The Firm of the Future

We’re beginning to see what the next generation of successful companies will look like.

By James Allen, James Root and Andrew Schwedel
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In the world of the firm, something is changing. It’s not that your local bookstore went out of business. Or that your taxi driver now rates you on a 5-point scale. Or that anything can now be outsourced, allowing even the smallest firms to rent capabilities on demand. It’s more profound than these.

The prevailing paradigm that has underpinned business for the past 50 years is under review. The simplest version of that paradigm is that firms exist first and foremost to deliver returns to their shareholders’ capital—and the sooner they deliver it, the better. We will describe the challenges confronting this paradigm. But the first question we asked as we observed the changes was this: Is such a shift unusual? Has the idea of the firm been consistent over time, or has it changed before?

What we learned from looking back was that, similar to other human endeavors, the idea of a business has evolved slowly but profoundly through a series of what we can now see as definable eras: periods when particular strategies, corporate forms and styles of management became the dominant norm. We have observed five distinct eras since the industrial revolution (see infographic). These eras include the current period, which we call the “shareholder primacy” era.

Transitions between eras play out over decades. The edges are fuzzy and often become clear only in hindsight. Some elements of the previous era remain in place, while others evolve into something quite different. The shareholder primacy era, for example, retained and enhanced several features of the previous period, including the importance of professional managers and the pursuit of scale to achieve leadership economics. But companies in the current period refocused on their core businesses, shed noncore assets, outsourced more and more functions, and made their remaining assets sweat harder. That focus, combined with a high rate of mergers and acquisitions, fostered increasing concentration within industries. CEOs and management teams, often holding significant equity stakes designed to align their interests with those of other shareholders, dedicated overwhelming attention to delivering shareholder returns. The ones who succeeded earned substantial rewards.

Today, the shareholder primacy era is under pressure from multiple sources. Technologies, markets and customer expectations are all changing rapidly. To cite just a few examples:

- As the economy has become more service-oriented and increasingly digital, the importance of speed has increased dramatically. Those who can’t keep up fall by the wayside. For instance, five-year survival rates for newly listed firms have declined by 30% since the 1960s, according to new research from the Tuck School of Business at Dartmouth College.
- Capital is superabundant. Global financial assets are now 10 times global GDP, making talent and ideas rather than capital the binding constraint on growth in most large companies.
- Industries have become more winner-take-all. A Bain study of 315 global corporations found that just one or two players in each market earned (on average) 80% of the economic profit.
- The pursuit of shareholder value itself increasingly focuses on the short term, driven by shorter management horizons and greater pressures from activist investors. Leverage, buybacks and dividends are up, while long-term investments in growth have lagged.
A Brief History of Business

Precursors to the firm (800 BCE–1500 CE)
Businesses with at least some resemblance to the modern firm have been around a long time. Guild-like shreni played a central role in the trading and craft production sectors of India’s economy between the eighth century BCE and the end of the first millennium. Song dynasty China had modern-sounding capital structures such as partnerships and joint stock companies. Merchant collectives grew in importance in medieval Europe.

Trading empires (1500–1800)
As international trade became synonymous with geopolitical power during the 16th and 17th centuries, the holders of trading routes—capital-intensive, decentralized enterprises that were tightly connected to governments—began to organize themselves to trade their stocks and bonds on exchanges they created, and to appoint boards of directors. Organizations such as the Dutch and the British East India companies came to dominate the world economy.

Scale apprenticeships (1790s–1830s)
Companies began to capture the advantages of mechanization, the power of steamboats to lower distribution costs and specialization of commercial activities (in finance and transport, for example). While some of their practices were unchanged from the trading empires, these firms were owned by partnerships, families and individuals such as Josiah Wedgwood. For the first time, the firm itself became the primary unit for value creation.

Early industrialists (1830s–1870s)
Companies responded to a world of accelerating production speed, urbanization and telegraph communication by growing ever larger. The US railroad companies may be the first truly modern management organizations, and their rise led to advances in accounting methods, the first large groups of salaried middle managers and more sophisticated capital markets to finance investments. Consumerism began to take off, as brands emerged and firms such as Singer and Marshall Field began to innovate around marketing.

