

Three growth models

By

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There are three growth models: organic growth, growth through bolt-on acquisitions and growth through strategic acquisitions. No one model is better than any other; each has a different rationale and context, requiring specific approaches, management tools and organisational structures.

1 – Organic growth

This is generally the growth model used by most companies.

It is assumed to be less costly, poses fewer cultural and adaptation problems and is usually less visible in the event of failure.

Unfortunately the reality is more complex, depending primarily on growth in the market.

In mature countries, in businesses with weak growth, winning market share through organic growth presupposes:

- *Overinvestment compared to competitors.* In this case, the cost of growth is likely to be higher than the gains growth brings. There is a risk of resources being poorly allocated and of overinvestment. There is no point making considerable investments in prices, advertising, concept renewal, etc., if you then end up absorbing all the benefits gained from these investments.

In general, excluding the creation of new niche markets, an organic growth strategy in mature countries can result in gains of 3 to 5% in annual growth.

- *Development of a unique business model.* This model makes it possible to grow more quickly than competitors, without significant overinvestment. In this case, organic growth models offer significant advantages.

Take The Boston Beer Company as an example: this niche brewery in the US has employed an organic growth strategy over the past five years by focusing on developing specialty beers. Its core offering (Samuel Adams Lager & Sam Adams Light) has grown by 4% per annum since 2001 (and contributed up to 25% of the company's growth) while the new collections (Brewmaster's Collection, Imperial Series and Barrel Room Collection) contributed almost 75% of growth (see Table 1). This strong growth in niche segments has been aided by the implementation of two different organisational structures: at the industrial level, with mass-production and limited-production runs (lager and light beer, and the collections respectively), and at the marketing level, with a traditional advertising approach for the lagers and segmented advertising for the collections.

In emerging countries, organic growth is less expensive but presupposes a sufficiently robust growth platform. The key is not just strong growth but also faster growth than competitors.

One such example is KFC in China. The company opens around 400 restaurants in China every year and has reallocated 60% of its global investment to the country. It is now structured by region, with regional platforms to select sites, construct restaurants, train restaurant managers and recruit employees.

For organic growth strategies to succeed, a number of conditions must be fulfilled:

- The aims of organic growth must be prioritised and focused on the main sources of growth: emerging countries where the company has a development platform, high-potential segments in mature countries, etc. Organic growth requires operational “investments” which have an impact on the margin. As a consequence, companies cannot make considerable organic investment in all segments; only the most strategically and financially relevant should be chosen;
- Business models must be precisely defined and adjusted to ensure that the planned overinvestment results in the expected gains in market share. In emerging countries, the key is not just to move more quickly than before but to move more quickly and more effectively than competitors. Generally, leaders grow at least twice as fast as the market. Those which are unable do so are marginalised;
- A specific organisational structure must be defined because growth strategies are not managed in the same way as those relating to profitability and the defence of attractive positions. Colgate-Palmolive has been organised by growth zone rather than geographic zone since 1997 (see Table 2). This organisational structure enables each division to focus on the main issues and to develop specific models adapted to different markets: optimisation and segmentation of the offering for developed markets and growth and market share gains in the core business for emerging markets;
- Management tools and performance indicators must be adapted to growth targets. There is no point giving the same performance criteria to an entity which needs to maintain its high profitability in mature countries and to an entity which needs to grow and win market share to attain leadership positions.

2 – Growth through bolt-on acquisitions

As a general rule, this is the growth model which groups put least effort into structuring.

This model requires a large number of small, local acquisitions which strengthen the company’s core business. If “industrialised”, it can make regular, low-risk contributions, leveraging the balance sheet rather than the income statement. It is generally used as a complement to organic growth and is effective in businesses with a large number of small national competitors:

- As a method of concentrating the market in mature countries, it is generally less expensive than organic growth;
- In emerging countries, it can be used as a growth platform or growth accelerator to establish leadership.

