

# Global Innovation

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## Shopify – the engine of ecommerce refocusing on its core

**Innovation cash kings of the next decade** - *In our new series we look at the standout companies that are 'pivoting to profit' and are at an inflection point of converting customer-driven innovation into shareholder value. This week we take a closer look at Shopify.*

Returning from Silicon Valley in October last year, we were struck by the number of companies we met refocusing their businesses on 'profitable growth' after years of 'growth at all costs.' This was a seismic shift in the narrative of management, and a necessary one: 2022 was bruising for technology companies who were faced with the sharpest interest-rate hiking cycle in history combined with a climb down from unsustainable covid-induced demand.

Almost a year on, we are starting to see the impacts of this shift come through in improved operational efficiency. The key question we are now asking is whether 'pivoting to profit' sacrifices a company's ability to grow. Does the customer value proposition remain intact when investment dollars are stripped away? We believe that innovators who have not just cut costs but are finding more productive ways to achieve similar growth are excellently positioned to capitalise on the new technology cycle we have just entered.

Shopify has taken some of the most dramatic actions across our holdings in the past twelve months to refocus on its core business – being the essential ecommerce infrastructure for merchants. Headcount reductions have been deeper, began earlier and have lasted longer than their peers; inefficient marketing expense has been culled (leading to a 50% payback improvement on paid advertising), R&D has been diverted away from wasteful projects. The company has gone through its operating expenses with a fine toothcomb, taking out 10% in the last quarter alone.

Most spectacular though – underscoring the agility we look for in innovators – was the transformational decision to sell Shopify's logistics division in May. What was the rationale? Logistics was a side quest, not Shopify's main quest. This capital-intensive project could not be justified as core. Overnight, the company once again became an

asset-light platform with management expecting free cash flow profitability for every quarter in 2023. We expect this number to inflect meaningfully at the turn of the year when logistic capex falls out of the equation entirely.

Has this dented the customer value proposition? On the contrary, these actions have enhanced it. Shopify is now 100% focused on its original mission – to make commerce easier for merchants by becoming their retail operating system. Naturally, we wanted to test the platform’s ease of use ourselves, and so the Global Innovation team set up our very own Shopify store, ‘Innovation Bits & Bobs’, to sell the one mandatory product every Brit needs – umbrellas. The whole process was so simple we had to resist the urge to follow through on a career change. For just \$39 a month, we were able to set up an online storefront with just a few easy clicks and could instantly sell our umbrellas across multiple channels. Shopify takes care of everything: its single integrated back end allows merchants to source products, manage inventory, process payments, ship orders, access financing and discover buyers, all through one dashboard.

Perhaps more insightful than the ‘review’ by ‘Innovation Bits & Bobs’ is what merchants are telling us about the platform’s value. More and more merchants are joining the Shopify ecosystem, an increasing number are upgrading to Shopify’s enterprise offering, and the fact that the company’s take rate recently hit a record high demonstrates the inherent value of solutions offered to merchants. Revenue is growing at a healthy 30%. Price hikes in April were swallowed with no customer attrition, attesting that the value-to-cost ratio of Shopify’s product is very much from the side of value. This is precisely what we would expect from a company whose playbook is textbook low-end new market disruption.

With the ratio of revenue to operating expenses reset at a sustainably more profitable level, lower capital investment requirements going forwards and a large runway ahead for a company leading the democratisation of commerce, we think that Shopify has turned a critical corner. We have long believed in the power of the company’s compounding machine where it grows alongside its merchants; that growth is now set to be much more profitable.

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