Trusts (1870s–1920s)
With continued reductions in the costs of moving goods (for example, ocean freight advances) and information (for example, the telephone), a new era emerged that was characterized by vertical and horizontal integration. These industry-spanning companies, often led by iconic founders such as John D. Rockefeller, came to monopolize production of oil, steel, rubber and many other commodities and services.
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The professional management era (1920s–1970s)

As trusts were outlawed, the founder-led company gave way to professionally managed corporations such as Alfred P. Sloan’s General Motors—large multidivisional enterprises owned by diversified retail investors and run by powerful executives. The age that these companies ushered in defined the idea of the firm in the world’s developed economies for much of the 20th century. At its height, this innovative, quasiscientific management system encouraged the rise of management as a career, separate from ownership. The professional management era reached its zenith in the 1960s, as large conglomerates expanded rapidly, backed by a belief in executives’ ability—with the right set of management tools—to allocate capital effectively across a diverse portfolio of businesses.

The shareholder primacy era (1970s–present)

The turmoil of the 1970s saw the rise of a new, more aggressive idea of the firm, led by thinkers such as Michael Jensen. The new theory attacked conglomerates and emphasized unlocking value from trapped assets. It argued that managers should be disciplined by debt and incented by the promise of huge rewards tied to shareholder interests. Combined with a host of regulatory and tax changes, the new thinking kicked off a boom in leveraged buyout activity, as the rush was on to find hidden sources of value within sleepy incumbents.
Within the firm, it feels harder than ever to translate strategy into rapid and effective execution. In our conversations with CEOs, we consistently hear how difficult it is to free up trapped resources to mobilize against important challenges and opportunities, despite the obvious and growing need for speed. Many companies are stuck in a resource-allocation doom loop that, despite best intentions, allocates next year’s resources more or less in line with this year’s revenue. It’s a formula for incremental improvement, not one for reacting to new competitive threats or new customer needs—or for proactively creating new demand.

Meanwhile, many younger employees, who now form the largest generational cohort in the workforce, are increasingly skeptical about corporate career paths. Some prefer the gig economy of Uber, TaskRabbit or Amazon Mechanical Turk. Others join corporations but plan on staying for only a few years. Though we can't yet know how this generation’s work lives will play out, many of its members today place a higher value on new learning and new experiences than on traditional incentives such as moving up the corporate hierarchy.

Many of these younger employees, along with many older ones, also want to work for a company that pursues a higher purpose in addition to profits. CEOs have become acutely sensitive to this concern; in conversation after conversation with leaders, we are struck by how quickly the talk moves to how a company can engage and inspire team members with a vision of making a difference in the world. Jack Ma, founder and executive chairman of Alibaba Group, puts it clearly: “Customers are No. 1, employees are No. 2, and shareholders are No. 3.” Even Jack Welch, the shareholder primacy era’s greatest maestro as CEO of General Electric, has more recently reflected, “Shareholder value is a result, not a strategy.... Your main constituencies are your employees, your customers and your products.” A growing number of CEOs see a higher purpose not as a side issue or fluffy topic but rather as a central element of their culture, people and customer strategies.

Externally, governments and public opinion have become more activist, whether through regulation, the courts or simply exerting pressure on CEOs. Critiques of inequality and the role of the modern corporation in feeding it have increased. Productivity in most developed countries is stagnant, as are most households’ incomes, leading to a global backlash against trade and immigration. Large companies don’t necessarily create new jobs in their home markets; job growth in the US and other developed nations comes almost entirely from young, small businesses, and the rate of new business formation has been steadily falling in recent years.

The cumulative impact of these pressures has already set in motion another profound shift in eras, which, over the next 10 years, will result in the biggest change in business since the 1970s. The fundamental goals of strategy will not change: Companies will still win by achieving a lower or better cost position, delivering superior customer experiences, or controlling an industry standard. But virtually every element of how firms pursue these strategic goals will look quite different.

What will be different about the firm of the future?

