REVIEW

THE STERN STEWART INSTITUTE **ANNUAL SUMMIT 2016**

None of the issues we have discussed in recent years including the Syrian refugee crisis (with its repercussions for Europe) and the debt crisis seems any closer to a solution. On the contrary, though, the British decision to leave the EU plunged the UK and the whole continent (including itself) into a state of shock, and no one dares to predict when it will be over.

Seen in a broader context, Brexit raises further issues such as the extent to which the result of a referendum should be regarded as part of the global phenomenon – the rise of populism. In the end, we have not only seen electoral successes of populist parties in Europe, but also the rise of Donald Trump. How he managed to not only become the Republican presidential candidate, but to also turn the whole political system in the US upside down, will provide years of hard work for political scientists.

One of the reasons why these developments should be of great concern to us is that they are closely connected to a growing distrust in the process of globalization. This can be seen from the very heterogeneous protest movement that opposes current free trade agreements like CETA and TTIP. So, at the end of the day, there is simply no place to hide. Every company has to come to terms with these developments and observe political processes as closely as possible. With our lively and controversial discussions at Schloss Elmau, the Stern Stewart Institute Annual Summit made an important contribution to this debate. So it comes as no surprise that our meeting has become an indispensable event for entrepreneurs and experts who want to share their views and to gain new insights.

Large corporations are no start-ups, my friend. How to organize innovation and determine tomorrow's core?

How do we explain the fact that so many executives are currently being lured to Silicon Valley? What is it that makes this place so attractive for so many? What do they take away when they return to where they come from?
For quite some time now, the connotations of start-ups which include innovation, flexibility and inspiration have been the primary focus when discussing the pros and cons of old industry versus start-ups. However, even though there is only a very moderate percentage of start-ups that really is making money, there still seems to be a strong force of attraction. How can we explain this?
The results of our annual poll hint to some explanations. When asked where they see the most relevant drivers for innovations, more than 60 percent of our participants mentioned either corporate culture or supportive and inspiring top management. So, there might indeed be a vague fear that the old recipes have failed and new ones need to be found (**Figure 1**).
However, the discussion among our participants revealed that most of them are quite confident about finding the right answers to the challenges posed by the new economy. Nevertheless, when asked about the future of long-established, large corporations, the participants expect that a certain number of enterprises will vanish ten years from now with 63 percent of those surveyed thinking that between 15 and 25 percent of today's large corporations will have failed, and 16 percent expect even more to have disappeared (**Figure 2**).
As inhomogeneous as these results may seem, they just might be consistent with the current overall situation of uncertainty, with some start-ups overperforming and others struggling and especially with many of them facing increasing bureaucratic and fiscal resistance, notably in Europe.

What are the most relevant drivers for innovations?

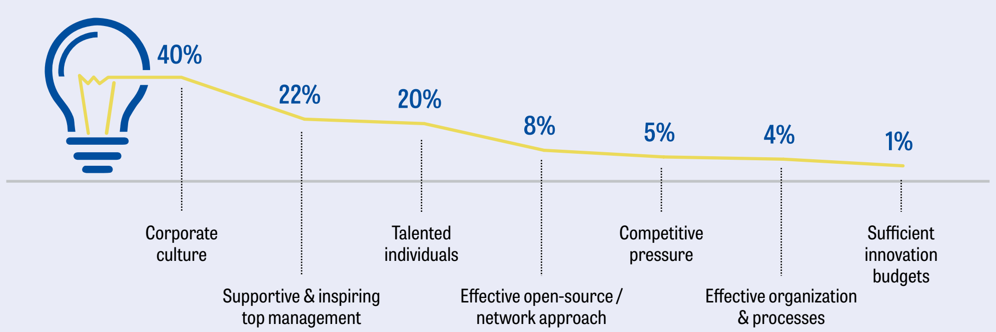

Figure 1

In 10 years' time, how many of today's large corporations will have failed due to competition from innovative start-ups?

