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Part I

THE GROWTH LANDSCAPE

CHAPTER 1

Mapping the Challenges and Hurdles to Growth

Growth is a universal mandate for business leaders. Every CEO talks about it. Every annual report highlights it. Every equity analyst values share prices based on it. The term *blue chip* refers to a company that seems to have an impenetrable growth model—sustainable, profitable organic growth creation in both good times and bad—that makes it a foolproof investment.

But the conclusions we've drawn from our research, and the focal point of this book, show a different picture. Growth was easy to come by in the boom times of the 1990s. But when the market soured, there was a subtle, yet perceptible, shift in how executives approached the issue of growth. The rhetoric among CEOs stayed the same, but the actions behind the words slowed to a standstill. In a down market, few seem willing to invest in creating a growth engine for their companies. Or, when faced with a tough quarter, growth projects invariably rise to the top of the funding casualty list. Although this helps to achieve short-term cost-cutting gains and hold the share price steady, it sacrifices long-term growth. Another common misstep is to obfuscate growth by pursuing ill-conceived and poorly executed mergers.

Many of these tactics filter down from the top, where compensation packages effectively encourage this behavior, for better or, often, for worse. Most packages, for example, penalize CEOs for investing in growth and force them to resort to short-term profit improvement programs. Although this approach maximizes the value of stock options, it leads to cost cutting by throttling back on longer term value creation necessities such as product development and brand building. This mind-set often works for a year or two, but over a longer period, it virtually guarantees that competitiveness, growth, and shareholder value will be destroyed.

In this chapter, we examine the state of growth as it is perceived—and misperceived—among today's top executives and their companies. We begin the discussion with one of the most telling findings of our research: CEOs confess they are able to realize just 50 percent of the growth potential of the firms they lead. A 50 percent success rate is a number that no executive is satisfied with, and the fact that it's now the norm offers little consolation. This performance gap, as disconcerting as it may be, represents a huge opportunity for potential increases in share prices, as well as in the economic development and wealth creation capabilities of nations. Taking advantage of this opportunity begins with finding the answers to some key questions: Why is it so difficult to overcome the barriers to growth? Why are directors, executives, business advisors, and management consultants so much less successful in implementing *growth* than they are in bringing about efficiency improvements, reducing costs, and reengineering business processes?

THE GROWTH CHALLENGE: IT'S MORE THAN ONE SUMMIT

Want proof that growth is the biggest management challenge in business today? Do you need to be convinced that growth is hard to come by? Look at the plight of four companies—all global leaders, flagship components of the prestigious Dow Jones Industrial

Average (DJIA), and synonymous with growth. The only problem: They aren't growing.

1. *Procter & Gamble:* A global consumer products powerhouse, Procter & Gamble (P&G) is often cited as the world's leading marketing and brand management company and is a mainstay example in classrooms and books, including Tom Peters' blockbuster *In Search of Excellence.* In the late 1990s, P&G's growth engine propelled it to Asia, where the company made aggressive moves into the high-growth markets of China and Southeast Asia. Despite its efforts, P&G grew at a rate of just 2.4 percent compounded between 1997 and 2002. This is slower than the U.S. economy, which grew at a rate of almost 3 percent.
2. *International Business Machines:* Under the helm of CEO Lou Gerstner, Big Blue achieved what many consider to be the most successful—and highest profile—corporate turnaround ever. Gerstner stormed into new markets, including business consulting and software solutions, made several large acquisitions, and created significant internal growth engines. Yet its growth rate between 1997 and 2002 was only 2.4 percent—the same as P&G and just as far behind the growth rate of the U.S. economy.
3. *Coca-Cola:* Surely Coca-Cola, the world's most recognized brand, enjoys stellar growth rates. A marketing powerhouse and the dominant soft drink in both mature and emerging markets, Coca-Cola is also one of the largest equity holdings of Warren Buffett, the legendary stock market guru. But Coca-Cola also faces growth challenges. Between 1997 and 2002, it grew at a rate of 3.3 percent.
4. *Disney:* Finally, there's Disney, the global entertainment powerhouse. From movies and television to theme parks and retail stores, Disney is everywhere there are children—and parents seeking to keep their feisty offspring amused. In recent years, Disney has gone global, opening theme parks in

Europe and Asia. But although the company's reach has expanded, its growth rates have not: From 1997 to 2002, Disney grew at just 0.7 percent.

