest for the activities that require the least flex from business

as usual (e.g., having a variety of functions and seniority levels give input on innovation initiatives). Participation falls off quickly as the need for real investment and real change increases (e.g., establishing a corporate venturing unit).

None of our respondents has pursued all 12 disruption activation activities.

Figure 8. Disruption readiness activation



CEOs versus investors, perception versus reality

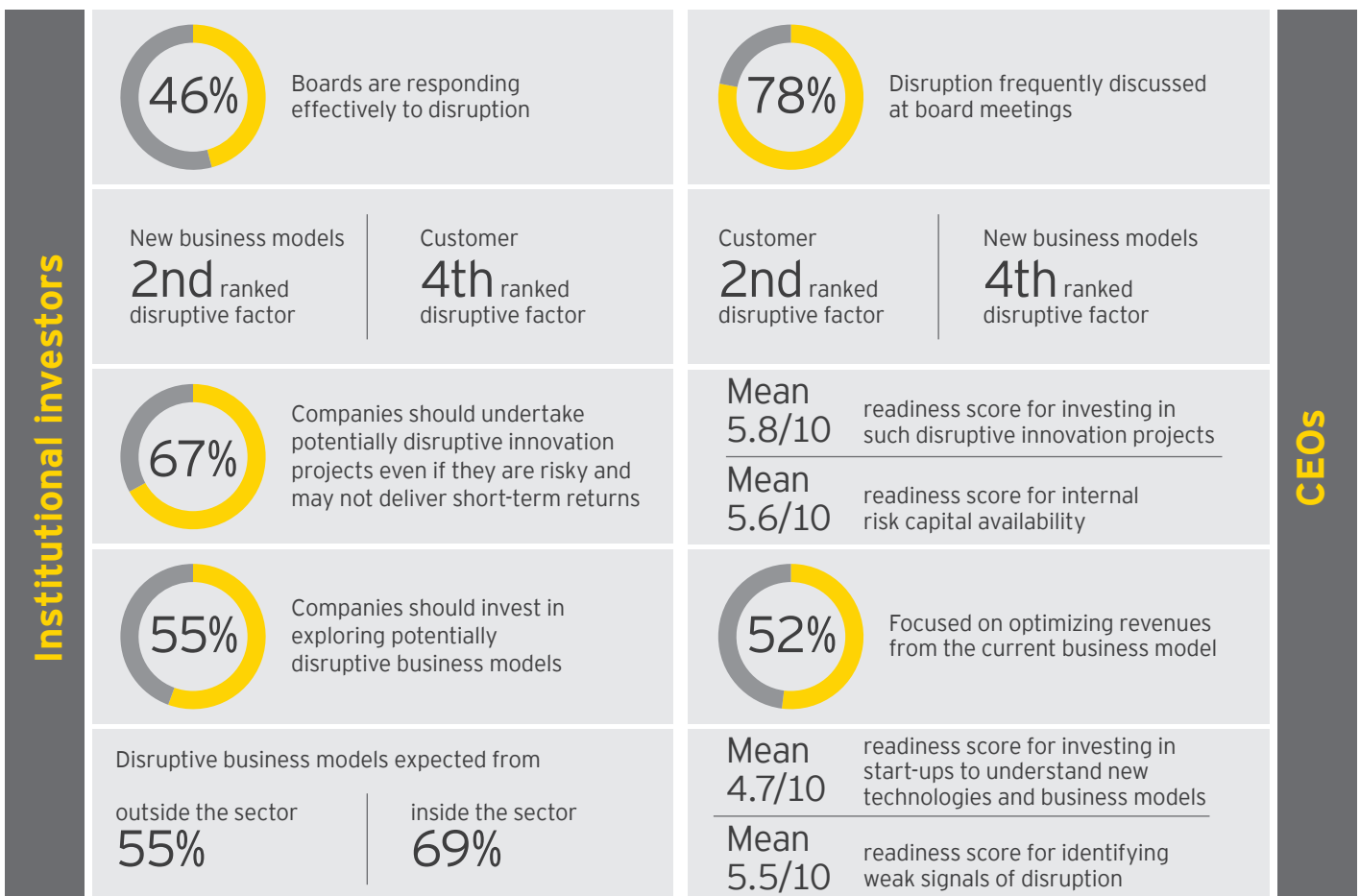
CEOs keenly feel the tension between focusing on the disruptive future and running the current business (e.g., managing stakeholders, operations, sales, etc.). It's a tension exacerbated by the perception that institutional investors are averse to the long-term and potentially risky investments that could detract from immediate returns.