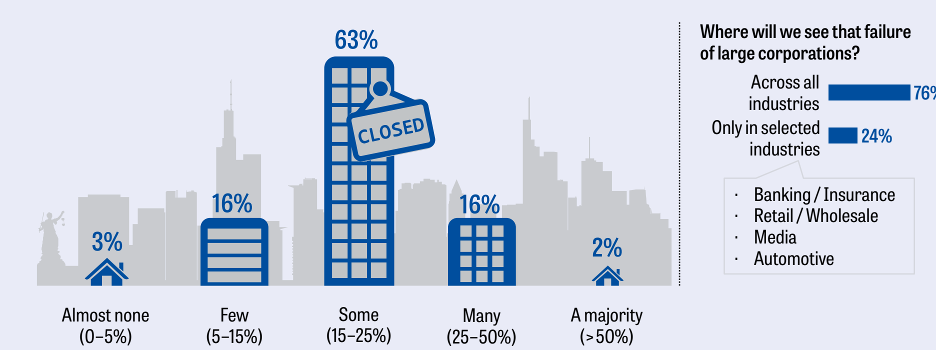

Figure 2

Stretch targets make leadership appear removed from business reality – Is there a need for a radically new thinking?

At the core of many discussions on how to motivate people in companies is the notion of stretch targets. As with other economic terms there is always the danger of creating meaningless phrases without establishing a connection to business reality. Do we really need stretch targets? Or is it yet another attempt to copy some element of the start-up culture, like the slogan "think big to achieve greatness!"
Numbers from our poll seem to hint at a strong confidence in the human capital. Some 63 percent of those questioned said that "Having the right people in the right place" ensures compliance with objectives and alignment with reality and ethics. "Fostering entrepreneurship and engagement" comes second, and other factors lag relatively far behind (**Figure 3**).
As to the most important constraints, participants mentioned, above all, the company's leadership model (45 percent); corporate governance (24 percent) and own business ethics. So, at the end of the day, is it more a question of "not wanting" stretch targets rather than "not being allowed" or regarding their implementation as being too complicated?
One thing seems certain, though. There is little inclination to completely do without targets, fearing either a loss of orientation or a loss of control which were two of the top answers to the question "What would happen in your company if you stopped setting targets?" with 68 percent and 9 percent respectively.

How do you ensure that strategic objectives and execution are both grounded in business reality and ethics?

Figure 3

A greenfield approach for Europe – How to ensure the survival of a competitive European Union

Building the European Union from scratch, avoiding all the mistakes that have been made and generally doing a much better job this time around – that sounds very tempting to the increasing number of those who are losing faith in Europe. But how realistic is this scenario? And what has to be changed first?

Several of our discussants stated that there is no way for a real greenfield approach because we have to start with what we have. This applies in particular to the UK where the June referendum result threatens to upset the whole political system. As to the question whether the UK is better off without Europe in its current state, those surveyed in our poll reached quite a unanimous decision with 82 percent saying "no" (**Figure 4**). However, the feeling that something has to change and certain policy areas must undergo a major makeover is equally clear. Almost two-thirds of our participants think that Europe needs a greenfield approach.

Still, there are considerable differences when we take a closer look at the perceived threats to Europe's cohesion. So, when we asked for the most realistic threat to the Union's long-term success, the top answer at 38 percent was "disintegration of members", followed by "weak economy" at 25 percent and "unequal wealth distribution" at 15 percent (**Figure 5**). Of course, this result might partly be explained as an immediate reaction to Brexit, but the fault line inside Europe, particularly distinct since the beginning of the refugee crisis, has been visible for a while now. As for the fear of a weakening economy, a lot will depend on how fast Europe as a whole recovers from the economic shock that many expect as a result of Brexit, especially a hard Brexit.

The worst case scenario might even threaten Europe's current pole position as far as global trade is concerned. This brought a slight majority of 56 percent of those surveyed to voice a negative view, saying that either the US or China will dethrone Europe in the years to come.

Innovation (32 percent); productivity (22 percent); stability (17 percent) and growth (15 percent) – these are the ingredients most often mentioned when asked what will be most relevant for Europe's long-term success. However, following the lively discussion at our Summit, we have to concede that these notions seem somewhat vague and that the answers to Europe's crisis of confidence might be even more difficult to find than is currently to be seen.

Is Britain better off without the EU as we know it today?