Our experience with clients in many industries around the world points to five emerging themes for leadership teams: scale and customer intimacy; professional managers vs. mission-critical roles; assets vs. ecosystems; capital gets a reset; and Engine 1, Engine 2. In each area, we see many examples of change today, but we view these merely as green shoots compared with what may come next.

Scale and customer intimacy

Some companies become synonymous with an era and help to define its characteristics. General Motors—the first company to create a multivisional structure—exemplified the “professional management” era. GE, with its stock price rising nearly fortyfold under Jack Welch, typified the shareholder primacy era. Today, it is tech-based disrupters such as Google, Facebook, Tencent, Tesla, Alibaba and Amazon—as well more established companies like Vanguard, Starbucks, Haier and LEGO—that symbolize the emerging era. In their own
ways, they each exemplify a new firm objective: to compete using the benefits of scale and the benefits of customer intimacy.

This is a change from the past. A long-held central belief of strategy has been that you can be big and low cost, or you can be focused and differentiated—but not both. We have studied dozens of industries and found practically no correlation between scale leadership and leadership in customer advocacy. In fact, sometimes it’s an inverse relationship—that is, the bigger the firm is in its industry, the less likely it is to be the customer advocacy leader. But what if you could drive scale and experience and, at the same time, learn quickly what customers want and react to their changing preferences? Today, new technologies and analytic techniques are making it possible to minimize or eliminate the traditional trade-off.

Although it is enabled by technology, this change is not just about the tech sector. Nordstrom, the $14 billion apparel retailer long famous for its strong customer advocacy, has grown its revenue by 50% over the past five years in part through a series of investments to get even closer to customers. These include software that allows store associates to communicate with customers via texts and the purchase of Trunk Club, a personal shopping service. Starbucks delivers intimacy through the baristas at the front line while investing in a superior mobile experience, personalization and value based on loyalty program insights. Vanguard, the mutual fund giant, has combined large scale with technology and a focused, repeatable business model to drive down the cost of direct and advised investing. Its industry-leading Net Promoter Score® is based on a rigorous customer insights system and increased investments in frontline service. Figure 1 shows three more examples of firms that enjoy high relative market share and high rates of customer advocacy. Green shoots such as these show that even established companies are learning to transcend the traditional split between scale and intimacy—and to master both.

**Figure 1**: The firm of the future will no longer need to choose between scale and intimacy, thanks to technology.
Underlying the historic trade-off between scale and intimacy is another very real tension—this one between size and speed. A constant throughout all eras, especially the professional management and shareholder primacy eras, was that scale matters—particularly scale relative to your competition. Relative market share, properly defined, was highly correlated with profitability and return on capital in most industries.

For firms of the future, scale will still offer potential benefits. But the dynamics of scale are changing. First, it is now possible even for small firms to access the benefits of scale without owning assets or capabilities themselves. Amazon Web Services, Salesforce, Workday and ServiceNow are at the forefront of a new wave of cloud-based capabilities that others can rent for a price. Second, the importance of speed relative to scale has increased across multiple fronts: time to market, time to gather and learn from feedback, time to make and execute decisions. Speed is now essential to customer intimacy. If people in customer-facing roles can make quick decisions and continuously improve their products and services, they will outstrip competitors. Third, just as digital technology and changing consumer expectations are pushing organizations to raise their metabolic rate, size often gets in the way. Bain studies of organizational fitness reveal that companies with more than $25 billion in sales are more likely to be slower at decision making than their smaller competitors.

The experience curve was an essential tool for realizing the benefits of size: With more scale and experience comes the opportunity to decrease your costs. But firms of the future will have to develop a new kind of experience curve, one that takes speed as well as scale into account. They will need metrics that track their metabolic rate. They will need systems of operation that allow teams to work quickly on a specific problem, solve it and move on, rather than staying trapped inside annual planning and activity cycles. One sign of the pressure companies already feel to speed up is the rapid spread of Agile methods from IT departments to other parts of organizations. As our colleague Darrell Rigby and his coauthors have observed in *Harvard Business Review*, National Public Radio now employs Agile tools to create new programming, John Deere to develop new machines and Saab to produce new fighter jets. Agile burndown charts are a rough-and-ready metric that lets teams see how fast they are working. One John Deere unit using Agile techniques compressed innovation cycle times for its next-generation tractors by as much as 75%.