Some might argue that times today are tough and it is difficult to generate growth. Others might say that these four companies are simply maturing and will never be able to recapture the heady growth rates of their youth. We disagree. In fact, we argue that growth is possible in any company, at any point in the business cycle; it is a mind-set and a way of doing business, and companies that are bigger, smaller, older, or younger than these four can achieve it.

Throughout this book, we refer to the concept of growth as a business model that creates sustainable, profitable organic revenue increases over a substantial period of time. In this context, growth does not refer to short-lived spurts achieved by picking up on the latest industry trend or by stopgap cost cuts. To close that 50 percent gap, executives must strive to create a growth engine in their companies that will lead to sustainable competitive advantage, higher share prices, and a fun, innovative, and exciting workplace.

We found that many CEOs take a simplistic approach to growth. After a recent presentation to a group of senior executives in Chicago, the CEO of a US$4 billion company approached us and said, "I really liked your presentation—it has great stuff—but what I'm really looking for is the silver bullet."

Other clients say that their core business model is profitable but maturing and believe that new growth is virtually impossible to realize. The common cry among this group is, "We're stuck!" But the most frustrating cases we've encountered are those in which a company began on a strong footing by developing a suite of solid growth programs, only to curtail them when the investment funds required to implement them get squeezed.

Our response in every single case is the same: There is no silver bullet to growth, there is no panacea, and there are no shortcuts. If this is not the most popular answer, it is, without doubt, the most truthful one. Organic, sustainable growth comes only through carefully laid strategies and obsessive attention to execution. Along with this—and just as important—it requires long-term investment and patience.

A comprehensive growth model is complex, particularly when compared to other performance levers and initiatives at a CEO's disposal. How easy it is to reduce costs with a large-scale strategic sourcing project. An area is targeted, results are tangible, and the time period is defined by months, not years. How easy it is to slash both product delivery times and costs by 50 percent and increase delivery reliability up to 99 percent through a supply chain improvement initiative. These business improvement strategies have strong CEO appeal. The level of disruption or intrusion on the company is clearly defined, the time line is short, the risk is low, and the probability for success, which is easily measured by equity analysts, is high.

In this light, it becomes clear why CEOs, with such a cache of tried and true strategies to choose from, can justify postponing those longer term, decidedly less straightforward plans. But this is precisely the reason that growth initiatives are so rarely fully realized and the potential remains unexploited. Growth requires the successful integration of all the firm's activities; the entire value chain, the sales and the supplier market, strategy, and operations must all link, both for today and tomorrow. As the case studies in this book illustrate, building a growth engine in a company requires years—not months or quarters. It requires selfless behavior from senior management teams. It requires taking some risk and spending investment dollars in the anticipation of making even more in the future. The bottom line is that a good growth strategy is not easy to conceive or to implement.

Another important characteristic of growth is remarkably simple: Growth is inevitable. Regardless of the industry, at least one of your competitors is growing. Even in industries that are contracting or struggling through hard times, at least one competitor always finds a way to grow, even if it is at the expense of other competitors. Consider Southwest Airlines, which continues to prosper and gain market share while all the other major airlines in North America teeter on the edge of bankruptcy. What is Southwest's growth formula? Good, reliable customer service at a reasonable price. Sounds simple, doesn't it? In the steel industry, a notoriously tough business in which to achieve growth, Worthington Industries holds an equally impressive track record.

The inevitability of growth is also reinforced by our Endgames consolidation research, which we delve into in greater detail in Chapter 4. Companies can solidify their competitive position in a consolidating environment in one of two ways—either by being the most aggressive grower and acquirer or by simply surviving and growing while other competitors exit the business. Toyota has used this second method as the basis for its success in the global automotive industry. It has grown organically and produced the most competitive products, while its competitors have either exited the business or suffered declines in competitiveness.

