Quarterly Report

Castelnau Group Limited

31 December 2022

Introduction

This report concludes our first full year and coincides with the bid for Dignity, which we deal with in some detail in the report. Because of that process we are operating under additional restrictions on how we report to you, and this report has had to go through more external scrutiny than usual. The result is that it is coming to you later than usual, for which we apologise. Despite the restrictions, we have gone to some lengths to give you as much information as we can to judge what we believe is a hugely positive development for you.

As well as offering Castelnau shares to eligible existing Dignity shareholders as part of the bid, we are also undertaking a placing of new shares for eligible existing and new investors. We will be organising meetings for investors who are interested and able to participate in the offer.

We hope that you find that the report is helpful in understanding what is a unique and unusual beast. In time we will define ourselves by our actions and record, but for now we realise that you take a lot upon trust and faith. We don't take that for granted and we are determined, as in all we do, not to let you down. We have in Castelnau, we strongly believe, a portfolio of future greatness that will generate exceptional returns for long term shareholders, the onus is on us to demonstrate that.

2022 Q4 Financials

Table 1: Summary Overview

	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Q4 QoQ Change
Net Assets £m	£155m	£142m	£138m	£138m	0%
Net Assets /share	£0.84	£0.77	£0.75	£0.75	0%
Share Price	£0.95	£0.83	£0.81	£0.69	-14%
No. of shares	184	184	184	184	0%
Market Cap	£175m	£153m	£148m	£127m	-14%
Prem / Disc	13%	8%	8%	-8%	
Assets					
Equities	£115.3m	£118.6m	£116.9m	£122.7m	5%
Loans to Subs	£5.4m	£5.2m	£6.9m	£10.1m	47%
Cash & Equiv.	£36.3m	£20.7m	£16.2m	£7.6m	-53%
Share Price (£)					
Dignity	£5.05	£4.04	£3.75	£4.15	11%
Hornby	£0.33	£0.30	£0.29	£0.29	0%
Phoenix SG (unlisted)	£2,366.00	£2,239.71	£2,261.38	£2,014.16	-11%
Cambium (unlisted)	£1,047.06	£1,251.81	£1,250.99	£1,062.90	-15%
Ownership					
Dignity	21%	21%	21%	21%	
Hornby	55%	55%	54%	54%	
Phoenix SG	60%	60%	63%	63%	
Cambium	35%	60%	60%	60%	
Rawnet	100%	100%	100%	100%	
Ocula	77%	77%	77%	67%	

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Table 2 below shows a breakdown of the Castelnau NAV by Asset.

Table 2: NAV Breakdown

Asset	2022 Q3 £m	2022 Q4 £m	% of NAV
Dignity	38.9	43.0	31.2%
Hornby	26.3	26.3	19.1%
Phoenix Stanley Gibbons	21.5	19.2	13.9%
Showpiece	0.0	0.0	0.0%
Cambium Group	24.1	20.5	14.8%
Silverwood	0.0	2.2	1.6%
Rawnet	6.1	6.6	4.8%
Ocula	0.0	4.9	3.6%
Total Equities	**116.9**	**122.7**	88.9%
CGSL		0.1	0.0%
Prepaid Fees		0.0	
Loans to enabling companies	6.9	10.1	7.3%
Cash	16.2	7.6	5.5%
Short Term Bonds	0.0	0.0	0.0%
GAV	140.0	140.5	
Accrued Liabilities	-2.5	-2.5	-1.8%
NAV	137.5	138.0	

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Table 3: Castelnau Q4 2022 'Look-Through'