Achieving full potential from such methods requires robust organizational learning systems, and the best ones that we have seen are peer-
to-peer. Enterprise Rent-A-Car is a good example. At Enterprise, the branch makes most of the key decisions that affect customer satisfaction; branch managers have great discretion to add or change features to improve the service experience, and they have the responsibility to follow up with dissatisfied customers. High-impact ideas are shared from branch to branch: Famously, a complimentary cold bottle of water in the shuttle bus, implemented independently by a driver in one airport branch, led to significant improvements in customer advocacy. News spread quickly via an all-branch phone call, and within 72 hours, every branch had made water bottles part of its service.

What this could look like in 2027: Firms will combine big data, which will be pervasive, with human intelligence from frontline interactions with customers, and the resulting information will all be instantly visible throughout the company. Transactional activity will be almost entirely automated; algorithms and machine learning will simultaneously reduce the need for routine interactions while opening up new avenues for customer engagement. Cloud-based service firms will become the default providers of back- and middle-office functions, dramatically shrinking the size of the average firm. Some firms will create enormous variety, with each offering carefully tailored to target customers—who may not even know they are dealing with the same large company. Products, services and experiences will blur.

Professional managers vs. mission-critical roles

The best companies have articulated not just a higher purpose but also a bold, insurgent mission around how they will serve customers. This, too, is a central element in their business, culture and people strategies. Having defined a clear mission, a firm can then identify the roles that are most central to delivering it. We call these the mission-critical roles. At the home furnishings company IKEA, for example, the mission is to create well-designed products at breathtakingly low prices, which demands low initial product costs and relentless ongoing cost reduction. The mission-critical roles include purchasing and product design. At Yonghui, the supermarket chain, the mission is to provide safe food for Chinese families. That elevates supply chain teams working with Chinese farmers to a mission-critical role. Such roles should include people who deliver the benefits of both scale and customer intimacy—the two sides of the organizational matrix that typically come together only at the executive committee level. These roles will be at the heart of the firm of the future, and they will be integrated much closer to the customer to shorten feedback loops and increase speed and agility.

This is a pronounced shift from the shareholder primacy and the professional management eras, both of which viewed professional managers as central to a company’s performance. The organizational goal was to advance the best performers into management—to take expert bricklayers, so to speak, and make them managers of other bricklayers. Rewards and recognition flowed accordingly. In the coming era, the priority will be to create communities of expertise within the firm or within its ecosystem—think guilds of bricklayers—to reorient investment around the key roles that deliver the customer mission and to place the best talent in these roles. The payoff can be significant, as top talent can dramatically outperform average talent in these kinds of roles (see Figure 2).

The green shoots that we have seen so far include the music streaming company Spotify, where the mission-critical roles are filled by software engineers. The company organizes its engineers into self-managing teams of no more than eight members, known as squads, each with end-to-end responsibility for a cluster of features. Squad members decide what to build, how to build it and who they need to work with to ensure interoperability. The game designer Valve uses an even more radical model, one without supervisors or structure, where the team chooses what it wants to work on and gets publicly rated by other team members.

Here, too, the changes are not limited to Silicon Valley. At Haier, the $30 billion Chinese white goods manufacturer with more than 70,000 employees, the core organizational units are self-organizing teams built around the mission-critical roles of marketing, design
Teams are fluid, focused on specific projects and staffed through an internal market for talent. Recently, Haier has further transformed this system by moving to eliminate most support teams, which historically played a coordination role, and opening up its teams to external partners through what it calls a “networking strategy.”

Properly designing and resourcing mission-critical roles will change the rest of the organization. Budgeting and planning will have to be revamped. Firms won’t need as many professional managers as they commonly have today. Managerial spans will widen considerably as more information flows become peer-to-peer (as at Enterprise Rent-A-Car) rather than hub-and-spoke. The definition of leadership will change, with multiple tracks available. Some tracks will recognize and reward the efficient management of routine processes, while others, just as highly prized, will value the coaching and development of apprentices as they migrate from one role to another. We will increasingly see continuous and public peer feedback and performance reviews, allowing internal and external markets for talent to clear fast. Already, firms such as GE, Microsoft and Adobe have dropped their formal performance-ranking systems.