This may explain why 52% of CEOs said that their corporate priorities were weighted toward optimizing revenues from current business models, with only 27% indicating that their corporate priorities skewed toward generating new sources of revenue. At the same time, 64% of CEOs reported spending 25% or less of their time on issues related to disruption.

Yet, based on our survey with institutional investors, this perception does not match reality. In fact, investors appear to embrace a corporate disruption readiness agenda that sees more upsides than risks in disruption:

- ▶ Investors expect disruptive business models to come from both outside their sector of focus (55%) and from inside the sector (69%).
- ▶ 55% of investors say they think companies should invest in exploring potentially disruptive business models.
- ▶ 67% of investors want companies to undertake potentially disruptive innovation projects even if they are risky and may not deliver short-term returns.
- ▶ 73% of investors say that disruption readiness will become more important to their investment decision-making over the next five years.
- ▶ Only 46% of investors say that company boards are responding effectively to the opportunities and challenges arising from disruption.

Figure 9. Institutional investor vs. CEO results



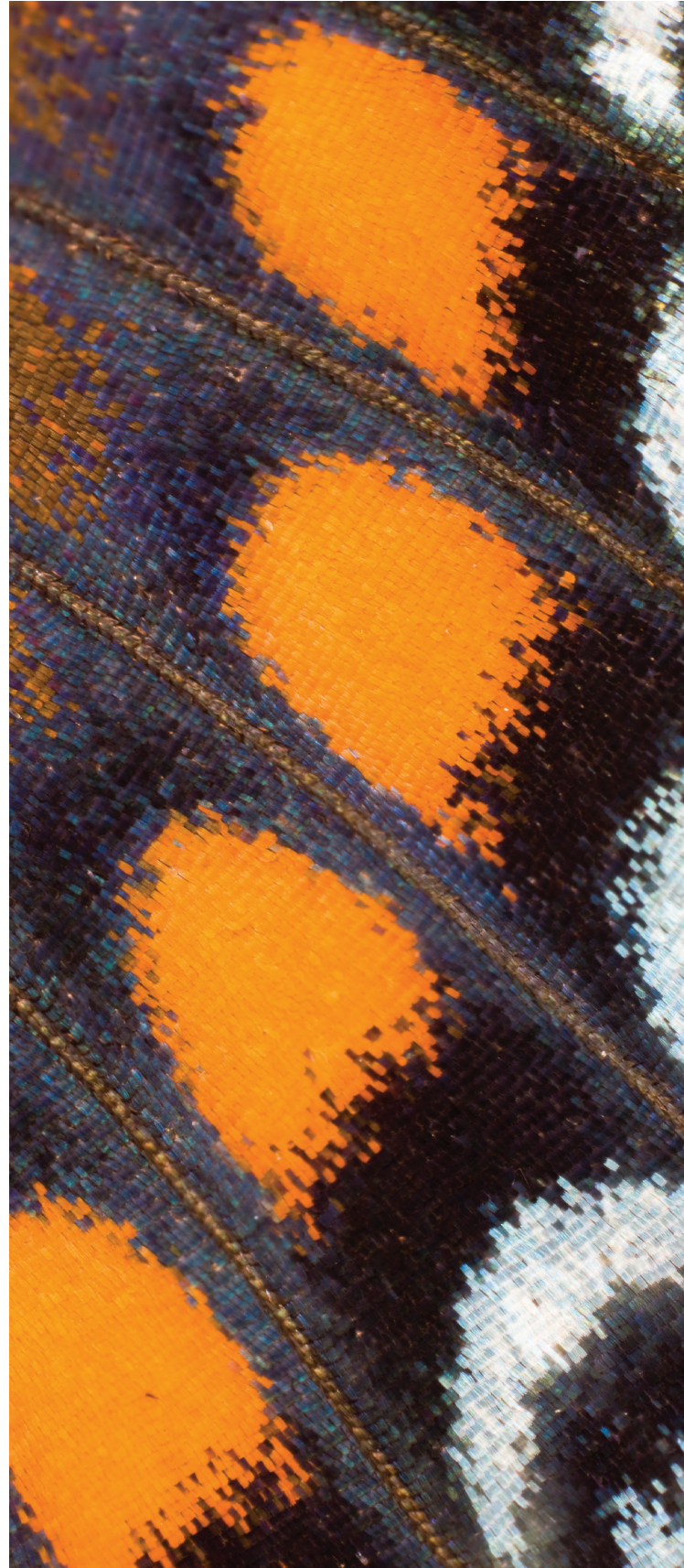
Who should own the disruption agenda?