	Pro-Rata Castelnau "Look-Through" ↓	listed stakes			unlisted stakes				
		Dignity	Hornby	Silverwood	Phoenix SG	Cambium	Rawnet	Ocula	Showpiece
Castelnau (CGL) Ownership stake		21%	54%	17%	63%	60%	100%	67%	100%
Employees	1050	3,375	210	3	61	180	70	19	9
Sales annual run-rate	**£112.2m**	£275.0	£53.7m	-	£12m	£23.5m	£4.9m	0	0
per CGL share	£0.61								
underlying Pre-tax profit *run-rate*	**£3.2m**	**£20.0m**	**-£0.5m**	-	**-**	**-£2.0m**	**£0.5m**	**-**	**-**
per CGL share	£0.017								
# CGL shares (m)	184								
CGL Share price (latest)	**£.69**								
CGL Market Capitalisation	£127m								
CGL NAV (31/12/22)	£138.03m	£43.0m	£26.3m	£2.2m	£26.3m	£20.5	£6.6m	£4.9m	-
CGL NAV per share	**£0.75**								
premium	-8.0%								

Source: Phoenix Asset Management Partners Ltd.
Past performance is not a reliable indicator of future performance.

Dignity

Buying control of Dignity plc is a game changer for Castelnau Group in so many ways. It brings together all the best of what Castelnau is about in a transaction that will change our scale and add considerably to upside value.

The NAV of Castelnau Group fell 20% in 2022 (from 94p to 75p) despite the cheapness of the starting assets. That was caused by a fall in the share prices of our listed holdings and an adjustment in the valuation of our private holdings. Because the public market prices declined and interest rates rose, the discount rate used to value our private company holdings was increased by around 5%, e.g. where it was 15% it was increased to 20%. Intrinsic value did not decline.

Using our estimates of intrinsic value Castelnau Group shares are worth considerably more after the Dignity bid than before. We would like to be able to share those intrinsic value calculations with you but as Castelnau is a bidder for Dignity, offering its shares as an alternative to cash, then we are not permitted to do that under the rules laid out by the Takeover Panel. We will do it though when the bid process is over, as we do in Phoenix.

The impact of this transaction will be to increase the proportion of the fund held in Dignity to over 60% and it will represent around 75% to 80% of the intrinsic value. Given the enormity of that, we will focus on Dignity in this report.

Suggesting that we have the potential to transform your £1s into multiples of that, and do it in a fairly short time frame, 3 to 5 years, is a bold and seemingly overconfident assertion that requires proper explanation. Even those who know the Dignity story well and understand the value potential will want to know how inside Castelnau that will translate into observable and realisable gains. We aim to cover all of that.

The rules that we are constrained by in our communication with you right now (from the Takeover Panel regarding the bid and the FCA regarding the placement) stop us just laying out what we see those values being, but we will do our best within the rules to convey the significance of this to you. We are partially helped by using the presentation at the 2021 Dignity AGM by the CEO who at that time was Gary Channon. Gary is also the CIO of Phoenix. In that presentation he used a Phoenix style methodology to talk about the potential intrinsic value of Dignity should the strategy be successfully executed.

This divergence in the current valuation versus the potential intrinsic value (as referred to above) came about because of a confluence of factors including delays in executing the strategy, staff shortages, a rise in input price inflation, especially employees and energy, and the slow pace of the capital restructuring work. Taken together, these put strains on Dignity's current financial position which can be seen in its published results. That difference between share price and potential intrinsic value reflected the market's scepticism about the likely success of the strategy and perhaps a concern that it would need more capital to get there.

The value creating formula at Dignity though can be summarised in this way. The business has high operational gearing and so growth translates into profits at a high marginal level so that modest growth causes big gains in profits. The best way to grow is to earn the right by being the best and drawing attention to that. Gaining customers starts with funeral plans which feed into funerals and growing funerals grows activity at the crematoria. Dignity is being positioned to earn and deliver that growth.

Gaining control allows us to do a number of things which we believe change the probability of success very materially. Operating with control and partnering with Sir Peter Wood and his team allows us to speed up strategy execution and bring more resource to assist the Dignity executive team. There is a lot being changed at Dignity which would challenge the bandwidth of any executive team.

We have a clear vision and a detailed plan for Dignity which, if successfully executed, increases the value into the range from that AGM presentation.

