UK CEO Outlook 2015

Revolution or Evolution?

A tale of two strategies

About the study

KPMG interviewed over 1,200 CEOs from 10 key markets to take the pulse of business, as recently published in ***KPMG's Global CEO Outlook 2015.*** This new report seeks to complement that work by drilling down specifically into UK CEO sentiment, based on the views of 151 country respondents.

The analysis partly confirms that British business leaders share many similarities with their global peers: they are worried about the rise of cyber risks, and they believe in the value of data and analytics, to give two examples. It also highlights that UK CEO views are distinct from those in other countries in important ways: they are more confident about their prospects than their global peers, and feel less threatened by the risk of disruption.

In turn, this appears to lead to strategic choices that differ from the norm, with two sharply differing camps. One sees the need to transform their business for a new world (Revolutionary CEOs); the other believes in holding firm on their current model, but optimising it wherever they can (Evolutionary CEOs).

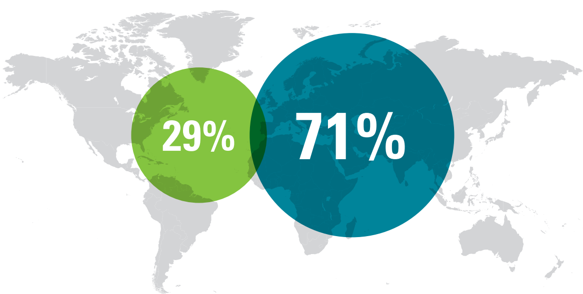
KPMG interviewed over

1,200

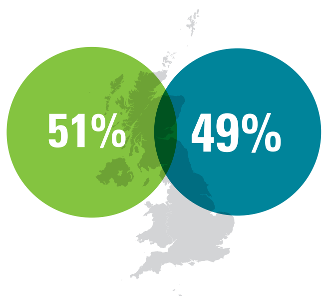
CEOs from 10 key markets
with over 150 UK responses

Looking at the next 3 years, what statement best describes the company you lead?

Global



UK



- We will be largely be the same firm we are today
- We are likely to be transformed into a significantly different entity

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Foreword

Beware the agile collaborator

Nicholas Griffin
Partner, KPMG in the UK
Head of the Global Strategy Group

Chief Executive Officers are generally a bullish breed but the UK CEOs polled for this study are exceptionally confident about the prospects for the organisations they lead compared to their international counterparts. This is a surprise to me.

Why? I believe UK organisations are becoming increasingly exposed to – and subsequently have to respond to – major transformational pressures. In addition to the usual macroeconomic and geopolitical issues, a new set of change drivers is emerging and causing market disruption. Specifically, I believe that we are in the early phase of a prolonged and broad-based structural reconfiguration of markets. This is not a cyclical change.

One of the key drivers is sector convergence. Take connected cars as an example. What was once clearly the product realm of the automotive industry is now being redesigned and occupied by a growing list of sectors that includes technology, energy, software, healthcare, insurance, retail, media, banking and telecoms. Business models are being reshaped and the process of disruption is creating opportunities and threats for new and existing players. What surprises me is that so few Revolutionary CEOs expect their customer base to change (just 18%).

To respond to this, UK CEOs will need to embrace innovation. Two key routes are open to them: increase R&D or collaborate with others, whether as partnerships or outright acquisitions.

On the R&D route there are challenges: UK companies have, in aggregate, been reducing R&D spend over the last decade. Listed firms are pursuing share buyback programmes at a high rate, following a similar path to their US counterparts. Last year S&P 500 companies returned between eight and nine dollars to shareholders for every dollar spent on R&D. CEOs either don't feel the need to increase R&D to boost competitiveness or they don't believe it will generate a sufficiently positive return on investment.

On the other hand, collaborating with other parties is likely to become more prevalent. Disruptive business models tend to use technologies, knowledge and channel strategies from more than one sector and then combine them to create new offers, dis-intermediate, and pull in new customers. Many CEOs are realising that they do not have the capabilities in-house to create and control new models. Furthermore, investing at the required pace and level is high-risk. Not only in terms of the probability of backing a winning solution, but because payback periods are reducing in line with the shortening life-span of financial, business and operating models. Yet technology-led change also opens up new cyber risks, which UK CEOs admit is a weak spot for them.

Grappling with this innovation dilemma is one of the key debates within this new report, which complements KPMG's recently released ***Global CEO Outlook 2015: The growth imperative in a more competitive environment.*** It reveals that UK CEOs are divided into two camps: those who feel they must transform their businesses to thrive (Revolutionary CEOs), and those who believe they've got to double-down on their existing strategy (Evolutionary CEOs).

When a CEO is deciding between Revolution and Evolution to protect and grow their organisation they should assume that someone, somewhere is figuring out how to change the rules of the game they are currently playing or perhaps the game itself. Beware of the agile collaborator.

Nicholas Griffin

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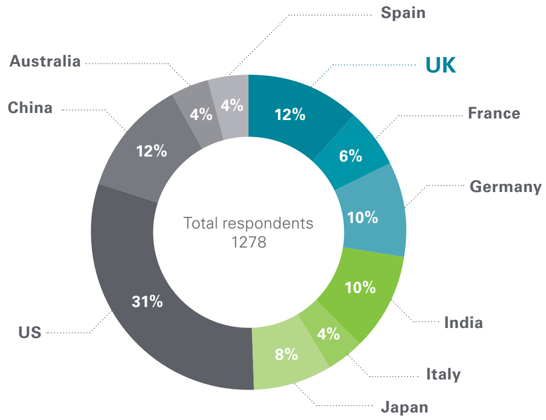
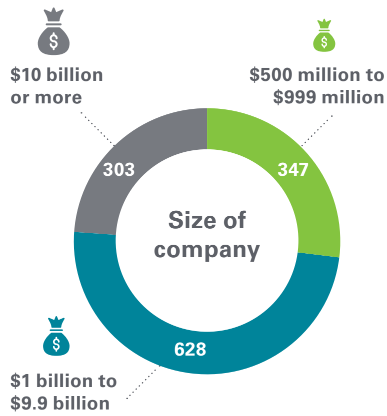
Global respondent profiles and key findings

