10 lessons for success in today's capital markets

Change is inevitable. The challenge faced by us as individuals and in business is that the rate of change is increasing exponentially. With that exponential change, the perplexing question is this: what is the value of experience (skills, years of services, degrees, etc.) when it's becoming outdated and irrelevant at an ever-increasing pace?

Change, such as new technologies, geopolitics, consumer behaviour, and sustainability expectations bring disruption more akin to a tsunami than a storm. Tsunamis start off as a tiny ripple deep in the ocean. As it gets closer to shore, it builds in amplitude and strength and, by the time it makes landfall, it hits with devastating consequences.

The same is true in business. Below the surface, largely out of view of most listed companies, asset managers, analysts, advisors, and banks, capital markets have undergone fundamental changes over the last few decades. Here are the 10 lessons of the new capital markets playbook. Understanding the application of these lessons will unlock tremendous shareholder value. Ignore them, and face the possibility of extinction.

Lesson 1: Your strategy must cover the business of today AND tomorrow.

Companies must have a distinct strategy focused on renovating, optimising, and growing their current business – including the development of new products and services. Additionally, a dedicated team purely focused on developing new, game-changing opportunities is critical to long-term success. The business of today and the business of tomorrow are like oil and water – they don't mix. Don't try to create radical new businesses within your current business, managed by the same people responsible for operational performance in the business of today. Focus and passion ensures accountability and results.

Lesson 2: Eliminate 'core business' from your corporate lexicon.

Everyone defines their 'core business' at some point, with relevance to a specific market. The problem is, they often cling to that definition, not realising that markets have moved and continue to do so at an ever-increasing rate. Equally, what capital markets value and are prepared to pay a premium for also changes. In the 1900s, it was oil, textiles, railroads, and steel. In the 2020s, it is energy, technology, financial services, consumer business, and healthcare. The market capitalisation of these industries amounts to twice that of the next 16 of the Fortune 500.

Lesson 3: Tangible assets no longer determine corporate value.

In 1975, the S&P500 market capitalisation was comprised of 83% tangible assets and 17% intangibles. By 2020, tangible assets accounted for only 10% while intangible assets, such as patents, brand value, customer data, and software, had increased to 90%. Recent research indicates that Price-to-Earnings multiples have very limited correlation with share prices.

Lesson 4: Industries and sectors are morphing and the magic happens at the intersect points.

Many game-changing opportunities are emerging outside the formal definitions of an industry or sector. Instead, they happen at the intersect of multiple industries, where enormous premiums are being paid. For example, is Tesla an automotive manufacturer, a technology company, a lithium miner, a battery storage producer, or renewable energy company? The market has voted with its capital, making Tesla nearly three times more valuable than Toyota, the biggest automotive company in the world.

Lesson 5: Capital markets place high value on businesses with BIG aspirations and a transformative purpose.

Capital markets have always backed entrepreneurs with bold dreams, those intent on changing the world. This has not changed. Too often, companies either don't have a purpose, or have pedestrian aspirations, like 'growing at last year plus a few basis points'. Those that are bold and transformative generate enormous value for their investors.

Lesson 6: Exponential revenue growth has the biggest impact on total shareholder value – nothing new here!

Research confirmed that, for the top quartile companies across all industries, 72% of total shareholder returns (TSR) were informed by revenue growth and expectations. An expectation premium is a proxy for growth, informed by having a bold and transformative purpose and access to significant new opportunities and markets. Factors like operating margin or asset efficiency have a negligible impact on TSR, so it's understandable that capital markets place such high market values on platform businesses with global scaling potential. Especially when the competition is largely from incumbents, entrenched in their businesses of today!

Lesson 7: Invest in assets that supercharge Economic Margin.

A positive Economic Margin refers to the return on capital a company generates over their inflation adjusted, weighted cost of capital. To supercharge shareholder value, capital should only be invested in new assets when they will convincingly deliver a positive Economic Margin. Companies often make capital allocation decisions focused on sustaining their core business. And while this is more predictable, it generates a low or negative Economic Margin.

Lesson 8: Set an 'expectation premium' target.

Monitor and measure your company's market capitalisation over its intrinsic value. A positive market capitalisation vs. intrinsic value ratio – an 'expectation premium' – is a proxy for innovation and leadership.

Lesson 9: Beware disruption.

When companies are disrupted, it's like looking left and right before crossing the road, then getting hit by a plane. Don't follow the trends. When something is a trend, it's too late to invest and you will be just another player in the market. Rather look for signals – those unique blips on the radar no one else has seen where you can create opportunities to be the only one, instead of trying to be number 1.

Lesson 10: Embrace change!

The Cretaceous-Paleogene extinction event 65 million years ago happened because an asteroid over 13km wide, plunged into Earth at 72,000km/h, punching a hole 180km wide and 19km deep in the Yucatan, off the Mexican coast. The lesson is this: the extinction of the dinosaurs caused new life, like mammals to flourish. Disruption and change render some companies extinct, but allow others to flourish. The future is a matter of choice, not chance. Will you be disrupted, or cause disruption to others?

At **Futureworld**, we have a wealth of experience helping our clients to understand the signals shaping the future of their industries and sectors. If you'd like us to help you discover new ways to unlock exponential value for your shareholders, get in touch.

About the Author

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Louis has a longstanding passion for corporate innovation and entrepreneurship. He is the former Global Executive Director for Service Innovation and Growth and former CEO of Deloitte Consulting Southern Africa. He established a global Strategy and Innovation advisory unit at Deloitte, advising large multinational clients in the area of growth strategy and innovation process, and developed significant new businesses for clients across industries.

Louis was also the Group CEO of Capitalworks for 7 years, a leading emerging markets alternative asset manager.

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