Execution, i.e., the ability to get things done, is an underappreciated differentiator in business. At Castelnau we use a system in all our businesses called OKRs (Objectives and Key Results) which John Doerr taught famously to Google and wrote about in his excellent book, Measure What Matters. He learned it at the foot of a true master of high-performance management, Andy Grove of Intel who is considered by some to be the best CEO of all time. He shared with Doerr what he considers to be the single most important lesson of his career. He said, "John, it almost doesn't matter what you know…it's execution that matters most."

The transformation of Dignity, from a group in terminal decline and losing share in all its activities, into the UK's leading end of life business, growing share on the basis of merit by offering the best proposition to the communities it serves, is well underway. It is worth putting what has happened so far into perspective.

A top-down hierarchical organisation arranged into divisional silos has been inverted, those silos abolished and rearranged into around 180 separate local businesses. Almost all of the most senior leadership from 2019 has left, around 300 middle management roles have been abolished and every one of those new local businesses has run a process to appoint a new business leader. Those business leaders are empowered to serve families and build successful funeral and crematoria businesses in their area. That process took longer than initially forecast but is now done and it is no surprise that it was disruptive.

When your aim is to make a very significant change to an entrenched organisational culture, then it is thought best to start by dramatically smashing up what went before. We have certainly done that. At the same time the company has laid out the Company Principles that define what the new culture will be. The work now is to teach, embed, train, recruit and retain for that new culture. The Company Principles focus the group on serving families, the ultimate customers of the group, and doing it in way that empowers those closest to them.

Funeral Plans

The strategy of growth starts with funeral plans. Phoenix drew the Dignity board's attention to poor practices in the funeral plan division, including using unscrupulous third-party telephony partners in early 2021. Those warnings were ignored but following Gary's appointment in April 2021, Dignity withdrew from all those relationships immediately. Most of the people involved in that activity have now left Dignity.

The focus in 2022 was in getting ready for FCA regulation and introducing a new and innovative product as well as helping where other players went into administration. Taking an organisation the size and complexity of Dignity into financial regulation for the first time in such a short period put an enormous strain on the organisation, then completely changing the nature of the funeral plan product and the way it is presented and sold added to the challenge, and on top of that all of the rescue operations of other funeral plan companies have added to the strain and inbound workflow at a time when the company was struggling to recruit. However, that puts the company in the position to now push for growth in 2023. The product proved highly popular even before any marketing has been started.

Our goals in funeral plan sales are not just based upon growing share, they are also based upon raising the very low penetration of the product in the UK population compared to other countries. Regulation has changed the nature of the proposition and now we must widen the group of people considering them. Dignity's new product is based upon designing how you want your life celebrated but first we need people to be thinking about that. Sir Peter Wood has a great track record of changing the way financial products are thought about and purchased, and following this transaction is ready to help Dignity do that.

What is happening in funeral plans at Dignity is a great example of what we think the Castelnau and now SPWOne involvement can do. Firstly, we stopped poor practice and let the wrong type of people go, we took the best of what is within Dignity (and there are a lot of good people in Dignity) and we brought in some people from within the Castelnau Group to help with everything from product redesign, software development and financial structuring. Dignity was led through this process initially by Gary and then by Kate Davidson the new CEO who, having worked previously at Dignity, knows it strengths and weaknesses well and was able to bring about such enormous change in such a short period of time. What has been created is, we believe, the best proposition in the market and so adding Sir Peter and his team to that will allow us to grow it substantially with all the knock-on benefits that brings to the group. We have also drawn upon our network of contacts from various fields at different times to help us with our work at Dignity.

Funerals & Cremations

Growth in funerals and cremations is based upon having the best proposition. That includes everything that families value starting with people and including premises, price, reputation, facilities, vehicles and products. Rearranging over 900 locations including funeral homes, crematoria and service centres into independently led and branded businesses, of which there are around 180 has been seismic and the investment in the proposition is still underway. Around 10% of the network was closed or is being closed.