Source: KPMG Global CEO Outlook 2015: The growth imperative in a more competitive environment

Countries represented



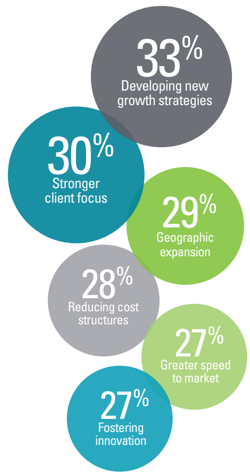


Industry

Banking	Insurance	Investment management	Automotive	Manufacturing	Technology	Retail/Consumer markets	Healthcare	Energy/Utilities
8%	8%	8%	7%	22%	8%	18%	7%	13%

The most critical challenges CEOs expect to face over the next three years

Strategic priorities over the next three years



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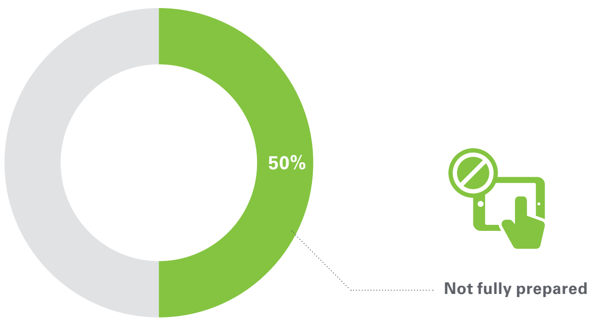
“The more intense a regulatory environment, the more CEOs have to think of other ways to grow business, because the cost of regulation is increasing and eating into profits.”

Jim Low, Partner
Leader for Regulatory Change, KPMG Global

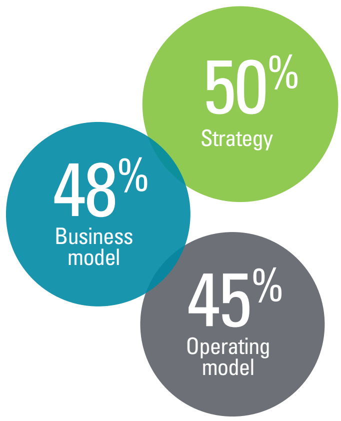
Issues that have the biggest impact on their company today	
Global economic growth	54%
Regulatory environment	45%
Disruptive technology	34%
Geopolitical risks	32%
Currency rate volatility	30%

How comfortable are you with your current business model?

How prepared are you for a cyber event?



What areas will be most transformed over the next three years?



“Any CEO who really understands risk knows that cyber is possibly the most unpredictable risk there is. Historically, organisations have prepared against data disclosures and breaches of confidentiality. Industrial control systems are another matter. We have manufacturing processes, such as mills, factories and pipelines controlled by computer systems that are relatively out-of-date and therefore more vulnerable to attack.”

Malcolm Marshall, Partner
Head of Cyber Security, KPMG Global

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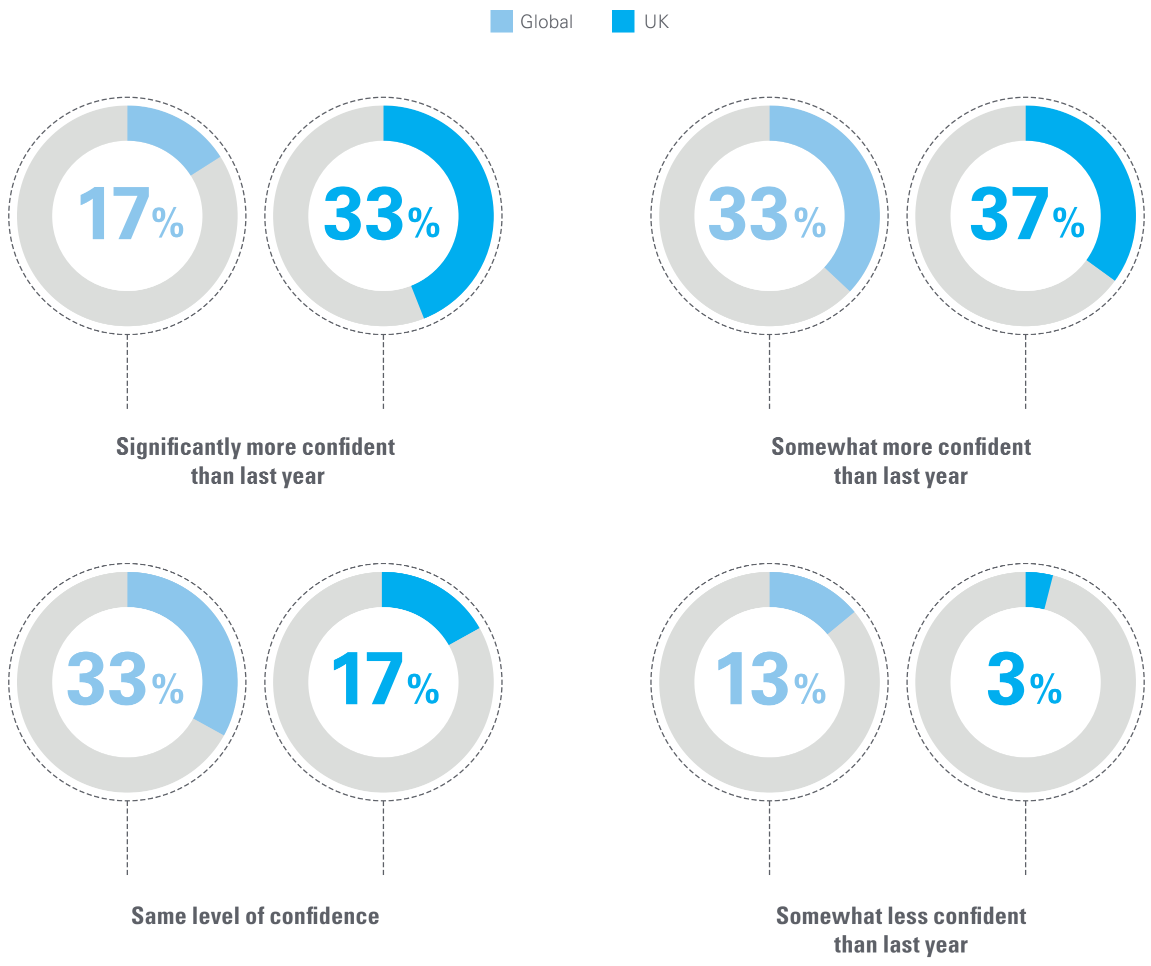
Section 1: The UK growth outlook. Confident but inward looking