What this could look like in 2027: With most activity automated or outsourced, almost all remaining roles will be mission-critical. Most work will be project-based, with Agile teams the dominant organizational unit; such teams will blend internal and external resources to provide the right skills as needed. Teams will be self-managed, leading to a vast reduction in the number of traditional managers. Employees will have no permanent bosses, but will instead have formal mentors who help guide their careers from project to project. Coaching and feedback will be real-time and continuous, with performance reviews transparent the way social media ratings are today.
Assets vs. ecosystems

Turn the clock back a century, and you find that many leading firms were vertically integrated. Henry Ford famously owned the farms that raised the sheep that provided wool for automobile seat covers—plus the iron ore and coal freighters that fed Ford’s sprawling River Rouge manufacturing complex. Firms such as Ford created an ecosystem under one corporate umbrella. Later, Japanese keiretsu and the Korean chaebol created ecosystems out of legally separate but affiliated companies cooperating strategically and financially. Today, the automotive industry is split vertically, but external collaboration is essential both across industry boundaries and among competitors. For example, BMW is teaming up with Intel and Mobileye to work on autonomous vehicles, and BMW and Toyota are reportedly collaborating on a new-generation sports car.

The shareholder primacy era accelerated the idea of industry ecosystems with its embrace of outsourcing. Starting with noncore activities, but eventually stretching through almost any aspect of a firm’s value chain, many companies, large and small, took the opportunity to shed assets and rent the capabilities of other firms. Today, there is literally no part of a business value chain that cannot be outsourced. The successful outsourcers offer their customers scale, experience, methodologies and variable economics that they could not achieve on their own or that they simply prefer to hand off to others in the interest of staying ruthlessly focused on what they uniquely can do. The scale of investments required to win in outsourcing is staggering; Foxconn, for example, is planning to install tens of thousands of robots in its factories just in the next few years.

Increasingly, outsourcing can also be provided by individuals who want only a transactional relationship with a firm. According to the most recent estimates, as much as 40% of the US workforce engages in a variety of nontraditional employment arrangements, including part-time and independent contractor work, and employers are now able to access this labor in diverse fields, such as journalism, data analytics and even investment banking. At an extreme, technology-based platform companies such as Google, Apple and Facebook have earned huge revenues from very small employee bases—$2.1 million per employee at Apple and $1.4 million at Facebook vs. $0.7 million per employee at Procter & Gamble and $0.3 million at Wells Fargo. Calculations of market capitalization per employee show similarly skewed results (see Figure 3).

The influence and disruptiveness of platform companies affect much of the business world these days. Platforms can come in many types,

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**Figure 3:** Technology-based platform companies have earned huge values from relatively smaller employee and asset bases

including a de facto standard such as Microsoft’s Windows, a trust architecture such as Airbnb’s, a user base such as Facebook’s and Cisco’s “virtual manufacturing” system. Combining elements of disintermediation, profit pool migration, globalization, speed and customer transparency, many of these companies are emerging as critical pivot points in their sectors. And the model is spreading. Freight logistics, genetic sequencing, travel, order management, toys, customer relationship management software, consumer lending, digital advertising, payments, fashion, car rides, asset management, publishing—it might be easier to list industry sectors in which no one has yet thought to attempt a platform model. Listening to the rhetoric, it’s easy to assume they all succeed, but they don’t. Twitter is struggling; Napster was a platform business that didn’t work; so was MySpace.

For all the buzz about platforms—we call them “type 1” firms—the vast majority of companies will not deploy this model themselves. Instead, we see two other viable models emerging: outsourced service providers (“type 2” firms), and product and service companies (“type 3” firms). It is not a credible scenario that all value will flow to type 1 firms. Governments will react; consumers will react; the extremes of firm behavior will be reined in. Uber’s ascent, for instance, is being challenged by judiciaries acting on behalf of drivers worried about their rights and legal protections. Amazon is no longer just the disruptive enemy but the most important partner to thousands of growing brands.