Each local operation is also going through a branding operation to tap into their heritage and present themselves freshly and uniquely, which results in new websites and facias. These started showing up in number as 2022 ended and the exercise will be largely complete during 2023. The branding combined with local community engagement and marketing will build those brands' reputations within the markets they serve on top of the goodwill they generate from the way they serve families every day.

The starting state of the premises and facilities means that this programme is capex intensive and has contributed to the capital need of the business. There isn't an alternative to not doing it and moving slowly ultimately costs value and slows the turnaround, so it is capex with a high return, and it is all scrutinised for expected return before being signed off. A thoughtful approach to capital allocation is one of the contributions we have been able to make.

The restructuring of the business occurred at a time of a very tight labour market and another year of an elevated death rate which we expected to decline after Covid. This left the teams doing funerals severely understaffed, vacancies at the worst point were over 400 positions which meant that funerals were being turned away and the turnaround time for funerals extended. As we addressed the issue of pay and conditions and changed the recruitment strategy the situation started to ameliorate.

We addressed price early and have been refining it since but the impact on average prices per funeral have been dramatic. No one has done more to lower the cost of dying in the UK in the past few years than Dignity and although that's good news for customers and society in general, it was done to restore competitiveness. The goal is to always provide the best value for money across all of Dignity's products and services.

When all is taken into account, the scale of change, its disruption, the shortage of staff and the reduction in the number of trading locations, to have gained market share at all was a great achievement for a business that is used to losing like for like share every year. It wasn't as much growth as we had planned for but that probably says more about the plan than the outcome. In other words, we had unrealistic expectations if we'd known the scale of what was coming. The business enters 2023 in much better shape from a trading perspective but that delay in growth which, with operational gearing, drives profits and cash generation has left the business short of capital which we intend to address post the bid.

The separate work on deleveraging Dignity's capital structure has also taken longer than we envisaged. Not because it wasn't pushed, it has been pushed hard from the Dignity side, but due to external factors and the nature of these things. A deal has been reached with bondholders that allows Dignity to sell a portfolio of crematoria to an investment buyer, Dignity will still run them, and those proceeds used to reduce gearing and thereby the financial hurdles that have constrained the Group. At the same time, a number of other changes will happen to the securitisation that will allow Dignity to operate more rationally in a variety of ways. That process must be completed within 12 months and that is what we expect.

We have never bought and may never buy again a business with which we are so familiar and where we have such a clear plan to turn it into the great company that we believe it will be. All of the challenges and delays above and their financial consequences have reduced the value that the stock market has put on the business. This comes at a time when the UK stock market puts low values on businesses, especially UK businesses, in general. That has given us the opportunity to pay a significant and fair premium for control and at the same time expect a very attractive long-term return.

We will be valuing the Dignity holding monthly and reporting to you on it quarterly. We expect the value creation to be showing up in those values and reports. At some point the consortium (the name given for our bidding partnership for Dignity, i.e. SPWOne, Phoenix and Castelnau) will seek some form of a value realisation event, although its form is not being discussed at this point. One avenue would be to partially relist the company, having transformed it and grown its profitability. For our part, Castelnau's current intention is to hold onto a majority holding in Dignity in perpetuity (as we state with Cambium, Hornby and Stanley Gibbons).

Liquidity

We realise that a discount could emerge between the rising NAV of Castelnau and the price it trades at. We don't want investors to back the deal to buy Dignity, for the value creation to be shown and then not to be able to receive those gains and so we plan to have a partial liquidity event in 3 years' time where Castelnau will probably tender for shares. The details of such a partial realisation event are still being worked out and we will take soundings from investors in due course on the best form of this.

We believe this to be a great opportunity for Castelnau shareholders, old and new. We expect returns in Castelnau materially greater than we have been making in Phoenix. As Castelnau is a holding of Phoenix portfolios then that will benefit all investors. The acquisition turbo charges the value creation path we were already on.

