Global Stewardship – monthly bulletin

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Investing in the Age of AI

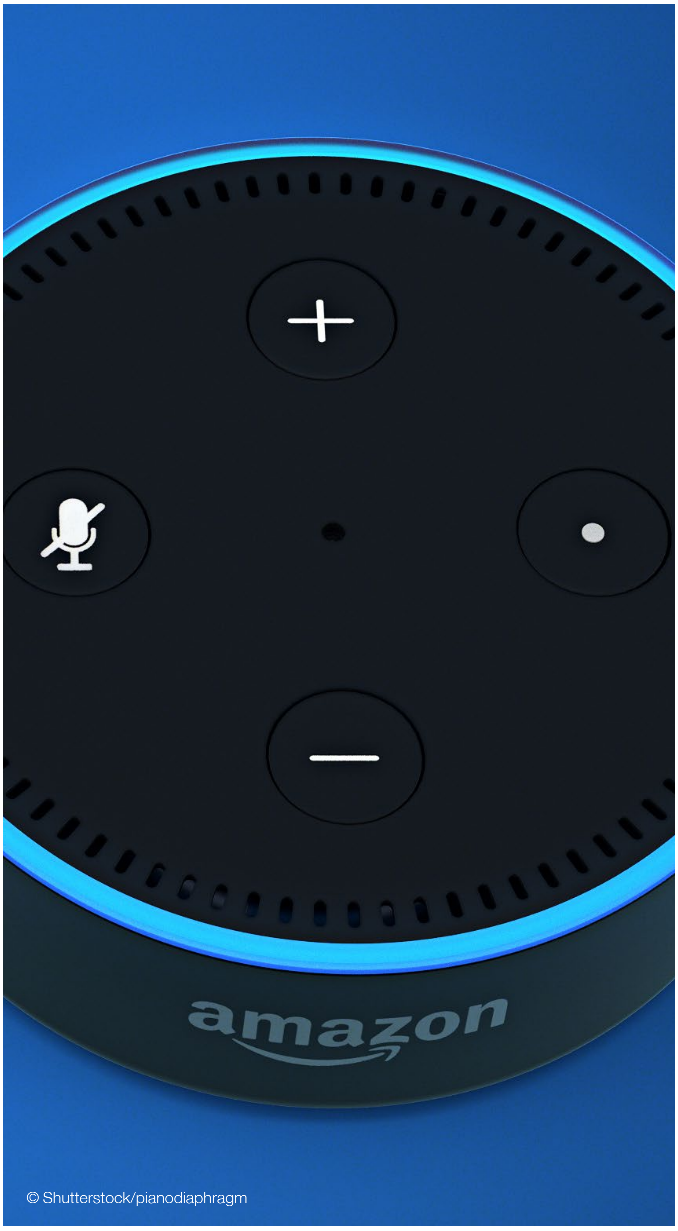
As long-term investors, we have to work hard to step back from the incessant noise of daily market news flow. One way in which we seek to do this is through book discussions. During August, members of the Global Stewardship team got together to discuss *Competing in the Age of AI* by Marco Iansiti and Karim R Lakhani. This is highly relevant, given the preponderance of technology-focused firms in the portfolio which are having a significant impact on many aspects of society.

Competing in the Age of AI outlines the emergence of a new breed of firm which is structured around data: its collection, analysis and usage in driving improvements in the company's core operations, as well as forays into new business ventures. This goes beyond a narrow traditional definition of a 'tech company', encompassing retail, pharmaceuticals, financials and entertainment – essentially any company with sufficient vision and leadership has the opportunity to reorient itself and become an AI factory.

The book also makes it clear that this is far from easy, and that incumbent companies will find it very tough to transform in this manner. It describes 'architectural inertia', saying, "as organisations become good at doing something in a certain way, they develop routines and systems that reinforce each other and make it difficult to do things differently."

This is consistent with our thinking in a couple of different ways. First, on the importance of company culture and the benefits of the presence of a founder/manager with a controlling stake. The book repeated the famous 2002 memo by Jeff Bezos at Amazon, demanding the entire company effectively start again from the ground up, rebuilding its retail and other business units on top of a software layer that would break down silos and open up access to data both internally and to external customers. But examples of such vision, combined with the drive and influence to follow through on it, are extremely rare, hence our central philosophy of investing in a small number of truly special companies.

Second, it provides support for our belief that tech-driven disruption is far from over. If legacy firms cannot or will not revolutionise themselves in the manner of Amazon, then that provides an opportunity for the newcomer who has the benefit of starting from a blank sheet of paper or, more accurately, a blank server. As one of the team put it, it's a reminder of one of our core advantages as high-conviction long-term growth investors: we can buy the leaders and ignore the laggards.



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Our preference for the challengers has been clear in the portfolio for many years, from Amazon and Alibaba in ecommerce, Spotify and Netflix in entertainment, Hargreaves Lansdown in finance, to Zalando and Wayfair in fashion and furniture retail respectively. It is also apparent in more recent investments, such as Twilio in communications, Affirm in payments, Ocado in food retail and Workday in human resources. Moreover, the book provided an interesting framework to help consider strategic networks, taking in analysis of learning effects, network clusters, the risks of multihoming and disintermediation, and the potential for network bridging – the latter perhaps the most exciting, allowing the firm to evolve from a narrow service to a widely-used hub.

As sustainable growth investors, we were particularly interested in the sections within *Competing in the Age of AI* which covered the ethics of data and AI, and the need for greater leadership on this topic. We have long considered data governance to be one of the key ESG issues facing many of our holdings, and this has been a significant element of our programme of engagement. Again, the book was helpful in providing a framework for our thinking and conversations with companies in this area, categorising some of the risks. For example, digital amplification, cybersecurity and platform control were all covered, while our discussion gravitated towards the challenges of algorithmic bias. Monitoring and regulating this will be daunting given the complexity of the computing involved, and Andrew Cave, head of our ESG team, noted that it has led him to think about what role a generalist non-executive board member can play. Is it reasonable to expect such an individual to truly interrogate the software?

There was general agreement among the team that we should expect our companies to 'step up' on this issue. Only if the leaders of the major technology firms work in the interests of all stakeholders, and with rather than against the authorities, will we be able to design an appropriate and effective set of guard rails for this new breed of business. To finish on a positive note, our investment framework – which explicitly considers impact on society, treatment of stakeholders, and company culture – means a consideration of these questions is a fundamental part of Global Stewardship. We believe we are well-placed to both identify the incredible opportunities of data and AI, and where there are challenges to tailor our engagement activities to help provide a positive influence.

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