The art for any firm—type 1, 2 or 3—will be to figure out what to do itself and then to form win-win partnerships with firms in the other two categories to maximize value for customers. This will require a new set of skills, and many people in the firm will be engaged with managing partners who might also be competitors or customers or suppliers. A paradox here is that firms with strong cultures, a positive outcome of having a clear...
mission and focus on front-stage roles, are often the worst partners. The firm of the future will require leaders who can understand the industry in terms of these firm types and create a sense of mission across partnerships.

**What this could look like in 2027:** Platforms will continue to proliferate and pursue a winner-take-all dynamic, constrained in part by social and regulatory pressure around the world. Both platforms and outsourcing will require huge scale, but small product and service companies will be able to use that scale to thrive as well. “Everything as a service” will be available on demand, from a mix of horizontal (cross-industry) and vertical (industry-specific) outsourcers, with the latter often set up as joint ventures by industry participants. There will be ongoing battles at the seams between the three types of companies. Gig economy platforms will become a material force for building community and increasing bargaining power among skilled workers, much as unions have done historically for lower-skilled workers.

**Capital gets a reset**

The shareholder primacy era evolved during the late 1970s in part from a conviction that management and shareholder interests had become misaligned—the classic agency problem. Managers were undisciplined in spending investors’ money, pursuing profitless growth and wasteful diversification, as they owned few shares and had little of their wealth tied up in their companies. There was some merit in this criticism.

Over time, however, the pendulum has swung back, and today it sometimes seems that CEOs are highly skeptical about investing in their businesses, despite a steady decline in the weighted average cost of capital, which we estimate is now between 5% and 6% for most large companies; hurdle rates have remained stuck at 12.5% in 2016. Capital expenditures and research and development budgets have declined on a relative basis, while buybacks and dividends have increased. According to Reuters, 1,900 companies repurchased shares between 2010 and 2015, and within this group, buybacks and dividends amounted to 113% of capital spending, compared with 60% in 2000 and 38% in 1990. Meanwhile, spending on R&D has averaged less than 50% of net income, compared with more than 60% in the 1990s.

CEOs, CFOs and corporate boards have voiced increasing dissatisfaction with this dynamic, and many institutional investors such as Vanguard, BlackRock and Warren Buffett have urged greater long-term focus and reinvestment. At the same time, however, activist investors have been
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**Figure 4:** New ownership and investment models are evolving to better match the time horizons of the firm with the risk needs of the investor

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<th>Activist investors are increasingly collaborative</th>
<th>Private equity firms are extending investment horizons</th>
<th>Scale start-ups are staying private longer</th>
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<tr>
<td>Level of collaboration (percentage of demands)</td>
<td>Average North America PE holding period by year of exit (in years)</td>
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increasingly successful in applying shorter-term pressure to the CEO/CFO agenda, despite controlling only about $150 billion in assets under management (compared with the $30 trillion held by mutual funds).

Alongside the headlines from activists, a host of alternative models is gaining traction (see Figure 4). Private equity firms have had to lengthen their investment horizons to create value with their portfolio companies, from 4.5 years in 2006 to 6 years in 2016; Blackstone, Carlyle Group and others have recently launched funds with longer target holding periods. Scale start-ups—the leading engine of job creation—are staying private longer, on average 11 years in 2014, and, in some cases, are even going straight from venture to private equity ownership to provide liquidity to early investors and employees. Nasdaq’s Linq platform now enables many of the functions of public markets (shareholder services, share registries, even secondary trading) for privately held companies.

New vehicles are also emerging to connect investors to specific investments within a firm—investments that are suited to their risk profiles and that do not involve owning a share of the whole entity. In healthcare, Pfizer and other pharmaceutical companies have lined up one-off funding for the development of specific products, matching their capital needs with the risk preferences and expertise of individual investors. In 2014, Unilever issued a “green bond,” offering clarity and transparency around the use of proceeds, including a set of clearly defined criteria on greenhouse gas emissions, water use and waste disposal for the projects funded. Peer-to-peer lending and crowdfunding platforms such as Kickstarter and GoFundMe are another aspect of this evolution.

