Executive Summary

In the midst of an economic downturn, when it is all too easy to fixate on cyclical events, there is real danger of losing sight of deeper trends. Short-term cyclical thinking risks discounting or even ignoring powerful forces of longer-term change. To provide a clear, comprehensive, and sustained view of the deep dynamics changing our world, Deloitte's Center for the Edge has developed the Shift Index. The Shift Index consists of 3 indices and 25 metrics designed to make longer-term performance trends more visible and actionable.

Our first release of the Shift Index in 2009 highlighted the decline in firm performance that has been playing out for decades. Remarkably, in 2009, the Return on Assets (ROA) for U.S. firms had fallen to less than one-third of 1965 levels while improvements in Labor Productivity had modestly improved over the same period. While there has been a modest improvement in ROA over the past couple of years as the downturn eases up, we believe that this is simply a short-term adjustment similar to the improvements in ROA seen in previous economic cycles. The long-term trend is still an underlying reality and there is no reason to believe that these short-term adjustments, achieved largely through significant layoffs, mark a reversal of the long-term trend.

Additional findings of our Shift Index include the following:

- The ROA Performance Gap between winners and losers has increased over time, with the "winners" barely maintaining previous performance levels, while losers experience rapid deterioration in performance.
- The "topple rate," the rate at which big companies lose their leadership positions, has more than doubled, suggesting that "winners" are in a precarious positions.
- Competitive Intensity in the United States has more than doubled during the last 40 years.
- While the performance of U.S. firms is deteriorating, the benefits of productivity improvements appear to be captured in part by creative talent, which is experiencing greater growth in total compensation. Customers also appear to be gaining and using their market power as reflected in increasing Consumer Power and Brand Disloyalty.
- The exponentially advancing price/performance capability of computing, storage, and bandwidth is driving an adoption rate for our new "digital infrastructure"[3] that is two to five times faster than previous infrastructures, such as electricity and telephone networks.

This 2011 release of the Shift Index updates all 25 metrics and finds new revelations and examples. This year, we also explore several themes in depth that have influenced our thinking on the Big Shift.

A few of the key themes that we will discuss this year are:

- ROA performance continues its long-term decline due to deteriorating firm performance. This year, we explore ROA performance in context of two macro trends, Mergers & Acquisitions (M&A) activity and declining interest rates, which have been put forth to explain (or explain away) the observed decline. Based on our analysis, we contend that the declining trend in ROA reflects fundamental firm performance.
- Layoffs and other short-term measures taken by firms are largely the cause of the recent uptick in ROA. As performance pressures mount, firms are reacting by taking short-term measures and pushing hard on employment and payroll as the principal cost-cutting levers. While offering short-term relief, current efforts taken by firms to eliminate jobs are not sustainable drivers of firm performance going forward.
- Connected individuals, not companies, are the ones harnessing flows and have more power because of it. Declining information asymmetry, lower switching costs, and emerging trends, such as a technology-enabled resources sharing, are increasing Consumer Power and providing additional options for consumption. While individuals are leveraging knowledge flows to increase their power in the marketplace, this hyper-connectivity also drives volatility in the economic, social, and political arenas.
- Firms have untapped opportunities to reverse their declining performance by embracing pull. To accomplish this, firms must develop and encourage passionate workers at every level of the organization. Additionally, companies must tap into knowledge flows and expand the use of powerful tools, such as social software to solve operational/product problems more efficiently and effectively as well as to discover emerging opportunities.

Given these trends, we cannot reasonably expect to see a significant or sustainable easing of performance pressure as the current economic downturn begins to dissipate — on the contrary, all long-term trends point to a continued erosion of performance. So what can be done to reverse these performance trends?

3 More than just bits and bytes, this digital infrastructure consists of institutions, practices, and protocols that together organize and deliver the increasing power of digital technology to business and society.

The answer can be found in the three waves of deep change occurring in today's epochal "Big Shift." The first, the "Foundation" wave, involves changes to the fundamentals of our business landscape catalyzed by the emergence and spread of digital technology infrastructure and reinforced by long-term public policy shifts toward economic liberalization. The metrics in our Foundation Index monitor changes in these key foundations and provide leading indicators of the potential for change on other fronts. Changes in foundations have systematically and significantly reduced barriers to entry and to movement, leading to a doubling of Competitive Intensity.

The second, the "Flow" wave, focuses on the key drivers of performance in a world increasingly shaped by digital infrastructure. This second wave looks at the flows of knowledge, capital, and talent enabled by the foundational advances, as well as the amplifiers of these flows. Because of the rapid change, higher unpredictability and volatility created by the Big Shift, knowledge flows are a particular key to improving performance. Developments on this front are lagging behind the foundations metrics because of the time required to understand changes in foundations and develop new practices consistent with new opportunities.

The third, the "Impact" wave, centers on the consequences of the Big Shift. Given the time it will take for the first two waves to play out and manifest themselves, this third wave—and its related index—provides an even greater lagging indicator. While current trends in firm performance indicate sustained deterioration, we expect, over time, that performance will improve as firms begin to figure out how to participate in and harness knowledge flows. Doing so will require significant institutional innovations, not just changes in practices, resulting in value creation through increasing returns performance improvement. In the end, we expect these innovations to lead to a fundamental shift in the rationale for institutions from scalable efficiency to scalable learning as firms use digital infrastructure to create environments where performance improvement accelerates as more participants join. Early signs of these changes are visible in emerging open innovation and process network initiatives underway today.

The Shift Index seeks to measure these three waves of deep and overlapping change operating beneath the visible surfaces of today's events. The relative rates of change across the three indices can help executives understand

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where we are in the Big Shift and what to anticipate in the future. Current metrics indicate that we are still in the first wave of the Big Shift and facing challenges in moving forward into the second. Changes still manifest themselves much more as challenges rather than opportunities because our institutions and practices are still geared to earlier infrastructures. At the same time, an understanding of these three waves leads to significant insights about the moves required to reverse current performance trends:

- Deeper, yet strategic, restructuring of firm economics to generate maximum possible value from existing resources;
- Development of new management practices to more effectively catalyze and participate in growing knowledge flows; and
- Significant innovation in institutional arrangements to drive scalable participation in knowledge flows and reap the increasing returns to performance improvement.

The Shift Index is updated regularly to track changes over time and measure movement along the Big Shift. We have designed this year's Shift Index both as a stand-alone summary of the findings to date and as an update for those who have read previous editions.

In response to growing interest from executives, the Center for the Edge is also further researching which flow metrics at the individual firm level, could be drivers of performance, ultimately captured in operating and financial metrics. In particular, we are investigating the ability of companies to participate effectively in a larger and more diverse range of knowledge flows, with the intent of identifying a set of flow metrics that can be drivers of performance metrics for the firm to monitor on an ongoing basis.