FULL POTENTIAL PARADIGM™ SYNOPSIS

Introduction

During my early career at Bain and Company, I developed a strategic framework for CEOs and Boards that ultimately became The Full Potential Paradigm™ (FPP™.) It has been refined by me and members of my Acropolis Advisors team over the past 40 years. Together, we have used it to drive game changing decision making and have witnessed many clients alter their current strategy because of the insights derived from its application. Before getting into the details of FPP™, let me first illustrate its impact with one simple, yet powerful example.

At the start of the new millennium, Bill Ford asked me for strategic counsel: Ford Motor Company was feeling enormous pressure due to its languishing stock price, driven by deteriorating profits. Management was perplexed because they viewed themselves as the Number 2 automaker worldwide based on revenues and deserving of market leading margins. If scale and margins were truly positively correlated, how could they be consistently reporting lower and lower margins with their market position?

When we looked "under the hood" using some of our FPP™ analytical tools, we found that global revenue and market share were not in fact the right measures to use when it came to expected profitability. In fact, what did explain performance was market share in units, by country, and by model type. Through this prism of a lens, it was clear that Ford was not even close to being a leader in any model category other than their F-150 truck line and to a much lesser degree in their Mustang line for modestly priced sports cars. On a weighted average basis across all their models, they were significantly behind several automakers from Toyota, Nissan, VW, BMW, Daimler, and Porsche. In fact, using this new prismed lens of relative market share within a model type by country over time, we were able to show a steady retreat from the 1940's to 2004 in both relative market share and profitability.

So, what happened? In a nutshell, this work provided the company with the fact base and decision rules to drive greater focus in their strategy. Bill Ford made the biggest decision of his lifetime and turned over the reins of the company to former Boeing executive Alan Mulally who understood Ford's predicament and our analysis. He quickly divested long suffering premium brands like Jaguar, Land Rover, and Aston Martin along with Hertz and Volvo. He shut down the Mercury line and slimmed down the model offerings to customer segments where Ford could win. The decades old strategy of providing a car through a person's life cycle was replaced with a very focused strategy by model type and by country. I take no credit for all the wonderful leadership exhibited by Mr. Mulally, but the market context we provided him with at the beginning of his reign was an important element in his understanding of how the automotive industry worked.

This is but one example of the impact of applying the FPP™ – a data-rich and disciplined way of evaluating companies and charting their full potential path forward. Whether you utilize all or parts of FPP™, depends on the specific strategic challenges facing the company. What is clear is that it can be an invaluable construct to utilize and refresh. What follows is a summary of the tools within the FPP™, and we welcome the opportunity to discuss how it can work for you.

The Full Potential Paradigm™

Developed by Bill Achtmeyer and the Acropolis Advisors founding team over a combined hundred years of management consulting experience, the Full Potential Paradigm™ (FPP™) is our proprietary business strategy framework. FPP™ provides an objective and quantitative assessment of a business's full potential value and the gaps between the present value of the company and that potential. The framework is quantitatively derived from Acropolis Advisors founder Michael Porter's *Five Forces* and *Value Chain Analysis* and has a long history of guiding companies through business strategy, portfolio strategy and M&A strategy. The Full Potential

Paradigm™ has been continually updated to remain fresh and relevant to the most complex and pressing issues facing CEOs today.

Our definition of strategy is:

“A general framework for achieving a specific outcome for an entity with constrained resources under competitive conditions of uncertainty.”

FPP™ is founded on a rigorous examination of the proper business definition for each distinct entity within the enterprise. Properly defining an entity’s business requires understanding the economic model and its key drivers. Staying with Ford as an example, is it an automobile manufacturer or a mobility company? How does one factor into the equation, the entry of Tesla, Apple, Uber, and Zipcar to the automotive arena? Are they competitors? Does this expand the business definition? The simple answer is that the entire automotive industry is going through a massive transformation and the “old” ways of thinking need to be reexamined. What follows is a guide to how we think about strategy in the 21st Century.