As a group, British CEOs are a confident lot and growing more so; 79% say that they are more confident about growth prospects for their firms than last year. This differs markedly from those in other countries, with only a little over half (54%) of global CEOs reporting increasing expectations of growth. This sense of bullishness in the UK is consistent with other data. In the OECD's Business Confidence Index, for example, the UK has been above its long-term average for nearly two years and currently ranks higher than every major economy in the OECD and G20.

Unusually, the more positive outlook of British CEOs seems to arise from their assessment of likely developments in their own back yards. Nearly three in four (72%) of those surveyed rank Western Europe as one of the regions with the greatest potential for growth in the next three years. Indeed, those from Britain are as likely to call Western Europe a high potential market as they are the United States, with all emerging markets well behind. CEOs surveyed in other countries largely agree about America but demur strongly on Western Europe; only about four in ten see it as a likely high growth area.

How confident are you in the growth prospects for your company in the next three years?



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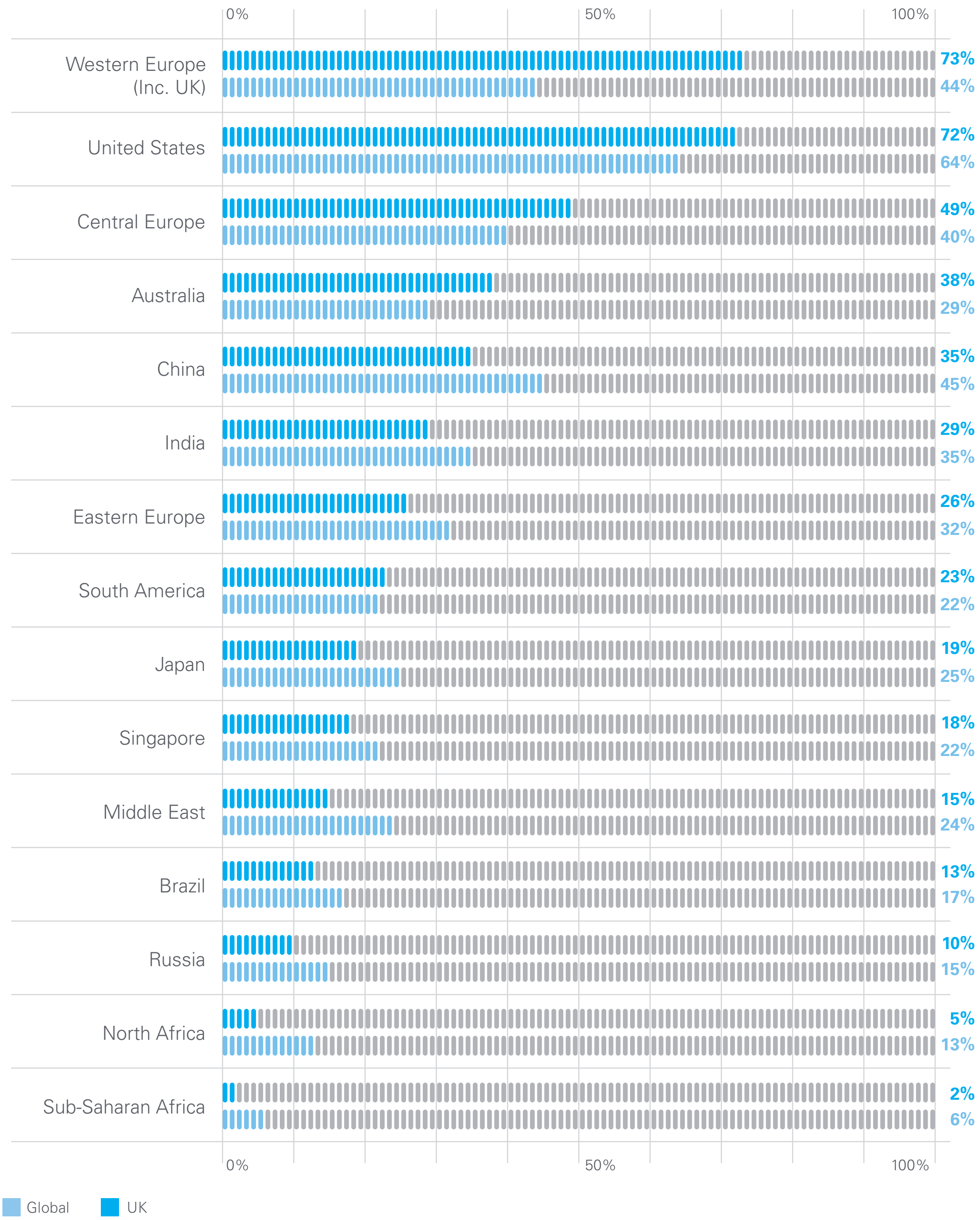
Where UK and Global CEOs see market potential:
"In which geographic markets do you see the greatest potential for new market growth in the next three years?"