Traditional equity and debt raising will continue to be vital to the firm of the future, but capital structures are likely to be more flexible, offering the potential to align investors more closely with the firm’s business
strategies and time horizons, and to link different types of investors to different types of investments. This will bring its own set of pressures; the emergence of these new vehicles will offer new potential for activists to target specific pieces of firms, and so will increase the sophistication required from a company’s investor relations strategy.

**What this could look like in 2027:** The line between public and private ownership will blur. Large public companies will pursue long-term anchor investors and adopt the governance practices of leading private investors, while larger private companies will trade in secondary markets that require enhanced investor protections. The line between debt and equity will also blur, as off-balance-sheet project-based equity becomes a significant funding source. Investors will invest in projects rather than companies, creating a new ecosystem of financial intermediaries to help them identify and gain access to the best projects. Activist investor techniques, both short and long term, will increasingly be adopted by traditional money managers in pursuit of alpha.

**Engine 1, Engine 2**

Companies have always pursued innovation in their core business. Clayton Christensen has called these “sustaining innovations”; they bring incremental improvements in performance or value. But what about the innovations that upend an entire industry? They are all around, even if leaders sometimes find it hard to believe it will happen to them. To thrive in this environment, firms will need to dial up their ability to see around corners, spotting trends before they are well formed and mobilizing resources quickly to adjust to changing circumstances. Seeing around corners is both art and science, and while outright prediction is usually a fool’s errand, there are ways to improve your odds of success. It pays to maintain a high external orientation, staying close to customer needs as well as to moves by current and potential competitors, and to learn from ecosystem partners. It’s also important to tap into the collective knowledge of your internal resources, particularly the front line, on a much broader scale than most businesses habitually do.

Whether the threat is visible and imminent or invisible and theoretical, leaders of the firm of the future will be toggling between running their core—today’s engine—as efficiently as possible, looking for sustaining innovations there. They will also need to create a new business—tomorrow’s engine—that reflects new customer needs, new competitors, new economics or all three.

This “Engine 1, Engine 2” approach is what allowed Marvel to continue to develop its publishing core while simultaneously expanding the character licensing business that has become its new core. Likewise for Netflix: From the mid-2000s, the core DVD business was progressively milked to fund the rapid growth of the streaming business. IBM has shrunk its traditional hardware business while dramatically expanding its newer software and services offerings (see Figure 5). In each case, moves into Engine 2 meant new competition, new cost structures and new economic models to run in parallel, and the new business took at least five years to flourish.

Defining and building an Engine 2 requires creativity on several fronts. It is not enough to define a compelling vision or point of arrival; that is often the easy part. The task also requires identifying a first step that is focused and that allows rapid testing of the core idea, as well as thinking through subsequent moves that could be opened up by initial success. In many ways, this was Steve Jobs’ genius at Apple. Everyone had the same idea for the first-generation move. But he was two generations ahead, and so understood the value of the ecosystem that could be created by keeping hardware and software vertically integrated.

The two engines demand different approaches. Discipline, repeatability, small continuous improvements, careful risk assessment and conventional financial analysis are the hallmarks of Engine 1. Agility, creativity and leaps into the financial unknown with the expectation that only a few investments will ultimately pay off are the chief traits of Engine 2. Running both in parallel raises some tricky operating model questions such as these: To what extent should Engine 2 redefine Engine 1? How and when should innovations get folded
back into the core (and who decides)? And how do you manage the allocation of talent and other resources across the company? Perhaps most fundamentally, is it better to build Engine 2 yourself, or is it better to monitor capabilities being developed externally and then acquire them? For the most successful firms in the coming era, we believe managing both engines will be required. These firms will use their Engine 2s not just as sources of new growth but as vehicles to transform their companies into firms of the future.

What this could look like in 2027: Companies will set up and manage Engine 2 under the corporate umbrella but will likely structure, staff and fund it separately. Resource allocation will be a point of integration across Engine 1 and Engine 2, and will be continuous and zero-based. Top talent will rotate through both engines, learning a balanced set of skills and fulfilling mission-critical roles on both sides of the business.