FPP™ Market Context Analysis

The core to any strategic work is an objective and explicit understanding of the current situation. We call this “*maniacal realism*” as it highlights our commitment to making sound, fact-based business decisions. Business definition serves as the foundation of this understanding by outlining the economic boundaries within which companies compete and identifying their meaningful competitors. We illustrate this understanding using several diagnostics, including the *Market Marimekko* (*Figure 1*) which shows market share by business segment, and our proprietary *Opportunity Strength Matrix* (*Figure 2*) which depicts business portfolio alignment.

Market Context Example

Figure 1- Market Marimekko

The *Market Marimekko* shows the competitive structure of an industry, based on the dominant business driver rather than simply revenue. The market map is subdivided into competitive businesses and highlights market participation across the full industry. Equally important, the *“mekko”* omits businesses which are not real competitors and businesses which are not truly part of the industry as determined by proper business definition. *The Market Marimekko* provides strong visual cues about expansion and adjacency opportunities as well as highlighting competitive dynamics.

Market Context Example

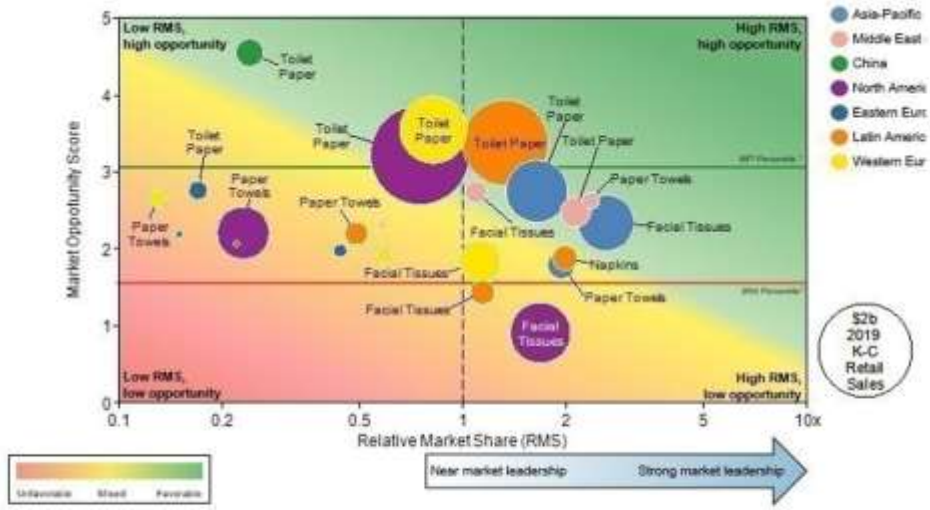

Figure 2 - Opportunity Strength Matrix

The *Opportunity Strength Matrix* is our update on the venerable *Growth Share Matrix,* which was conceived by Boston Consulting Group founder, Bruce Henderson. The *Opportunity Strength Matrix* adjusts to industry evolution and the *substitution curve* rather than relying entirely on the *adoption curve. The Opportunity Strength Matrix* can provide a single visual that is useful for managing portfolio strategy across a complex business.

We have additional analyses we perform in the market context phase which are driven by observed conditions and vary from industry to industry. These range from rank change analysis to better understand competitive dynamics, to a newer analytic targeted at understanding the impact of Artificial Intelligence on a business. (The latter is derived from Michael Porter's *Value Chain Analysis*.)

FPP™ "Gap" Analysis

Having addressed business definition and market context, our analysis breaks down business opportunities into three areas, which we call "gaps." The Full Potential Paradigm™ formula is straightforward:

Performance Gap x **Opportunity Gap** x **Perception Gap**

$$\left.\begin{array}{c} \\ \dfrac{\text{Net Income}}{\text{Revenue}} \times \text{Revenue} \times \dfrac{\text{Stock Price}}{\text{EPS}} \end{array}\right\} = \textbf{Market Value}$$

Each "gap" represents the difference between optimal and observed current performance.