The Rest of the Portfolio

The transformation work at Castelnau starts with the right people and it has taken us a frustratingly long time to get the right CEOs for two of our holdings, but they are now in place. Tom Pickford joined Stanley Gibbons in October 2022 and Olly Raeburn joined Hornby in January 2023. They join Kate Davidson who became CEO of Dignity in June 2022 and Anne-Marie Jenkins who has been the Cambium CEO since 2015. If you come to the Annual Investors Meeting in March they will all be there.

Tom has set about building the plan to realise the vision for Stanley Gibbons to be a world class leader in collectables. He has begun the process that will set out the principles that will define their culture and he has recently made some significant restructuring changes with personnel that has reduced the headcount. Olly has just arrived and is in listening mode.

They both inherit businesses that we have got at least to base camp; they were previously very unprofitable and in terminal decline and both can now wash their faces / make modest profits. They both have the potential to be much bigger, they serve markets with great opportunities to expand. The time it has taken to stabilise them both and find the right leadership has been frustrating but in 2023 we expect to see material progress in the way you saw at Dignity in 2022 as strategy was formed and executed.

Cambium grew sales strongly in 2022, total pledges reached £49m up from £35m in 2021. But the huge disruption caused by supply chain problems and the sudden resumption of weddings in 2021 initially caused major problems for customers and ended up in complaints and poor reviews. For a company whose culture is so customer focussed this caused deep distress. A team which we had to shrink almost in half to survive the pandemic was then under severe pressure and that's when culture is a more powerful force than strategy.

Their response is a great case study in what happens if you make the customer your north star. A read through the Trust Pilot reviews of their gift list brands (The Wedding Shop, Prezola, and The Wedding Present Company) during the year showed you how a business that started out by getting slammed with 1-star reviews responded and ultimately turned them back into 5-star reviews within the year. Once again, the biggest source of new registrations is now recommendations showing the strength of a good reputation and delighted customers. That effort postponed the return to profitability because it required investment in human resource but in the long run it will have been well worth it and operational efficiencies are now again being achieved.

In 2023 the business will extend into the baby arena and hopefully be able to utilise some of that goodwill with couples it has already delighted. The business is also extending its reach further up the wedding planning process in order to increase the number of people considering a gift list. It is doing this through its popular Rock My Wedding wedding advice business and Hostology, a platform for wedding venues to manage weddings on.

Summary

All four core businesses in Castelnau are well positioned for the coming year and years beyond. We expect growing sales and profitability across all of them. They all serve large markets and have big opportunities to expand into in value creating ways. With all the leadership teams now in place the Castelnau effort will be more effective as it has been at Dignity and Cambium. Our two enabling businesses Rawnet and Ocula are doing well and growing. Rawnet is increasingly profitable and Ocula has been expanding beyond Castelnau, signing external customers and will shortly announce a very important new partner who is joining us in backing them.

2022 was a formation year for Castelnau, including with our own team. A huge amount has been done but you may rightly conclude that not much seemed to happen in what really counts, which is growth in value at a per share level. We believe that we have put in place the conditions for that value to start coming through and buying Dignity will take it to a whole new level. We will update you openly and honestly whatever path it takes but we have never been more excited about the future. More than ever, we believe in our mission that we can find businesses that can be bought for attractive prices where we can add materially to their value by applying all of the best of what we have learned from studying others and by being practitioners ourselves. If we succeed you will hold a portfolio of great companies compounding your value into the future, those currently in the portfolio being joined occasionally by new candidates provided that we have the bandwidth to handle them. For now, we have our hands full.

Thought Piece:
Customer-centricity

Shoulder of Giants

In our inaugural Castelnau report last year, we referred to the debt that we owed to some giants of the business and investment world whose shoulders we metaphorically stand on. Giants such as Messrs Rales, Singleton, Barber and Leonard whose values and methods continue to teach us so much.