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At first glance, the data seem to back up those outside the UK. The Economist Intelligence Unit (EIU) forecasts that Western Europe will have the lowest overall increase in GDP of all major regions between 2015 and 2018, never breaking 2%. In contrast, global growth is expected to be in excess of 2%.

An explanation could be that UK CEOs are thinking more about their own country than about Western Europe as a whole. For example, 70% say that they have grown more confident in the last year about the growth of the British economy, compared to 61% of all those surveyed when assessing their own national economies. In part, this is understandable: the UK's economy is growing strongly relative to Western Europe, and a solidly pro-business government has been recently re-elected, putting more wind into corporate sails.

70% of UK CEOs say that they have grown more confident in the last year about the growth of the British economy, compared to 61% of all those surveyed when assessing their own national economies.

More importantly, UK CEOs are making investment choices based on that confidence: 47% of CEOs globally are looking to invest significant capital into geographic expansion outside of their home countries (the most commonly cited projected use of capital worldwide), but in the UK that figure is just 19% (the least commonly cited). Similarly, geographic expansion is a lower priority for UK executives than for others in the survey; it is the third most popular strategic priority for the global survey but is tied for 8th in the UK one.

It is not a question of retreating from the world. UK CEOs, for example, are still likely to report that the US economy remains very or somewhat important to their firm's growth prospects (89%). Similarly, 58% say that global economic growth is a leading issue impacting their companies today and most British respondents foresee little change in the proportion of income that will come from foreign countries.

What is clear is that after a decade of debate about the so-called BRIC economies, and beyond, CEOs are now consciously looking closer to home. First, UK CEOs are much more likely than peers to put their money into expanding existing facilities. Secondly, they foresee a strategic shift for their organisations from the current mix of inorganic and organic growth to one of largely organic growth in the coming years. Thirdly, according to EIU projections, British GDP should keep roughly level with that of the United States while outperforming the rest of Western Europe and even emerging giants such as Brazil and Russia.

On the other hand, despite rates down from the highs of previous decades, India and China's GDP will still grow at more than double the pace of the UK. The obvious question is whether focusing so closely on a reasonably healthy home market, with all the advantages of being a domestic player, makes more sense than pursuing potentially higher growth in foreign countries. This is especially true where greater risks of potential market instability – most notably in China – are becoming all too apparent.

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The UK is ready to grow

Bill Robinson, KPMG's Chief Economist in the UK, finds the bullish mood among UK CEOs unsurprising and driven by macroeconomic factors.

The two salient features of the UK economy are (1) that it is currently among the fastest growing economies in the developed world, and (2) that Western Europe is very important to it.

So it is no surprise to find UK CEOs more bullish than the global average. The result of the May election, promising another five years of business-friendly government, probably helped lift the mood. The official medium-term projections for the UK, showing steady growth at around 2.5% per annum against a background of steady reduction of the fiscal deficit provide the kind of stable environment that enables businesses to prosper. Rising wages and exceptionally low inflation together imply a strong rise in real spending power, while borrowing costs remain low, so businesses can borrow to expand and meet this rising demand. At home the prospects for UK businesses are among the best in the world.

The influence of global economic development on the mood of UK CEOs is conditioned by the simple fact that the main markets for UK exports are in the US and Europe. To put this in context, UK exports to China are about the same as those to Belgium. The US is currently performing as well as or better than the UK while the Eurozone, after years of stagnation, is at last showing some signs of improvement. This will have cheered UK CEOs. Continental Europe is a key market for UK firms and confidence has been picking up since the European Central Bank announced its own version of quantitative easing in February this year.

A final thought. British CEOs are often criticized for being slow to exploit opportunities in the so-called BRICs (Brazil, Russia, India, and China), which account for around a quarter of global output but less than a tenth of UK exports. In the current environment, with growth slowing sharply in the BRICs but picking up in the Eurozone, it is easy to see why UK CEOs are more optimistic than their global counterparts—and keeping a close eye on their own back yard.

Bill Robinson
Chief Economist, KPMG in the UK

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Section 2: Revolution or Evolution? A tale of two strategies

Compared to 29% of Global CEOs believing they will be leading a 'significantly different entity' in three years' time, 51% of UK CEOs believe this to be the case. UK CEOs differ not only with their peers in other countries: our survey reveals a sharp strategic divide among British businesses as well. Our analysis has identified a number of important and instructive differences between the 'Revolutionists' (what we have called the 51% of UK CEOs that will be leading transformed businesses) and the 'Evolutionists' (the 49% that believe they will be leading an organisation that will remain fundamentally the same).

29% of Global CEOs believe they will be leading a 'significantly different entity' in three years' time.

51% of UK CEOs believe this to be the case.

49% think they'll remain largely the same.

It is important not to overstate the differences. The two groups share a number of common views. Both believe that the markets with the greatest potential for growth are the UK and the US. Similarly, they both appear to be looking to domestic markets for growth: for each geographic expansion is a low strategic and investment priority. On the other hand, expanding existing facilities will be a leading destination of capital spending for both – it is the biggest one for Evolutionary CEOs. Nor does either group believe in playing it safe; large majorities of both describe their strategies as aggressive.