The Performance Gap

The first gap identifies an appropriate target **margin** based on industry structure and the **relative market shares** of the competitors in a business. Identified through our *Normative Band* diagnostic (*Figure 3*) which is based on the principles of the industry **experience curve** (a direct relationship between relative scale and profitability), the *Performance Gap* sets comparable industry margins in context and helps identify cost management opportunities via operational and capital investment shifts as well as pricing opportunities centered on the *Observed Pricing Premium*[1]. Capital alignment opportunities are identified through our *Return on Asset Utilization*[1] analysis, which isolates true capital investment advantage separating it from relative scale and serves as a needed update to ROCE or ROIC analysis which conflate strategic position with asset utilization. The *Normative Band* has been referred to as "strategic benchmarking" or "benchmarking on steroids" as it normalizes for differences in structure and scale and adjusts for differing accounting practices across a properly defined industry. Full potential performance is defined as achieving the 80th percentile level. Taking a page out of Jim Collin's research we aspire to have all our clients be considered "great companies" as opposed to simply "good companies."

Performance Gap

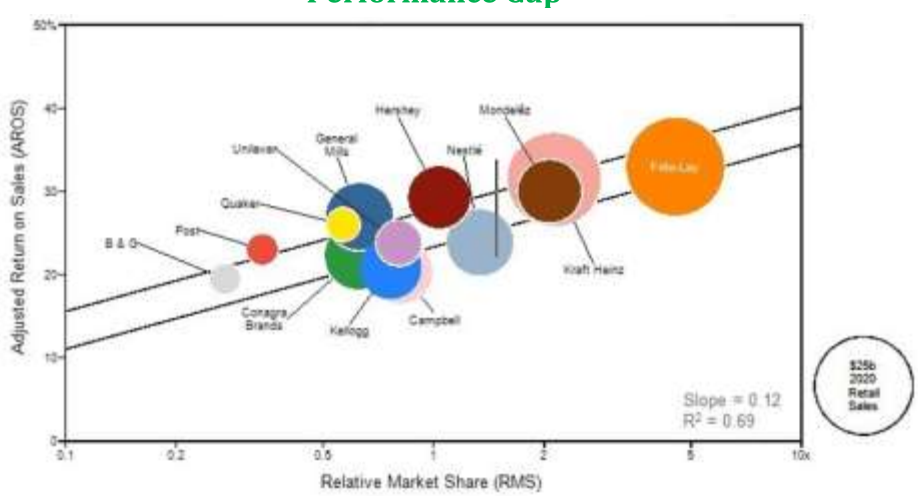

Figure 3- The Normative Band

The Opportunity Gap

Similar to our approach to understanding margin, the second gap identifies appropriate target **revenue growth** rates through quantitative diagnostics. The *Normative Growth-Growth* chart (*Figure 4*) shows whether the company is gaining or losing market share. As with the Normative Band, target performance is defined as 80th percentile performance rather than at the mean. This targeting is derived from extensive analysis of what leads to sustained and sustainable competitive outperformance, i.e., reaching "full potential." The *Normative Growth Band* (*Figure 5*) is a more complex rendering of the information which, among other outputs, demonstrates the fallacy of size limiting growth. Frito Lay defies gravity in the snack business and Campbell Soup seems nicely positioned to achieve 60th percentile plus performance. In 2023, both of these firms exceeded expectations.

