

Three rules for growth

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There are three simple rules for (profitable) growth:

- Look for growth where growth already exists. It is not possible to achieve strong growth (10%+ per year) unless at least 35% of your revenue comes consistently from business sectors where the underlying markets are growing by at least 10% per year
- In fast-growing markets, you must grow faster and invest more than your competitors
- You must develop business models and organisational structures specific to fast-growing markets, because they need to be profoundly different from those you use in mature markets

1. Look for growth where growth already exists

Most of the major European corporate groups are not growing... and that is because they have not taken the decision to grow.

On average, 80% of their business comes from marketing mature products in mature countries with low growth (5% per year), and 20% from fast-growing countries (emerging countries and products and/or business sectors in the development phase), where they are growing with the markets (at approximately 10% per year).

Their growth therefore averages 6% per year, and it is difficult to break through that ceiling. The statistical observation is consistent with the business portfolio analysis. There is a very clear link between growth and a group's business sector and geographical mix.

The strategies used to consolidate mature markets – slowly and either organically or via acquisition – can increase growth rates, but the additional TSR gained by implementing these consolidation strategies is often low (gaining market share in mature markets requires investment of profit, acquisitions create synergies whose value is often captured by customers, etc.). In other words, the additional growth is often diluted.

There is no substitute for a mix of activities where the underlying markets are growing strongly.

A portfolio of activities in which fast-growing countries and/or products account for at least 35%, and which allows the company to grow much faster than the country and/or product market is the only way to achieve sustained growth of 10% per year (cf. table 1).

So growth isn't something that just happens. To generate a third of your revenue from fast-growing activities and/or markets requires bold decisions to be made at least five years in advance. By the time you notice that the portfolio of activities is structurally unchanged, it is too late to grow. It takes at least 4-5 years or a major acquisition to reposition a company on the path to growth.

The beer market is full of good examples. Anheuser Bush is the highly-profitable US market leader, with over 50% of the market, but virtually zero growth (4% per year). It therefore generates a low TSR¹ of 4% per year for its shareholders. Conversely, SAB Miller generates 74% of its revenue in

¹ TSR: Total Shareholder Return: the total return investors receive on their investment (in the form of dividends, rights issues, share purchases, equity capital gains, etc.).

emerging countries, where it is establishing market-leading positions by concentrating national markets one-by-one. It is growing at 35% per year, and generates annual TSR of 32% for its shareholders. So in the same slow-growing world market, two global players of similar size are pursuing totally opposite strategies... but only the second is generating value for its shareholders.

**- Table 1 -
Two typical business portfolios**

	(1)		(2)	
	<u>Share of revenue</u>	<u>Annual growth</u>	<u>Share of revenue</u>	<u>Annual growth</u>
Mature activities	80%	5%	65%	5%
High-growth activities	20%	10%	35%	20%
Total	100%	6%	100%	10%



**Structure and growth typical
of the major European
corporate groups**

Source: Estin & Co analyses

2. Growing faster and investing more than your competitors in growth areas

In fast-growing markets (10%+ per year), the risks are naturally higher, and the visibility is sometimes more restricted. On the other hand, there is one unavoidable rule. No business can achieve long-term growth in line with the market average. Either it grows faster and concentrates the market, or it grows slower and is forced eventually to withdraw because it cannot compete effectively or make sufficient profit.

Western companies now enjoying strong growth in China (20%-30% per year), but on a scale two or three times smaller than their local competitors (which are growing at 50%- 100% per year), are in for some difficult times in the future.

This strategic challenge normally boils down to investment. In the vast majority of cases, leaders that concentrate their resources in fast-growing sectors invest more than their competitors in absolute terms (of course), but often in terms of percentage revenue as well (despite the scale effects relating to this investment): CAPEX and working capital requirement, of course, but also in R&D, advertising, sales & marketing, product quality and features, new product and range replacement costs, etc.

This observation has a corollary. If you invest heavily in high-growth sectors to grow at twice the market rate, and these sectors represent at least one-third of your portfolio, you will rapidly reach the point at which half of all the group's investment is devoted to growth.

Market leaders that grow at 10% or more per year are effectively allocating at least half their total investment (CAPEX, R&D, sales & marketing, advertising, etc.) to high-growth sectors, rather than to capacity maintenance and renewals, supporting market share, upgrading technologies and optimising and replacing product ranges in their mature markets.

If you devote the majority of investment to your basic non-growth sectors, you can hardly be surprised if you are not growing.

3. Developing business models and specific organisational structures different from those used in mature markets

Investment is a necessary condition of growth, but the strength of the business model and its long-term resilience are critical factors. The business model is characterised by three key factors:

- Its attractiveness to customers and its ability to penetrate customer markets on the basis of product, price, brand, distribution method, etc. Unlike mature markets, there is no need for micro-segmentation and customer niche range optimisation in fast-growing markets, but rather a need to develop the most attractive product or service in order to secure the core of the market (often 60%-80% of the total market) and build significant market share very quickly. The simplicity and power of the model and its associated products are more important than over-optimisation and multiplication of features, which are often not appreciated
- Its ability to compete with its competitors. This is connected with the speed of growth and investment discussed in point 2 above. Competitive costs enable reinvestment in features, brands and price levels that are more attractive to the market. They also provide the opportunity to concentrate the market over time, to the detriment of competitors
- Its speed of deployment. In most emerging countries and new technology markets, this is a critical consideration, because new product development time and time-to-market, the time taken to construct a new hotel or superstore, the ability to open 100 new sales outlets a year instead of 20 are all essential challenges. The issue is not perfecting the product or service, but rather having an adequate product or service *today* in order to grow 30%-60% faster than yesterday. Doing the same things as your competitors, but twice as fast, is the key to success if you want to grab the best locations, capture customer “share of mind” and very quickly establish the scale effects and cost base that will allow you to adjust prices to local purchasing power

The business models, organisational structures, teams and working methods that work successfully in fast-growing markets are therefore very different from those that work in mature markets, and speed of execution is everything. Very different reactions, processes and teams are required if you want, on the one hand, to grow at 30% per year and outstrip your competitors, or whether, on the other, you want to compete in a zero-growth, but highly-competitive, market simply to maintain revenue and maximise margins.

Three simple rules... The first requires regular early reappraisal of the business sector and geographical mix. The second requires decisions to be made concerning the allocation of resources: strong decisions that may often go against the established order. The third requires a different way of working. It's easy to see why few corporate groups achieve long-term growth above the average rate of the economy (5% per year). Growth is primarily a strategic decision to be taken at the very highest level.

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Estin & Co is an international strategy consulting firm operating in Paris, London, Geneva and Shanghai. The firm assists CEOs and senior executives of European and North American corporations in the formulation and implementation of growth strategies, and private equity funds in the analysis and valuation of their investments.