However where their views tend to split is on the likelihood of growth. Revolutionary CEOs are notably more likely than their Evolutionary peers to report that their confidence in the growth prospects of the UK economy and of their industry has risen significantly in the past year. The cumulative effect of these changes on expectations at the company level is even more striking: 68% of Revolutionary CEOs say that their confidence in their own businesses' growth prospects has risen in the last 12 months compared to just 20% of Evolutionary ones.

Most fundamentally, though, these different economic assumptions seem to be pushing companies in distinct strategic directions. The leading priority of Evolutionary CEOs is reducing cost structures (36%). Similarly, streamlining processes are the most frequently cited critical challenge facing CEOs in this group and, when faced with a straight choice, 58% put efficiency as more important than growth. Not surprisingly, the member of the C-suite most expected by Evolutionary CEOs to increase in influence in the coming years is the CFO. In essence, finance rules the roost as these companies continue to pare back and hunt for efficiencies in their existing game plan.

Revolutionary CEOs are more often focused on other areas. Cost structures remain important – 39% of this group say reducing them is a leading issue – but a far more common top strategic priority is a stronger customer focus (53%). Similarly, strengthening brand is the most frequently cited critical challenge facing these CEOs and 60% emphasise growth over efficiency. Consistent with such a focus, the corporate level executive most expected to see greater influence at Revolutionary companies is the Chief Marketing Officer, followed by the Chief Strategy Officer.

#1 For Revolutionary CEOs is a stronger customer focus

#1 Strategic priority for Evolutionary CEOs is reducing cost

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How Revolutionary and Evolutionary CEO views compare

	Revolutionary	Evolutionary
Numbers		
Proportion of UK Businesses	51%	49%
Similarities		
Regions with highest perceived growth potential	Western Europe - 84% United States - 61%	United States - 82% Western Europe - 59%
Growth focus domestic or international	Domestic	Domestic
How growth strategy characterised	Aggressive - 78%	Aggressive - 81%
Key differences		
Significantly more confident than last year in growth of own company	68%	20%
Significantly more confident than last year in growth of the UK economy	42%	20%
Leading strategic priority	Customer focus	Cost reduction
More likely to be focused on efficiency or growth	Growth	Efficiency
Proportion likely to invest in M&A	20%	41%
Proportion likely to invest in changing business model	58%	41%
Average expected growth in employees in next three years	5%	9%
C-suite officer most expected to increase in influence	Chief Marketing Officer	Chief Financial Officer
Company-wide innovation processes in place	43%	16%

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Sometimes your strategy chooses you

Alastair Barbour, a Non-Executive Director, understands the attraction of the Revolutionary view, but reminds us that strategic choices are not unconstrained.

All CEOs want their businesses to be succesful and grow. Indeed, one of the key attributes of a good CEO is that of being a 'visionary' - someone who can take the hard decisions, someone who can take a look into the future and someone who can drive the business ahead.

However, the degree to which a CEO might pursue an Revolutionary or Evolutionary strategy will very much depend on the individual circumstances of the business, the sector and the wider environment. Also, the degree and swiftness to which any business model can transform or evolve will be driven by the assessment of risks and opportunities, the board's appetite for risk, the capital resources available and the ability to spend.

I think there are very few companies that are truly transformational. Of course, businesses with failing business models will need to transform to survive. But generally companies evolve more steadily by constantly adapting to the changing opportunities and risks facing the business.

So, for example, in insurance, a sector I know well, we are conscious that the digital age is coming and that the insurance market will be revolutionised. But nobody quite knows how it will happen so most companies are dipping their toes in the water and experimenting with different ideas. However while it isn't a big bang approach, there is a whole raft of transformational things going on in the background but they are happening in a small way. There is work being done on things like customer experience and mobile accessibility, but the core business remains the same.

It would be the same with a big utility company. They might change around the edges by (say) developing an online presence, but they are unlikely to go through a step change unless they lose sight of the bigger picture and fail to evolve in line with the risks facing the business. The way businesses transform, by and large, is through M&A, managing risks well and simple survival of the fittest.

It's very difficult for a CEO to take a business in a different direction if the business is perceived to be doing well by those investors taking a longer-term view. So, at face value, the conversation around transformation is much easier to have if the business is doing badly and something transformational needs to happen to get it back on track. The reason is simple. If the business is in the basement then the strategy needs to be about rebooting the business. Revolution may therefore be thrust upon the company.

Alastair Barbour
Non-Executive Director

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Different investment priorities

The number one focus for investment by Evolutionary CEOs will be the expansion of facilities. Leaders at these firms are also twice as likely as Revolutionary peers to expect to spend significantly on acquisitions in the next three years. On average they expect headcount to increase 9.2% over the same period, again nearly two times the projection for Revolutionary CEOs (4.7%). In other words, Evolutionary CEOs do not plan to sit tight so much as to expand without transforming the underlying fundamentals of the business.

Revolutionary CEOs, in contrast, are looking to change. For these CEOs, not surprisingly, the most commonly cited focus for significant capital outlay in the next three years is business model transformation (58%). More interesting, though, is the shape this transformation is likely to take.

Consistent with a strong customer and brand focus, for Revolutionary CEOs the second most commonly cited destination for investment is advertising and sales (53%). Similarly, the function expected to see the biggest transformation in the next three years is marketing and sales (56%). This is consistent with 29% of Revolutionary CEOs who declare advertising and promotion as a top priority.

What is, at first glance, confusing about this strong marketing emphasis, however, is that so few Revolutionary CEOs expect the customer base to change (18%). This seems like a lot of work not to attract anybody new. A likely explanation is that all these changes reflect not so much an expansion of traditional sales activity as a growth of agile, user-led innovation. This requires closer communication with customers to understand, and react quickly to, their changing needs – hence the greater strategic role for the CMO.