One giant that went unnamed in that report was Jeff Bezos, a businessman who many rightfully laud to be among the best business leaders of the recent era.

Amazon's wide moat, 28 years after its launch, remains in no small part a result of Bezos' obsession with prioritising what seems a very simple business proposition - keeping customers happy.

Putting the customer first has become a trite expression these days - yet it is the linchpin of some of the widest business moats.

Bezos was on Two Others' Shoulders!

In an effort to understand this customer centricity concept properly, it seems important to realise that Bezos was not its true pioneer, nor was the man who introduced him to the concept in 2001. Rather the true pioneer was that man's boss and predecessor - Mr Sol Price [1916-2009] founder of Costco and its predecessor Fed-Mart.

As the dust sheet of Price's 2012 biography rightly says, Price was "arguably the most creative mind in twentieth century retailing". As evidence of the man's genius, his values live-on in the business that he first opened in 1954 and in the impenetrable moat that surrounds Costco to this day.

In 2001, seven years into Amazon's corporate life (and 40 years into Costco's), Bezos met with Jim Sinegal (then Sol Price's successor) in a Seattle Starbucks cafe. Brad Stone's *Everything Store* book recounts Senegal's advice to Bezos that day:

"My approach has always been that value trumps everything. The reason people are prepared to come to our strange places to shop is that we have value. We deliver on that value constantly. There are no annuities in this business."

The story goes that by the following Monday Bezos cut prices on all books, CDs and videos by 20-30%. Urban legend or not, the gist of it seems spot-on. Most observers can also now see with hindsight the strong similarity between Amazon Prime and Costco membership and the deep influence that Costco had on Amazon's strategy.

So, can we understand a little better the how of Price's steadfast obsession with delighting his customers? Indeed it is the very steadfastness that really interests us - how to make it last. It might be easy (ish) to delight a customer for a year. But can you keep doing it for six decades. It's the duration of something that really creates value.

The Golden Rule

Charlie Munger is approaching his 25th year as a board member of Costco and regularly refers to the company's unmatched excellence during interviews and meetings. If one pays close attention to Munger's comments on Costco, what is interesting is that Munger tends to emphasise the quality of the company's ethics more so than its strategy. That nuance might seem quaint but actually it is incredibly profound and absolutely pertinent to Costco's success. Costco's success is almost entirely derived from the values imbued by its founder.

In short, Sol Price's values represented The Golden Rule - that is: *"treat others like you would like to be treated yourself"*. It sounds glib to some but in reality it is possibly the most profound insight into humanity. And Sol Price showed that it works in business too. Treat customers well, consistently, and they will reciprocate with their loyalty.

Robert Price, Sol's son, wrote in his biography, "*whereas most retailers saw customers as adversaries, bodies to be sold to, Price saw the world differently. He felt he was on the customers' side. He felt his job as a retailer was to become the customers' greatest friend and in return pledge his loyalty back*".

Retailer as Fiduciary

Maintaining this attitude to people requires a truly authentic value system and so it is useful to realise that Price married two key value systems in his approach to business: ethics and law.

Price, a trained lawyer, saw himself as a fiduciary working on behalf of his customer with *"a duty to be very, very honest".* Using the fiduciary model seems an extremely creative way of thinking. Nowadays most people's idea of being a fiduciary is of being a burden, the cost of being an agent. Price saw it as a virtue, and end in itself. When you think about Price and his business strategy in this light, it shows why such strategies are so hard to emulate and why Price's integrity and virtue remains so valuable and sought-after in the business world.