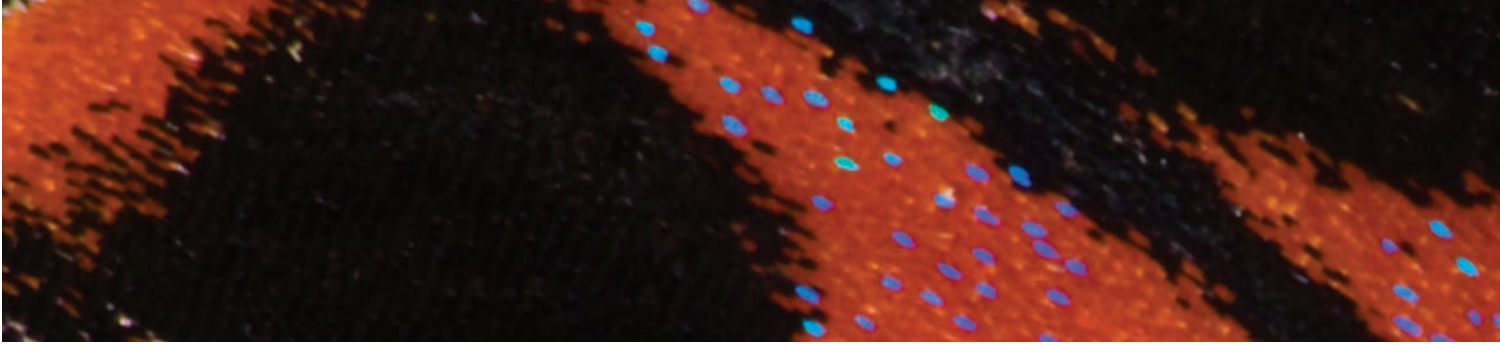
Overall, only 54% of CEOs report being the owner the company's disruption agenda. For caterpillar companies and chrysalis companies, CEO ownership of the disruption agenda falls to 47% and 52%, respectively. Butterflies, however, demonstrate much higher levels of CEO ownership – 77%.

Figure 10. CEO as owner of the corporate disruption agenda



This suggests that CEOs who wish to drive a disruption readiness transformation should own the drive for real organizational change. If operational pressures become too time-consuming for CEOs, they should look to an existing member of the C-suite – such as the Chief Innovation Officer, Chief Technology Officer or Chief Digital officer – to lead day-to-day disruption readiness with the CEO remaining the ultimate disruption agenda owner.





Ten actions to activate disruption readiness

The exponential advancements we see in technology today are only going to accelerate. To seize the upside of disruption, companies must take risks and invest in a disruption agenda, even as they continue to focus initiatives that will keep them competitive in the short-term. Standing still, waiting and seeing, relying on past success to carry you forward into the future, is no longer an option.

Although there is no single formula for activating disruption readiness, our study results point to ten key actions that companies can take on the path to seizing the upside of disruption:

1

Instill urgency about disruption to overcome inertia in the organization and set a leadership example of experimentation and risk taking – i.e., “walk the talk.”

2

Own the disruption agenda as the CEO and develop a leadership model that allows you to devote enough attention to disruptive change and opportunities.

3

Align the C-Suite and board of directors to a shared ambition for disruption to guide the needed investment, governance, link to purpose and message to shareholders.