For strategies targeting growth through bolt-on acquisitions to succeed, three conditions must be fulfilled:

- A specific “industrial” organisational structure is needed to find, attract and make a large number of acquisitions. It is necessary to define the role of the local entities in relation to the central entities, calibrate them and put an efficient process in place. Generally, the local entities find, negotiate and make acquisitions in collaboration with a central and regional support structure for investment and defined risk-taking;
- A strategy and an organisational structure are needed to “integrate” the acquisitions by developing a high level of autonomy and synergies; this is done by combining the entrepreneurial spirit, market knowledge and expertise of the acquired company with the experience, approach and (often) technology of the acquiring company;
- The capacity to make recurring investments of amounts which are small but will prove to be significant if the strategy is successful. The key is not just to organise the strategy but also to integrate it into a financial strategy. If the global strategy is to make a strategic acquisition, there is a risk of having insufficient financial resources for the bolt-on acquisition strategies; the solution is to focus on a few zones or a few business lines. Failure to do so may result in employees becoming demotivated when

they are consistently refused investment. Conversely, the company risks having insufficient funding for a strategic acquisition if all its investment capacity has been eaten up by small, bolt-on acquisitions.

This is the strategy followed by SABMiller, the South African brewer, since 2000. It has generated growth of almost 15% per annum over the last five years, with a combination of around 10% organic growth and 5% growth through acquisitions. Growth through acquisitions enables a company to provide the growth platform, to quickly consolidate the markets and to acquire good local management. Organic growth (on markets with weak growth) stems from the implementation of centralised in-house expertise in industrial optimisation, development of new products and implementation of marketing approaches tested in other countries.

This is how Google switched from an almost entirely organic growth strategy from its creation in 1998 to 2005 (doubling in size every six months on average) to a strategy combining organic growth and acquisitions (see Table 3). It made more than twenty acquisitions in 2010 and 2011, focused on three main areas (and representing around 20% of Google's growth, i.e. five growth points):

- Technological improvements of the Google platform: PushLife (community interaction technology), Katango (platform synchronisation), etc.;
- Strengthening Google's core business: SageTV (media centre), AdMob (mobile phone advertising), etc.;
- Diversification: eBook technologies (readers and tablets), ITA software (databases for tourism and air transport), etc.

3 – Growth through strategic acquisitions

Often seen as the Holy Grail by senior management.

When successful, this strategy makes it possible:

- To change size, allowing companies to follow a “strategy” of transformation. This makes it possible to move up a division at a stroke;
- To develop synergies if the acquired company is present on the same segments as the acquiring company.

This strategy does not require any specific organisational structure insofar as the high stakes mean that a company's senior management gets involved in the acquisition phase and the whole organisation gets involved in the integration phase.

It is appropriate for businesses which experience positive effects associated with size, when a challenger can catch up with and overtake a leader or when the leader wants to create a significant gap between it and its challenger. It must not be used as a strategy in mature countries to sweep up all those who have fallen behind.

This presupposes that certain conditions are fulfilled:

- An efficient approach in order to succeed in making the strategy a reality in a context with an inherently limited number of targets;
- Sufficient financial resources. Companies must have the financial resources for their ambitions and not have exhausted said resources (or must agree to modify the shareholder structure);
- Holding strong positions in certain places, requiring professional negotiations with competition authorities and potentially the resale of certain shares (if these positions are deemed too large);
- A proactive organisational structure and approach which makes the company the protagonist and not the subject of acquisitions.

4 – Managing different growth models

Each growth model is appropriate for specific situations.

The aim therefore is not to choose one growth model from the three but to combine them in order to adapt to individual contexts.

In mature countries, on segments with weak growth, consolidation through acquisitions is generally the most efficient strategy and the biggest creator of value.

In emerging countries, organic growth from a sufficiently substantial platform is generally the best solution.

Growth through strategic acquisitions makes it possible to consolidate in mature countries and is efficient if the synergies developed do not have to be passed on to clients; it also makes it possible to achieve strong positions in emerging countries. In many industries, the future world leader will be the Chinese leader.

Whatever the situation, two conditions must be fulfilled if a growth strategy is to succeed:

- A portfolio balance which makes it possible to finance the strategy in question. Businesses which are highly profitable and have low cash consumption must finance the growth and profitable development of high-growth businesses. The overall financial equilibriums must be secured (margin, profitability, investment and financing capacity). The main aim is to strike a balance between ambition, growth, profitability, investment and risk-taking, with each strategy having a different risk level and type (and being perceived as such according to the management profile);
- Implementation of an organisational structure, processes, and systems for control, motivation and delegation suited to each growth model. The main aim is to differentiate the organisational structures according to the strategies employed and to define the level of delegation and local resources (particularly in emerging countries) compared to the historical organisational structures.