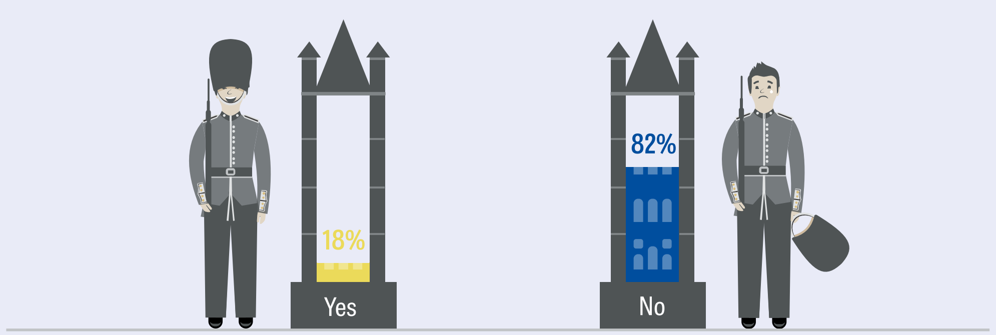

Figure 4

What is the most realistic threat to European Union's long-term success?

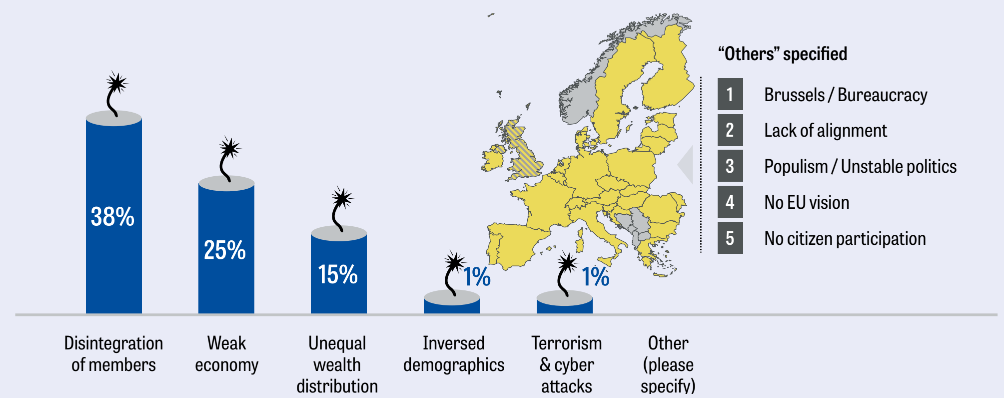

Figure 5

Leadership vs. laissez-faire – Are we able to manage Generation Y for the good, or will Generation Y manage us for the better?

Before talking about Generation Y and its possible effects on today's companies, it makes sense to take a closer look at the term and its connotations. The top characteristics our participants associate with Generation Y are "digitally savvy" (57 percent); "demanding" (40 percent) and "well-educated" (27 percent), the only negative characteristic among the top five answers was "spoiled" (22 percent) (**Figure 6**). When asked whether Generation Y is more difficult to manage, 50 percent answered "yes" and 50 percent said "no". So, one might ask what the fuss is all about and why we should be afraid of them.

What characteristics do you associate with Generation Y?

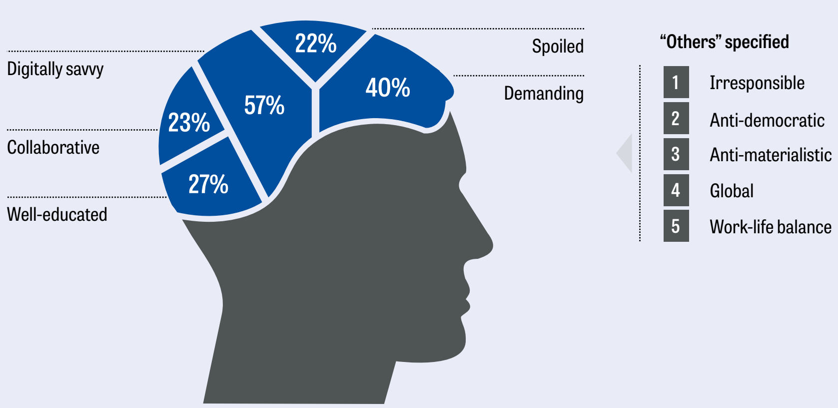

Figure 6

In today's world, how would you expect a company to perform if Generation Y took over its management (all other things staying equal)?

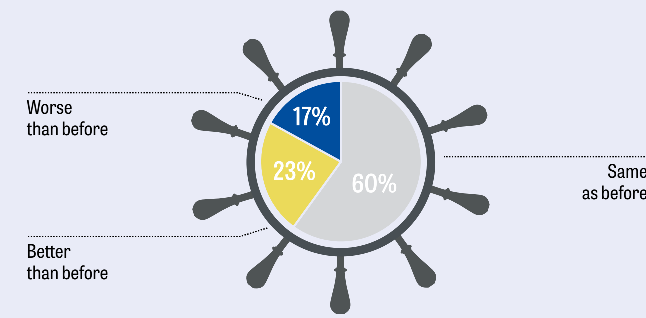

Figure 7

However, there are indications that some changes are underway with regards to the system of values which younger professionals have. Many of them attach more importance to a better work-life balance. In a number of cases, building a career is not an end in and of itself anymore, but, rather, it appears as an instrument or tool to achieve goals that do not necessarily have to do with professional life.