This is consistent with the much greater emphasis that Revolutionary CEOs are putting on innovation: 39% say that innovation is a leading strategic priority, making it the second most common choice. Only about half that proportion of Evolutionary CEOs have this as a priority and the Revolutionary CEOs also far outstrip their peers in having company-wide innovation processes in place.

In summary, our survey suggests two locally-focused strategies that UK CEOs are adopting: for those expecting high growth, it's an advertising-led, innovation-based effort; and for those who are less hopeful, it's a cost-cutting one mixed with expansion via hiring and M&A.

Cyber: The most unpredictable risk

Half of the CEOs in the Global CEO survey report they are not prepared for a cyber event. UK CEOs reflect this finding with just 28% saying they are fully prepared for a cyber event and 50% somewhat prepared.

Yet, cyber security was named by 20% of global respondents as one of the top five risks. Some of the strategic options that both Revolutionary and Evolutionary CEOs need to consider include turning cyber preparedness into a competitive advantage rather than a cost, by building security into new products, services and processes at the design stage. This starts with a mind-set that cyber security is not simply an IT issue.

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Enhancing the customer experience and building consumer trust is the key to growth

Mark Guinibert, Partner, KPMG in the UK and Head of Customer and Growth, explains what is driving companies to transform themselves in the pursuit of growth—and the difficult cultural changes that success will entail.

Revolutionary CEOs are more focused on growth than efficiency and they are significantly more confident in their growth prospects than Evolutionary CEOs. I think it is no accident that these CEOs also declare customer focus as their top strategic priority and see the Chief Marketing Officer as the C-Suite executive most likely to become more influential.

Many commentators are quite rightly calling customer experience the last great commercial battleground. The recently published KPMG Nunwood report, ***A New Era of Customer Experience Branding: Customer Experience Excellence Centre 2015 Analysis,*** indicated that the brands featured in the top 100 for customer experience achieved double the 5-year revenue growth of the FTSE 100 in the same time period. Those in positions 1-10 grew their revenues every year significantly more than those positioned 11-100.

Our analysis shows that to make this happen, however, requires a cultural shift – a reimagining of the means of production that puts customers at the centre of an organisation's structures and processes. Only those organisations that find ways to understand their customers better will be able to deliver mutually beneficial value.

Part of the challenge will be to take advantage of the opportunities presented by big data and analytics tools, which provide the means for businesses to generate actionable insights into their customers' needs and desires.

CEOs will also need to rethink their approach to customer relationship management, orientating their businesses as customer partners rather than product pushers. That will require structural change, with sales and marketing operations which are currently product-focused, shifting to align with the fundamental needs and values of the end consumer.

By doing so, CEOs have the opportunity to unlock the growth potential of their existing customer base - building stronger and more enduring relationships that add value to their businesses and their customers alike to achieve the double strategic aim of a step change in revenue and reduced costs.

Mark Guinibert
Partner KPMG in the UK
Head of Customer and Growth

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Partnerships can accelerate growth, but watch out for the pitfalls

Dr Marc van Grondelle, Partner, KPMG in the UK and Global Head, Joint Venture and Partnering Practice believes the case for cooperative innovation, whether Revolutionary or Evolutionary, is strong. Yet making this strategy a success is no mean feat.

Consider this extraordinary figure: more than one in three pounds (35%) of global corporate revenues are now generated from business alliances. M&A is clearly not disappearing given a record year of business tie-ups, but the balance is shifting from ‘buy or sell’ to ‘partner’. Equity-related joint ventures now account for more than 30% of M&A deals.

There are good reasons for this. Businesses entering new markets will do so more smoothly with a local partner. In some cases, such as China, India and Russia, they have little choice but to pursue joint ventures – they are either legally or politically obligated to do so. In other cases, businesses are seeking to share risk, or to secure project or technology expertise for a limited period. Additional advantages include the lack of an acquisition premium and the shorter learning curve that the partnership approach requires.

The problem for CEOs is that these transactions routinely fail: KPMG’s research suggests more than 60% of partnerships fail to achieve their objectives, eroding value and damaging relationships.

Such setbacks are a result of businesses’ failure to plan for the operational realities of joint ventures. They employ financiers and legal advisers rooted in the traditional M&A mind-set rather than specialists in partnership. They therefore prioritise negotiations over issues such as valuation and other financial deal terms, neglecting considerations such as trust, strategic compatibility and cultural alignment. Yet it is these softer factors that drive success.

Businesses embarking on joint ventures are also too ready to lock-in the terms of a transaction for long periods, rather than incorporating flexibility into the deal so that the venture may evolve to suit changing market conditions. In an ever more volatile business environment, such rigidity can prove disastrous.

The lesson is that partnerships work best when the groundwork is right and, if not, it makes sense to try to reset a sub-optimal joint venture agreement. Sometimes an extension of the dating phase can be a pragmatic step before seeking to tie the knot, and thinking about exits at the beginning can be less painful than when the relationship has not worked out as planned.

Dr Marc van Grondelle
Partner KPMG in the UK
Global Head, Joint Venture and Partnering Practice

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Size drives a Revolutionary strategy

Warren Middleton, Partner KPMG in the UK and Head of Risk Consulting and Management Consulting in National Markets, argues that for those outside of the FTSE 100 Revolution isn't only an option, it's a strategic necessity.

When you look beyond FTSE 100 companies, the next few tiers of firms tend to have a more Revolutionary stance rather than an Evolutionary one. This is true because the unfortunate reality is that they have little choice. They can see in their own activities that things are changing, that you need to get your platform and technology straight, that you need to differentiate your supply chain and make it better.

Moreover, a lot more disruptors, such as challenger banks or various e-commerce firms, are close peers operating in the same markets as these businesses. Small and medium-sized organisations also see more of such competition up close. They feel the threat more acutely than a larger company might.