[1]Further explanation of these two diagnostics are available upon request

Opportunity Gap

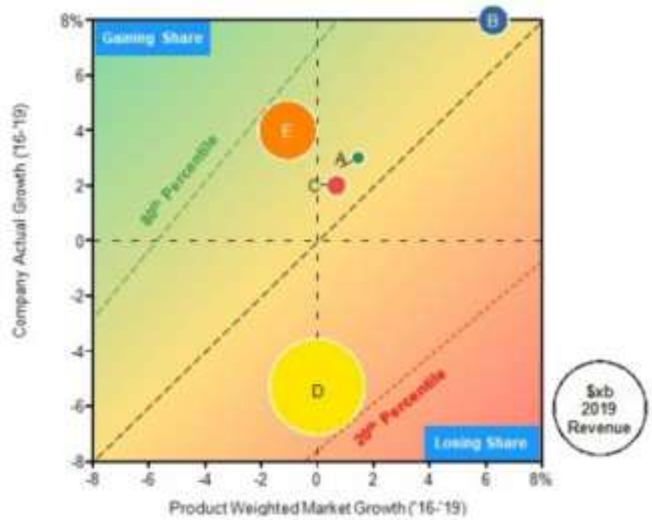

Figure 4- Normative Growth/Growth

Opportunity Gap

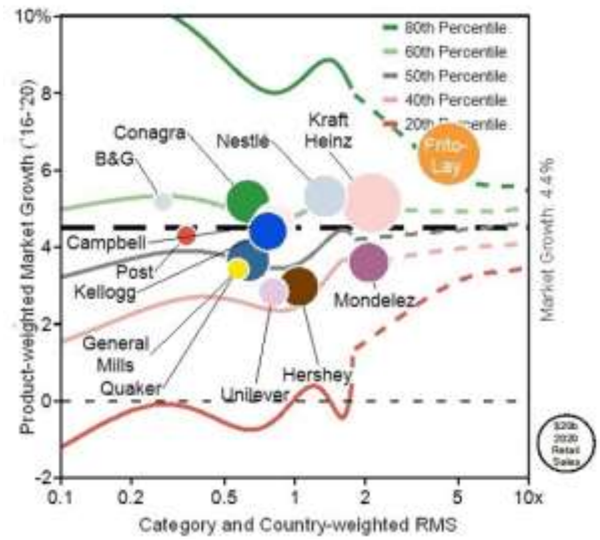

Figure 5- Normative Growth Band

The Perception Gap

The third gap in the FPP™ arsenal is the Perception Gap. Approaching the question of **relative market valuation** from a management perspective, FPP™ identifies core market valuation drivers for companies and industries and the relative importance of each of these drivers. We analyze performance over time across a range of management addressable factors (e.g., revenue, EBITDA margin, D/E ratio), as well as using relevant standard industry drivers and an applicable volatility index. We assess the relative importance of each factor by how they differ across industries and across competitors within an industry and over time. While our analysis is descriptive rather than predictive, it consistently explains differences in valuation across companies and industries and can be invaluable for prioritizing initiatives and strategies within a company. The approach has been the subject of an article published in Harvard Business Review. (https://hbr.org/2022/10/6-factors-that-determine-your-companys-valuation.)