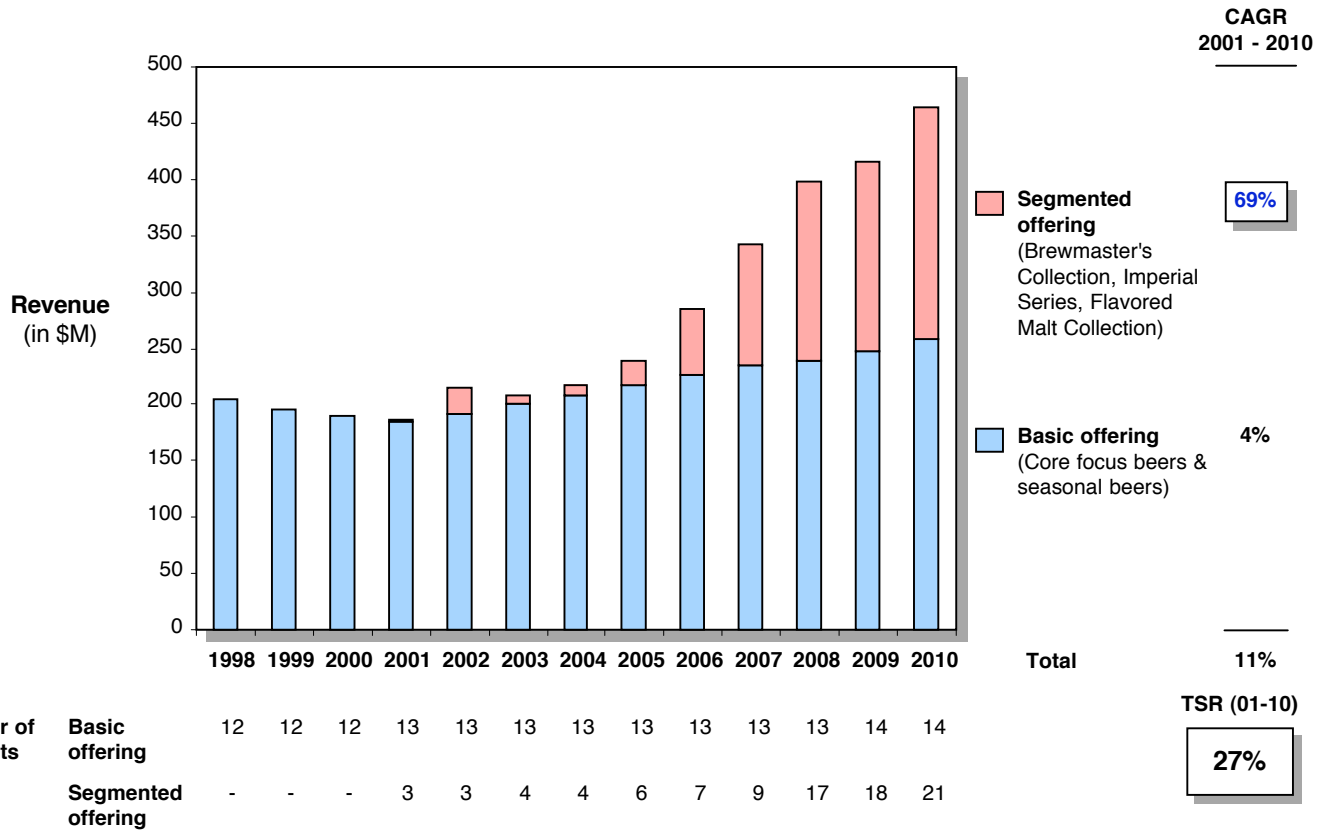
Now more than ever, growth requires making choices not only in terms of allocation of resources but also in terms of organisation and operating methods.

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Estin & Co is an international strategy consultancy based in Paris, London, Geneva and Shanghai. The firm assists the boards of major European, North American and Asian groups in their growth strategies, and private equity funds in analysing and improving the value of their investments.