Despite of all these facts, a considerable majority of our survey participants thinks that a company which has been taken over by Generation Y would perform the same as before (60 percent), and 23 percent expects an even better performance (**Figure 7**). All these results suggest that there is a very optimistic outlook when it comes to a possible "change of the guards." Admittedly, other opinions were expressed as well in our discussion. For example, it was noted that there has to be good cooperation between the generations, which Generation Y has yet to prove being willing to develop.

Interestingly enough, only 38 percent stated that if given a choice they would prefer being part of Generation Y. So maybe there is, after all, a latent feeling that quite a few of the attitudes and views that are associated with Generation Y come at a price. More freedom of choice can be intimidating if accompanied by higher pressure to perform and fear of failure.

Accumulation of debt: Is there a non-apocalyptic solution to the never-ending spiral in the developed world?

A short answer to this question could be: "Yes, but." Many of our discussants highlighted the necessity for quick action in order to avoid a worsening of the crisis. However, only one in five of those interviewed foresees an imminent policy change, while 60 percent think that the status quo with low interest rates and relative monetary stability will continue for the next four to seven years. As to what exactly will be done, the opinions differed, but half of our participants agreed that there will be a restructuring of the debt with substantial cuts for all debt holders, and almost 40 percent anticipate that central banks will write off parts of their governmental debt (**Figure 8**).

This rather bleak outlook leads to another question. Which country will go bankrupt first within ten years? As might be expected, Greece (78 percent) and Italy (40 percent) seem to have the worst hand. However, only about one-third of those questioned expect a major shock as result of these failures (**Figure 9**). And does this count as apocalyptic? And what about countries that may follow the British decision to leave the EU? With due caution, some of our discussants voiced the opinion that this does not have to mean the end of the EU nor does it need to prove disastrous.

What of the following actions to exit the current accumulation of ever higher debt levels do you expect?

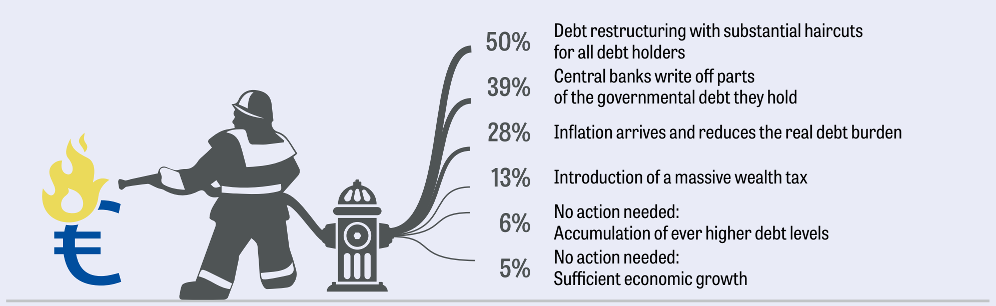

Figure 8

Which countries are likely to go bankrupt in the next 10 years?

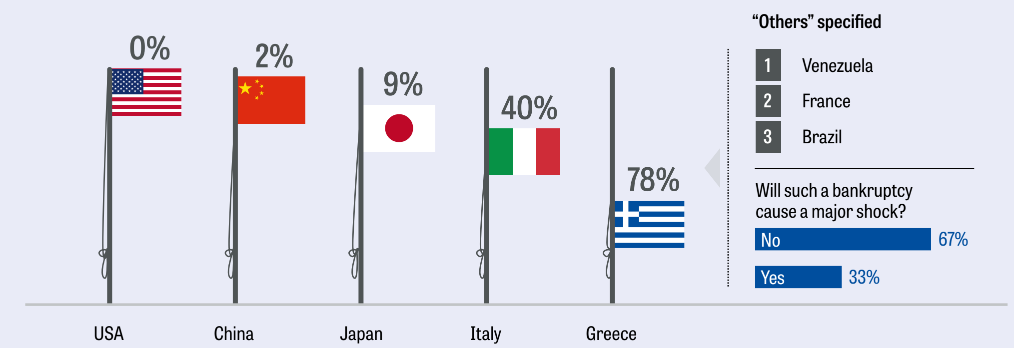

Figure 9

What are the consequences if central banks decide on forgiving part of the governmental or corporate debt?