In response, many of these organisations are talking about forming new partnerships and alliances, as well as finding more variation in the way they manufacture, deal with the supply chain and get products to market. In other words: transforming themselves.

Of course, they suffer in other areas: where some need to invest significant resources, they might not be able to move as quickly. But I think smaller businesses should exploit their natural strengths. They are more agile and their management teams are closer to the action. They can see things developing quickly and be faster to respond by not facing many of the time constraints of their larger peers.

Warren Middleton
Partner KPMG in the UK
Head of Risk Consulting and Management Consulting for National Markets

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Section 3: UK CEOs: Confident leaders of innovative businesses. Or worryingly complacent?

While many UK CEOs are bullish about their prospects at home, there may also be a need for caution. Although the speed with which business models change is increasing, UK CEOs seem remarkably unbothered by key competitive risks.

Despite the cautionary tales appearing regularly and frequently in the business press, nearly half are not at all concerned about either new entrants disrupting their markets or their companies' products heading for irrelevance. Indeed, only a handful express much concern. These figures differ markedly from those of global peers, who are much more likely to show concern over competitive risk.

What, me worry?

Proportion not at all concerned	Global	UK
New entrant disruption	26%	48%
Product irrelevance	34%	48%
Customer loyalty	14%	24%

UK CEOs need to be particularly vigilant to overseas competitive threats – for example, fast-growing, ambitious, new businesses from emerged and developing nations are bringing new ideas to our shores. They don't see geography or mature markets as too big a hurdle to overcome and have a fail fast, fail cheap mind-set in pursuit of accessing Western markets.

Sanjay Thakkar, KPMG UK

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Evolution or Revolution—all companies need to innovate

Charlie Simpson, Partner, KPMG in the UK and part of the Global Strategy Group believes that large companies are inherently difficult places to innovate within. Even Evolutionary CEOs will need to find new ways to innovate.

UK CEOs face a dilemma. They know that their organisations - often mature and suffering from declining advantages of scale - cannot deliver transformational growth from their existing businesses, they need new innovation. At the same time, they understand that while large corporations are good at generating new ideas, they have a poor record of securing commercial advantage from such intellectual capital.

There are a number of reasons for this. First, today's challenging market environment has seen CEOs focus increasingly on the short term. With this mind-set, medium-term bets that may or may not pay off look unattractive. For similar reasons, large corporations continue to be highly cost-conscious – and innovation and R&D budgets have often been regarded as a soft target for savings. And even where ideas are pursued, many businesses lack the agility to bring them to market in a timely manner.

At the same time, large businesses are increasingly struggling to attract the brightest young talent in innovation. In an era when young innovators have never before had such opportunities to appeal directly for capital, through movements such as crowd-funding, for example, many are opting to develop ideas for themselves, rather than to work within the constraints of a large organisation.

As a result, businesses that continue to look only within for growth from innovation are likely to be disappointed. They can also expect to come under mounting pressure from investors anxious to move their money to better growth opportunities, leading to calls for returns of cash to shareholders, for example.

CEOs must look outwards. They must consider new collaborations to find the innovation they instead need, and kick-start their growth. The big question is which strategic route should they follow: buy, merge, collaborate or something else?

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It is not that UK CEOs underestimate the amount of change they face. Indeed, the vast majority believe innovation is an advantage for their firms: 85% say they are innovating fast enough to secure a competitive future.

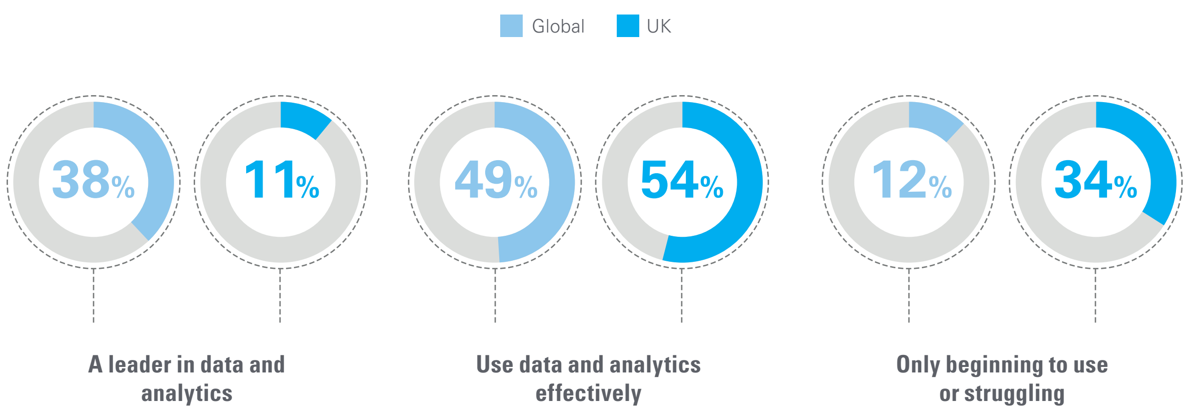
> "I think UK CEOs should be more worried about disruption. It's very interesting that it is only when a threat gets close that people jump from being unconcerned to very concerned. If you asked taxi drivers three years ago, they would have said 'digital technology won't change our business'. I guess they think differently now".
>
> **Warren Middleton, KPMG**

Is this foolhardiness or sangfroid? Capability in this area is notoriously difficult to measure, but various studies have tried and Britain usually fares well. INSEAD's 2014 Global Innovation Index put the UK second behind Switzerland. The 2014 Bloomberg Innovation Index and the World Economic Forum's Global Competitiveness Index both rank the UK 10th.