4

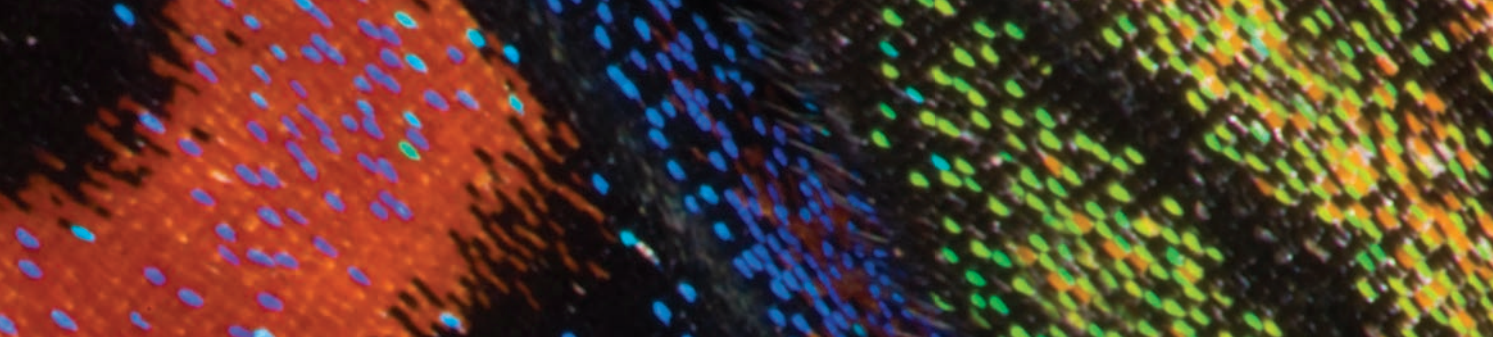
Engage with key investors to discuss disruption and assess appetite and attitude towards investing in innovation.

5

Find the change champions in your company, bring them together and then set them free to drive transformation, whether as dedicated teams or embedded in key functions.

6

Develop ecosystems, networks and innovative formats for collaboration to enable duality not only within the organization but also from the outside in. Venture beyond established hotbeds (e.g., Silicon Valley, Shenzhen) and listen in edge geographies and adjacent industries to determine what is really threatening or disruptive.



7

Avoid “innovation theater.” Approach disruption readiness not as project but as an organizational transformation that touches fundamental aspects of culture, purpose, operations and the current business model.

8

Harness digital by embedding it across the entire value chain, from strategy and design through to execution and the management of risks.

9

“Re-strategy” – frequently revisit the plan, re-design the future, and re-pilot concepts.

10

Ask, what part of my business is already dead? Then act on the answer to free up resources for fresh innovation.

Questions for CEOs and boards

- ▶ Are you willing to challenge (or change) your core business model?
- ▶ Have you cultivated a culture of yes that enables agile decision-making? Are you able to move a great idea forward as the result of a 30-minute meeting?
- ▶ How well does the C-suite and board of directors understand the dynamics of disruption both inside and adjacent to your sector?
- ▶ Is your business strategy fit for a digital world?
- ▶ Have you assessed your disruption readiness gaps? How do you compare to the Global 5000 companies benchmarked in this report? To your competitors?
- ▶ As incumbent business models shatter as result of industry convergence, can you build the capabilities needed to succeed or do you need to buy?
- ▶ Does your strategy address both the need to achieve short term financial objectives and to lay the groundwork for future disruption? Does it drive a transformation?
- ▶ How does corporate purpose inform your disruption readiness agenda?
- ▶ How secure are your funding commitments to disruption initiatives over the long term?
- ▶ Have you assessed your institutional investors’ views on disruption in your sector? Is your institutional investor base aligned to your innovation ambitions?

Study methodology

Global CEO survey

EY commissioned Ipsos-MORI and Kudos Research to conduct survey interviews with CEOs – or the equivalent senior-most executives – of the largest 5,000 companies ranked by 2016 revenues, according to OneSource. A representative sample of 101 Global CEOs were interviewed. Survey respondents came from 26 countries – 46% from EMEA, 27% from the Americas and 27% from the Asia-Pacific region – representing 16 industry sectors.

Both research companies are accredited by the UK Market Research Society and ESOMAR, and therefore bound by strict codes of conduct. The survey interviews were selected, arranged and conducted by Kudos Research. All survey responses were kept anonymous. EY received no survey data linked to any identifiable company.

Global institutional investor survey

EY commissioned the Institutional Investor Custom Research Lab to conduct an online survey of 100 senior investment professionals at institutional investor firms in the US/Canada (25%), Continental Europe (20%), UK (15%), India (15%), Mainland China (10%), Japan (10%) and Hong Kong (5%). Firm types included asset managers, insurance companies, public and private pension funds, family offices, foundations and endowments. All respondents represented firms with at least US\$1b of assets under management; 25% manage US\$50b or more. EY received only aggregated data generated in this project.

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If you are interested in learning more about *The CEO imperative: in this Transformative Age, seize the upside of disruption or be disrupted*, we encourage you to reach out to our team or visit ey.com/EYQ



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