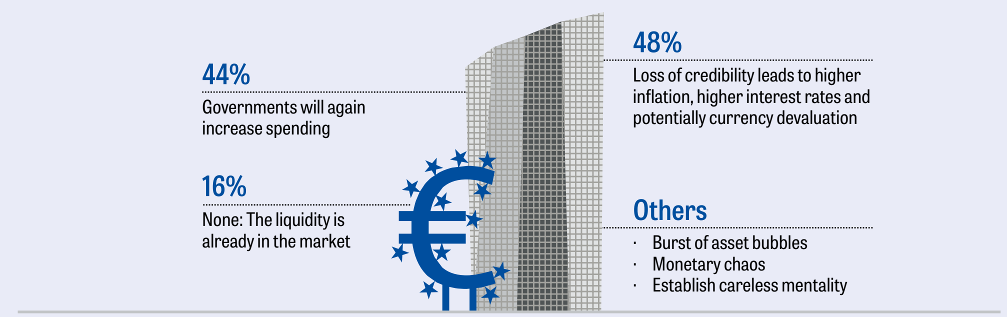

Figure 10

Certainly, at this point, it is not easy to foresee what would be the consequences if central banks indeed had to forgive part of the governmental or corporate debt. This is probably the reason why there is no consensus among our participants. In fact, the exact opposite appears to be the case. While 48 percent think that it would lead to a loss of credibility, higher inflation, higher interest rates and potentially currency devaluation, almost as many (44 percent) believe governments would increase spending again (**Figure 10**).

In any event, the debt crisis might not only prove more complex than the refugee crisis, but also more dangerous for the cohesion of the EU. Because at the end of the day, the refugee crisis depends to a greater extent on political will, while the solution to the debt crisis might require long periods of structural transformation. There are many reasons to believe that these changes will be all the worse the longer they are put off.

Europe in chaos, US disappointing, China in fall and no global growth in sight – Are we on the edge of the next big crisis?

Brexit has triggered calls for EU reforms.
What do you expect in the next year?

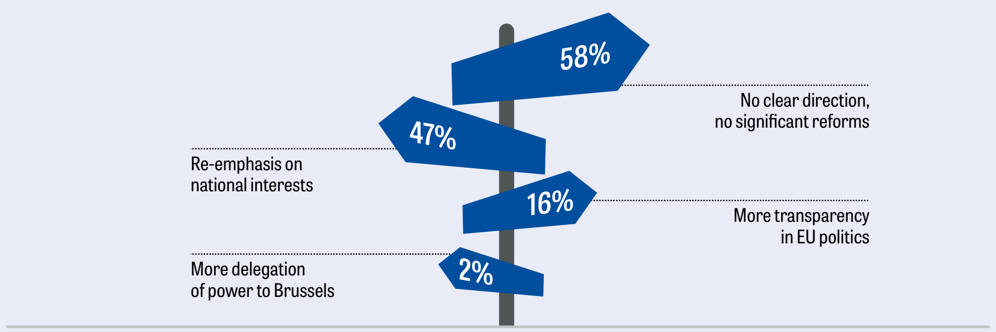

Figure 11

One of the main problems we are facing right now is the vast amount of unanswered questions related to economics, politics and social issues which are also all intertwined. This leads to a high degree of uncertainty. Given the sheer multitude and diversity of these issues, it is advisable to focus on particular topics to really differentiate between them.

One of the problems that hit Europe very hard (as well as the international community) is Brexit. The outcome of the referendum came as such a surprise that even today hardly anyone dares to predict the consequences for the medium and long term. However, only a relatively small minority of our participants (16 percent) expect more transparency in the EU, while most of them anticipate a lack of a clear direction and significant reforms (58 percent) or a re-emphasis on national interests (47 percent, **Figure 11**).

Nevertheless, panel members were all in all very positive. No one saw the next big crisis coming. Admittedly, we might face a new reality, but people questioned whether this would automatically be a negative development since companies always have to be flexible. This view was confirmed by the answers to another question in our poll. More than two-thirds of those surveyed are rather optimistic when asked about the impact of all those crises, especially with regards to the EU´s commercial relationship with the big players like USA or China. While 49 percent thinks it will have hardly any impact, 19 percent expects an imminent stabilization and reconnection.