Although these are strong results, they also indicated that important competitors may often have an edge in innovation. In both the Bloomberg and WEF analyses, not only does the UK fall behind the US, it also lags behind several EU countries, not least Germany. It would be all too easy for innovative companies from these states to take on UK firms in their home market.

More worrying, though, is that our survey suggests that UK organisations are falling behind in data and analytics - today's key to agile, customer-focused innovation. Over a third (34%) of UK CEOs report that usage of data and analytics at their firms is only at the evaluation stage or that the company is struggling in this area, compared with just 12% globally. Nearly four in ten (38%) of global CEOs overall say that their companies are leaders in data and analytics, compared to just one in ten (11%) of UK CEOs. This will have a major impact on UK CEOs being able to harness data and insight to drive competitive advantage. However, that could provide a significant upside to UK businesses if they were able to catch up.

How effective is your organisation in using data and analytics to improve performance?



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Financial services: Facing down disruption

Financial services face more disruptive threats than most sectors, but Giles Williams, Partner, KPMG in the UK and Head of the Financial Services Regulatory Centre of Excellence, advises that CEO responses must be measured and balanced.

CEOs in the financial services sector have been facing down a range of disruptive pressures for at least eight years. Like their peers in other industries, they are threatened by new entrants to their sector, in niches ranging from payments technology to small business lending. But they are also confronted by three other disruptors, with which most industries do not have to contend.

First, financial services chief executives are dealing with changing societal expectations: in the wake of the financial crisis, their customers have strident views about how their businesses should be reshaped. Secondly, there is the disruptive threat posed by politicians, who are responding to demands for greater accountability from a sector that has received bail-out funding from taxpayers. Thirdly, the regulatory authorities represent yet another disruptive force, as they seek to impose new rule books on the sector.

How best to deal with these challenges, whilst also warding off the threat from innovative new entrants? The good news is financial services chief executives have certain strengths to play to. Customers looking for security and protection want to deal with recognised brands, particularly where larger sums are at stake, or an ongoing relationship is required. Disruptors may have stolen a march in the market for one-off commoditized transactions – the annual purchase of car insurance, say – but they have had less success persuading customers to switch an ongoing relationship, such as a bank account, to them.

This is not to say that financial services CEOs can afford to be complacent. The threat posed by market entrants is very real. They must now seek to understand the business model of those disruptors that threaten them and work out how to respond – by getting ahead on price, for example. Their focus should be on business areas where customer loyalty is less pronounced and the switching threat is therefore greatest.

Financial services companies perform different roles, both for other businesses and consumers. They offer credit to borrowers who need it, provide secure and reliable payments handling and offer protection through services such as insurance, but also as guardians of savings and investments. In each case, the product must deliver what is needed, the brand must be strong and the price must be right – but after eight years of disruptive threats, financial services CEOs should now be well-practiced in forging a balanced response.

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If you're not concerned, think again

Sanjay Thakkar, Partner, KPMG in the UK and Head of Deal Advisory concludes that if you are not agile enough to respond quickly to wider trends playing out in the marketplace, you may not fail today but you may fail tomorrow.

It is surprising that so many UK CEOs in the survey show so little concern – especially relative to their global peers – about disruption, product obsolescence and customer loyalty.

These three issues are closely connected and, if they are not at the front of a CEO's mind, he or she may be in denial as to their potential impact. Today, the power of the consumer is accelerating rapidly and they are a lot more informed. Before, corporations could be more dictatorial towards consumers because they didn't know what they didn't know. That world is gone. A far more enlightened customer base doesn't see a clear distinction between the brands they interact with or respect product boundaries. They actively compare experiences, for example "I love how I can do so many things with a simple tap on my phone. Why isn't my bank like that?" Ten years ago CEOs wanted to know what competitors were doing. Now the enlightened ones are asking what other industries are doing. How, for example, will disintermediation of the music industry influence how I sell insurance?

Managing disruption has become incredibly important with huge advantages accruing to companies that can successfully navigate it as a pioneer or very fast follower. If you do not anticipate change, and you do not embed agility into your business model, you will be at a competitive disadvantage.

UK CEOs need to be particularly vigilant to overseas competitive threats. For example, fast-growing, ambitious, new businesses from emerged and developing nations are bringing new ideas to our shores. They don't see geography or mature markets as too big a hurdle to overcome and have a fail fast, fail cheap mind-set in pursuit of accessing Western markets.

Keeping consumers loyal demands far more than cutting-edge products, services, channels and customer service. These are only the price of admission. CEOs must now understand the importance of engendering trust and maintaining the trust of their customers. Corporate scandals, together with the proliferation of social media, have impacted the trust the average consumer places in big business.

Historically, businesses underwent transformation once a generation. Now most organisations will face business model change at least once during the average tenure of a CEO. Those organisations which are agile and alive to the need to evolve will be more successful than those that don't.

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Conclusion and key questions for the Board

The value of this study lies not in an ability to prescribe definitive answers to how companies should be acting, but rather to shed light on the important questions with which they are currently wrestling. Based on the results of this year's study, CEOs and their Boards are encouraged to discuss where they stand on the fundamental questions facing business today, including:

Questions
How well do you understand how your industry will be disrupted and the impact it will have on your financial, business and operating models?
Are you as client-centric as you need to be given the possibilities created by technology and data and analytics?
Are you investing sufficiently in innovation through collaboration or research and development to create new opportunities?
What competencies do you have to collaborate at speed with those who can accelerate and enhance your strategy?
How comfortable are you that you have the right mix of Revolutionary and Evolutionary thinking in your strategy?
How well do you understand the impact and interplay of multiple regulations on your financial, business and operating models? Do you see compliance requirements, threats or opportunities?
How robust and interconnected are the cyber security strategies you have embedded in your financial, business and operating models?

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