The leader of tomorrow

Leading and working in a firm of the future will feel different. It will sometimes feel as if you are venture capitalists, thinking in terms of payback over five to ten years or longer. Venture capitalists expect many of their investments to fail and that they will make their money on the few that turn out to be home runs. When they evaluate investments, they look for the chance to create whole new markets, or to back a product 10 or 100 times better than what exists today. They are relentlessly focused on mission-critical roles, and they naturally think about creating value through ecosystems.

Other aspects will feel like a professional services firm. Lawyers, accountants, consultancies and engineering firms work in ways unlike most corporations. They mobilize teams of professionals to attack specific business problems. When the problem is resolved, the team disbands, and the people move on to another project. Less constrained by annual functional business planning, this way of working has a faster speed and flow.

And still other aspects will feel more similar to a scale start-up. Examples include raising money from the right investors for specific programs, going all-out to hire and retain talent for the mission-critical roles and designing the organization around those roles, and keeping professional management systems simple to preserve focus and efficiency.

Putting all this in place will be a profound leadership challenge. At an organizational level, many new capabilities will be needed: new technology assets and skills, new deals for talent, new and expanded types of partnerships, new managerial tools and metrics, new balance sheet
approaches. At an individual level, leaders will need to evolve their own skills, shifting from management to inspiration and coaching, adding value through enabling the mission-critical roles rather than controlling information flows, building strong cultures not just within the firm but with partners as well. They will also need to guide their people through the mother of all change-management journeys.

Previous shifts in eras have seen more failures to adapt than success stories of navigating the transition. Many companies have done it once or twice (IBM, Coca-Cola, Goldman Sachs), and firms such as GE and Nestlé have done it as many as three times. But these shifts are rare enough that most leaders have no direct experience with them. How should they approach the journey? Where to even start?

Here are five questions leaders can ask, and some practical ideas for how to start addressing them:

- **What combination of scale, speed and customer intimacy do we need, and how can we deliver this better than current and potential competitors?** This is partly about strategy (what is the relative importance of these elements for your business, and how do you make investment trade-offs?) and partly about ways of working (how do you use technology and organization to minimize these trade-offs?).

  No-regret action: Translate your strategy into 25 to 50 specific market engagements (micro-battles), and deploy fast-moving teams that include the people who deliver the benefits of scale and intimacy to prosecute these battles.

- **How close are we to getting full potential value from our mission-critical roles?** Answering this question requires alignment around what these roles are, deployment of your best talent in these roles and understanding what you are doing to support this talent vs. holding it back.
No-regret action: Identify your mission-critical roles, and develop a plan to put your best talent in them. Establish a council to connect and build engagement within this group, and install rapid market and internal feedback systems to drive peer-to-peer learning.

- **What type of company are we—platform, outsourced service provider, or product and service provider—and how are we partnering across this ecosystem?** As technologies such as cloud continue to evolve, as outsourcers develop more capabilities and as gig economy platforms expand, ecosystems will grow and present more partnership options than ever.

  No-regret action: Map your entire ecosystem by activity, and assess your degree of capability in each activity as compared with external options.

- **What would we do if capital and investor requirements were not a constraint?** Said another way: Are you able to identify more good ideas than you are willing or able to fund? If so, it’s worth testing whether this is really an unbreakable constraint.

  No-regret action: Segment your investor base by degree of alignment with your strategy along two dimensions—time horizon and risk appetite.

- **What are we doing today to position our business for 10 years from now?** This question is not just about long-range scenarios but about how you build flexibility into resource allocation and develop the capability to see around corners.

  No-regret action: Establish an Engine 2 incubator, and segment the company into Engine 1 and Engine 2, with clear guardrails and operating models for each, and clear rules of engagement between them.

  These actions are not meant to be exhaustive, and we recognize that they just scratch the surface of the retooling that many companies will need for the new era. While the exact shape of the firm of the future is unknowable, history suggests that at a transition point between eras, change can happen abruptly. In such an environment, it pays to be bold, to think long term and, above all, to act.
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