And what other factors could foster a major and sustainable economic upswing? In the discussion, much emphasis was put on technology and digitalization as the main drivers of future growth, a view that is reflected in our poll. A total of 43 percent identified technology (alongside stable big industrial nations which also polled at 43 percent) as being the biggest factor, followed by trade agreements at 36 percent.

Finally, mention was made of the considerable yet untapped potential and that increased efficiency could create lots of opportunities. Accordingly, only one in five of those interviewed in our poll believes that five years from now the global economy will be in a worse state than today (in a better state – 31 percent and the same as today – 49 percent) (**Figure 12**).

Five years from now, the global economy will be...

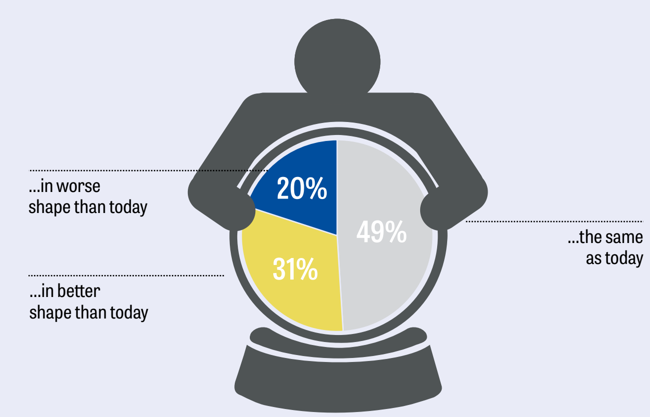

Figure 12

Just a digital bubble or skyrocketing productivity and growth? Pinpointing promising technologies that will transform the world

So, having seen the enormous expectations that are currently being placed upon technology, it seems suitable to take a closer look at it. Which technologies are we talking about? "Digital" is, after all, only a collective term for many different gadgets, developments and platforms, all too diverse to summarize in just one word.

One development which is unanimously seen as an important growth driver is big data analytics. There are many signs that its potential could have a much larger impact than assumed to date. On the other hand, many believe that social media (another collective term) belongs to the most overrated technologies, just as blockchain, the technology upon which the cryptocurrency Bitcoin is based.

Mention might cautiously be made that these assessments could have to do with the fact that the audience on average is not part of the target group of social media. However, social media has been around for quite a while, a fact which might contribute to the impression that it is far less revolutionary than often propagated. At the same time, blockchain, while mentioned as the most overrated technology, could not be explained by most of the people who voted (71 percent). And this might, indeed, be a general future problem, especially for digital technologies. The degree of expertise necessary to really understand them will increase. So, too, must the need for coordination between technical and managerial functions in the companies.

In our poll, further requirements were mentioned that have to be met to leverage technology for growth and productivity, the biggest being "getting talents on board" (49 percent); "identifying the actual potentials" (32 percent) and "defining a clear strategy" (26 percent) (**Figure 13**). The increasing importance of digital technologies implies that the digital agenda of companies is generally established at the highest hierarchical levels, i.e. CEO or CIO/CTO.

What are the biggest hurdles to leverage technology for growth/productivity?

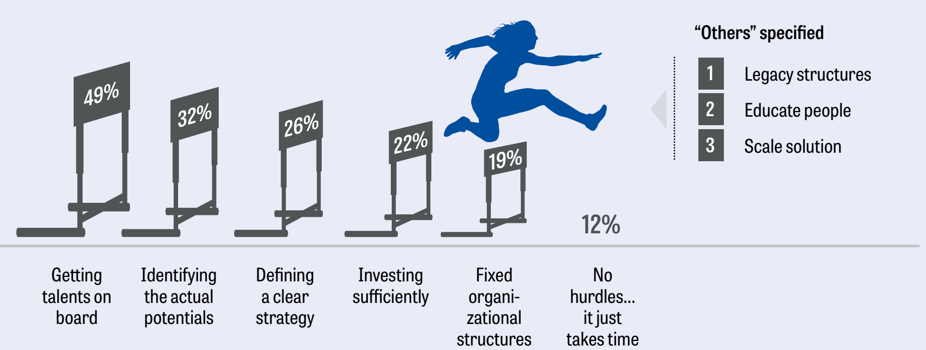

Figure 13