Perception Gap

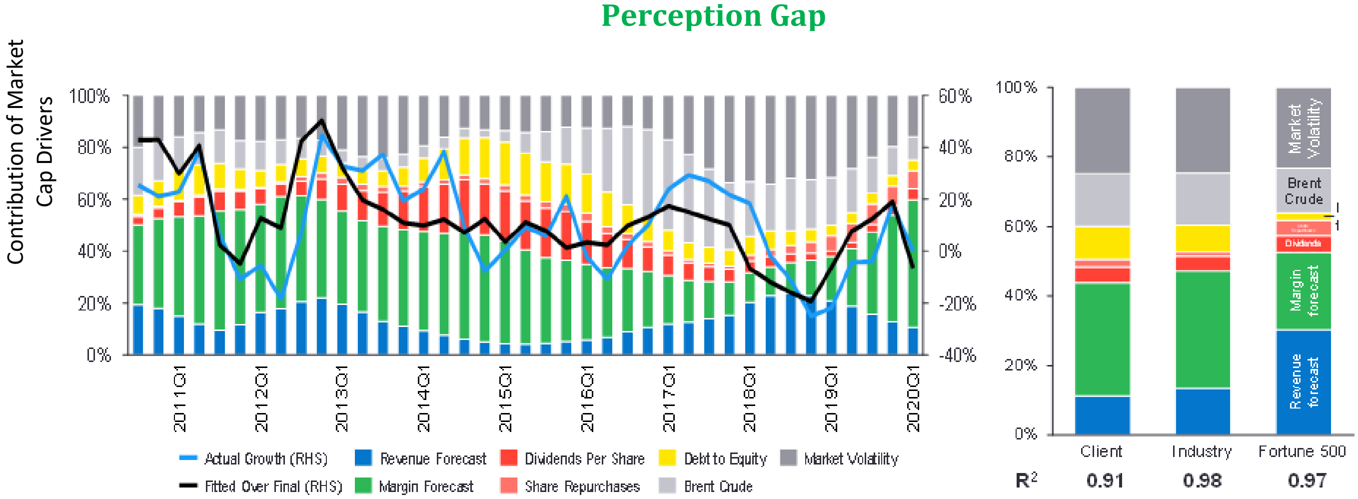

Figure 6 - Market Valuation Drivers

Understanding the market context and the three gaps gives a strong indication of the current situation and potential for a company. Building off this core, FPP™ supports the exploration of alternative strategies to achieving full potential for a business and portfolio of businesses using a range of analytics from our *Full Potential Value™* depiction (*Figure 7*), *Operating vs Transactional Value* and our sophisticated *Portfolio Optimization Simulator*. Using a range of sophisticated techniques from game theory and dynamic business modelling to scenario planning, as well as market leading valuation approaches, we can develop various strategies which could bring a company to its full potential value in revenue growth, margin and market valuation. The *Full Potential Value* diagnostic allows us to visually explore a range of scenario impacts on revenue and margin. The *Operating vs. Transactional Value* diagnostic similarly enables a visual comparison of the likely value of a range of assets, comparing the sales to operating value of those assets. *The Portfolio Optimization Simulator* allows us to model a large range of asset transactions, including acquisitions, divestitures and even asset "swaps" across an industry and then to visualize the impact of those transactions using the full range of Full Potential Paradigm™ diagnostics.

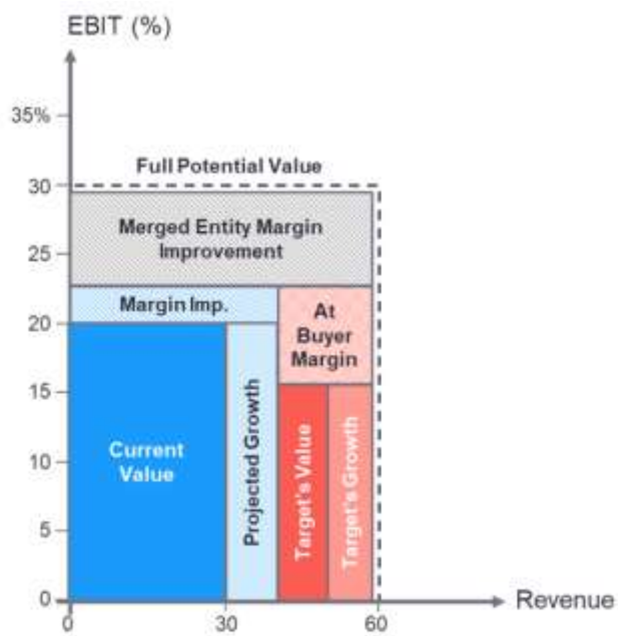

Figure 7- Full Potential Value

Summary

Taken together, the Full Potential Paradigm™ offers a robust, objective, and quantitative framework for examining, developing, and exploring a range of strategic alternatives for a company. Developed and proven over decades of successful partnerships across a range of industries, it has proven to be a valuable toolkit reliably delivering strategic insights. Working with Acropolis Advisors, the creators of the framework, allows a management team to rapidly and efficiently understand their strategic situation across a sophisticated portfolio and realistically address their strategic options with remarkable clarity.