- Table 1 -

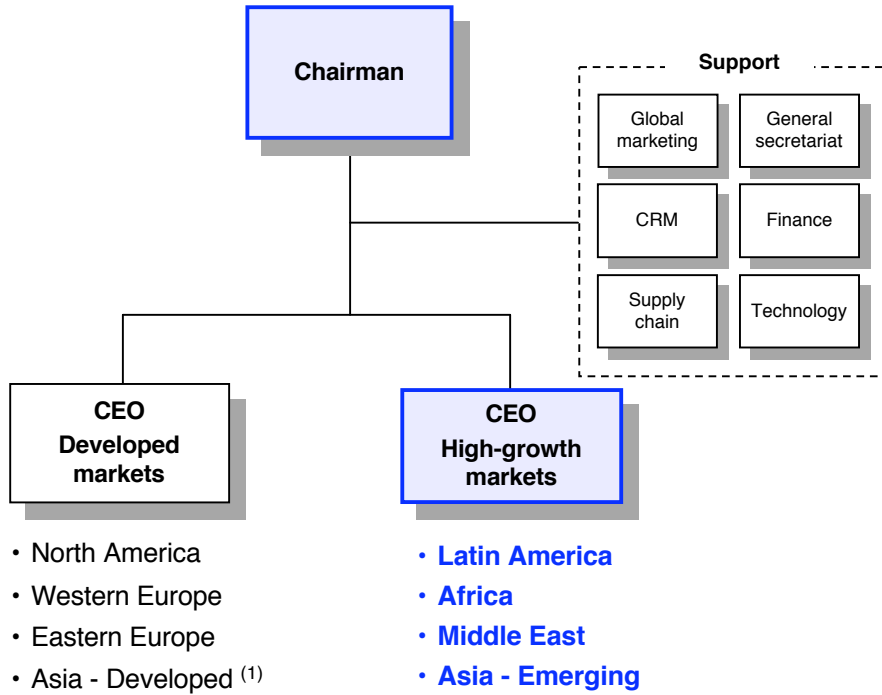
The Boston Beer Company has seen high organic growth by developing a segmented approach



Source: Annual reports, Estin & Co analyses and estimates

- Table 2 -

Colgate Palmolive set up a specific organisational structure for emerging countries



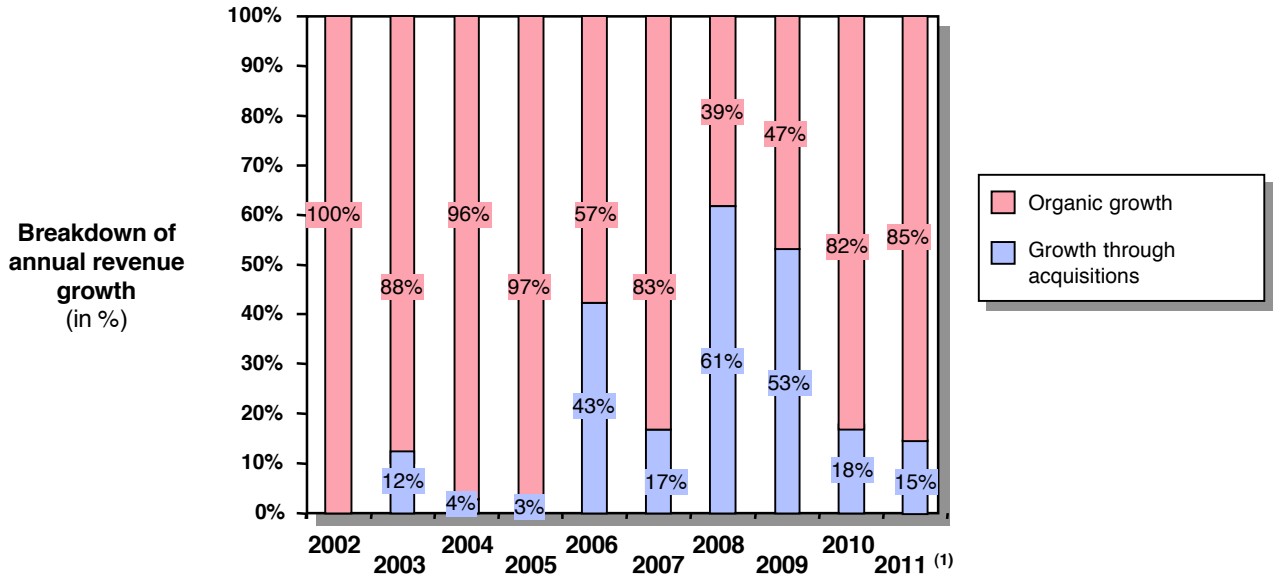
(1) Japan, Australia, New Zealand
Source: Estin & Co analyses

- Table 3 -

Google switched from a purely organic growth strategy to a growth strategy combining organic growth and growth through acquisitions

Breakdown of Google's annual revenue growth, 2000-2011

ESTIMATES



Acquisitions > \$500M (revenue)

0 0 0 0 1 1 1 1 0 1

Acquisitions < \$500M (revenue)

0 6 5 9 10 13 2 5 25 25

(1) Based on the first three quarters

Source: Bloomberg, Estin & Co analyses and estimates