Robert Price, again in his biography of his father Sol, wrote: *"Sol's experience as an attorney representing clients, and his own moral code, became a foundational feature of the FedMart business. Sol described his business approach as "the professional fiduciary relationship between us (the retailer) and the member (the customer). We felt we were representing the customer. You had a duty to be very, very honest and fair with them and so we avoided sales and advertising. We have in effect said that the best advertising is by our members...the unsolicited testimonial of the satisfied customer. This fiduciary relationship with the customer was similar to the Golden Rule; the way Sol put it—if you want to be successful in retail, just put yourself in the place of a cranky, demanding customer. In other words, see your business through the eyes of the customer."*

It's About Humanity

Integrity is not something that can be formed or evaluated by an algorithm. It is a purely human initiative. So for fun we turned to an AI bot to see what it had to say on the matter. We asked ChatGPT "what is the best way to measure customer delight". Sure enough, it gave us a pitch perfect answer, guaranteed to get someone through their business studies year 2 exams. It is a great demonstration of the 'simple, but not easy aspect' of all of this. Of course we can look to NPS, Trustpilot rankings and the like to inform us, but ultimately a true customer-first approach requires an unwavering human empathy behind it.

MA what is the best way to measure customer delight?

There are several ways to measure customer delight, including:

1. Net Promoter Score (NPS): This measures customer loyalty and is based on the question, "On a scale of 0-10, how likely are you to recommend our company to a friend or colleague?"
2. Customer Satisfaction (CSAT): This measures how satisfied customers are with a specific interaction or experience. It can be measured through surveys asking customers to rate their satisfaction on a scale.
3. Customer Effort Score (CES): This measures how much effort a customer had to put in to get a problem solved. It can be measured through surveys asking customers to rate their effort on a scale.
4. Customer Retention: This measures the percentage of customers that continue to do business with a company over time.
5. Repeat Business: This measures the percentage of customers that come back to make a repeat purchase.
6. Referral Rate: This measures the percentage of customers that refer others to the business.

It's important to note that, having multiple metrics to measure customer delight can give a more comprehensive view of the customer experience.

Source: Chat GPT

The Customer Contract

Munger once told an interviewer that Costco had one big advantage over Amazon - Costco was trusted more. In effect, Costco has a form of implied 'Customer Contract' in place between it and its customers (members). This is perhaps analogous to the social contract said to exist between governments and their citizens. Costco members trust that they will always get the best value from a Costco warehouse.

This is why the famous Costco '$1.50 for an in-store hot dog and soda' saga (unchanged in price since 1995) is so important - it symbolises the contract. Were it to change, it would signify a break in the contract. This explains the seemingly ridiculous lengths the company goes to to maintain the proposition. We are all familiar with funny anecdotes of Costco executives discovering a new price reduction in some obscure product and trying to keep it as margin rather than passing on the saving to the member. Invariably every such anecdote end with some form of "over my dead body" response from the manager! It is In the constant resisting of such slippage that Costco differentiates itself from almost every other customer-centric business on the planet. 99.9% of companies would keep just a little of those savings for themselves and thus the rot creeps in.

Obliquity

The mantra that Price (and later Sinegal and later still Craig Jelinek) all cited unwaveringly was focus on the Customer, then employees and then shareholders - in that order. Such obliquity also requires trust from shareholders too. Anyone watching Jeff Bezos' first decade as CEO will appreciate the uncertainty of the approach. It was not obvious at the time but Bezos was investing heavily in delighting his customers through a myriad of convenience, availability and delivery services. The pay-off - the moat - would not be obvious to most until many, many years later.

Whether it's the $1.50 hot dog or the £1.59 pint of Ruddles, whilst they seem irrational actions, these are external signals from customer-centric businesses to their customers that all is well - that they, the customer remains king (and queen).

For the last word we turn to an aforementioned Giant: Mark Leonard. Leonard inverts our idea and cleverly uses happy and loyal customers as a sign of good management.

"this largely dodges your question about management attributes. I despair of answers that are some version of "intelligent, energetic, ethical". I know some great business builders who didn't win the genetic lottery in the intelligence category but compensated with hard work and determination. Energy can be poorly channelled. Ethics seem to get pretty plastic under enough carrot and stick stress. I'd rather use a track record of consistently happy and loyal customers and employees to judge a team. This strikes me as a far better predictor of future performance than psychometric questionnaires or dowsing for cultural fit"

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