MANY POPULAR GROWTH CONCEPTS AND STRATEGIES HAVE FAILED

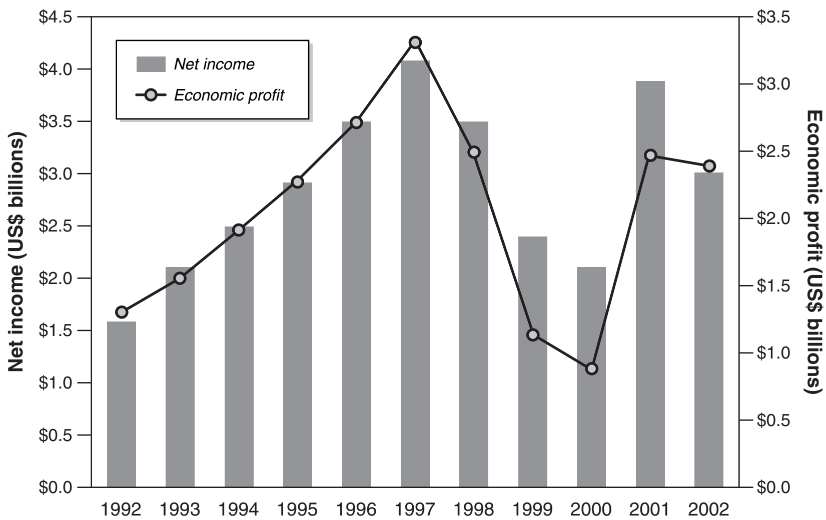
The notion that growth strategies are difficult to develop and execute has been proven time and time again over the past 10 years. During the 1990s, many growth strategies soared to popularity, only to achieve mixed results in the end. These included economic value added (EVA) and other financial strategies, special purpose entities (SPEs) to unlock value through creative financing, and Internet-based strategies to attempt to cash in on the dot-com boom.

An EVA growth strategy, for example, helps managers take an almost surgical view of their businesses' financial performance and make strategic decisions as a result (see Appendix). This tool can work wonders in rising stock markets, but it often leads to strategies that are detrimental to long-term growth. The shareholders of companies that actively embraced EVA—including

Coca-Cola, Eli Lilly, and Hershey's—know all too well the damage it can inflict on share price.

No single business metric can be a panacea, and EVA is no different. In a comparison of profitability data and EVA data taken from the Coca-Cola 2002 annual report (see Figure 1.1), several interesting points emerge. First, economic profit has a high correlation—90 percent—to the current year net income. If this is the case, CEOs who adopt EVA may have conflicting motives and may be more prone to make short-term profit enhancement decisions than proponents of EVA care to admit. Second, EVA appears to be more stable as a business metric when conditions are good, as in the period from 1992 to 1997. As business conditions became more challenging, the economic profit metric may have provided Coca-Cola's managers with a distorted image of its standing.

FIGURE 1.1 NET INCOME VERSUS ECONOMIC PROFIT FOR COCA-COLA



Source: The Coca-Cola Company 2002 Annual Report.

Other popular growth strategies suffer from various flaws as well. Special purpose entities and financing subsidiaries became popular as a supplementary growth engine in the 1990s, particularly in asset- and capital-intensive businesses. The idea behind these strategies is that companies could boost their growth and profits by exerting more control over their entire value chain. In turn, they could unlock value from their core business through creative financing. Again, these models worked well in a rising market, but as the economy turned south, so did the prospects of many companies that favored these strategies, including Enron, PerkinElmer, and Bombardier.

Finally, the dot-com boom created one of the most unrealistic growth mind-sets imaginable. The realities of growth seemed to vanish: Companies enjoyed boom times with endless funding and instant growth. *Seemed* is the operative word in the previous sentence. Such misconceptions about the dot-com revolution have since been laid to rest as companies continue to regain lost footing.

Internet start-ups such as the Internet Capital Group, Ariba, CMGI, and others attained market capitalization levels of tens of billions of dollars, eclipsing many of the DJIA component companies. From 1997 to early 2000, they seemed to have found a growth model that would last for decades—only to have it fall dramatically in the following months as reality set in.

The growth mantra about the convergence of media content and distribution has led to huge investments in licensing third-generation (3G) technology, especially by European telecommunications companies. Although this new technology has taken years longer than anticipated to become a reality, it is finally receiving the overwhelming consumer acceptance that was originally anticipated. Investments were financed primarily through billions of dollars of new debt, which is now being written off, causing huge losses for shareholders.

The convergence concept also led to several huge mergers in the media industry. At the time, the merger of AOL and Time Warner was expected to usher in a new era of tremendous growth and profits; today, it simply marks the pinnacle of Internet madness. The companies announced the deal based on the growth theory that AOL would control broadband Internet distribution and Time Warner would provide a content engine. As it turned out, the high valuation for AOL was unwarranted, and the Internet became flooded with content that consumers were not willing to pay for. When the business model proved unjustifiable, AOL Time Warner ended up writing off tens of billions of dollars. Disney, through its Go.com investment, and Vivendi, through its many media-related acquisitions, followed AOL Time Warner's unfortunate path in chasing the Internet growth fad. Other growth initiatives focus on changing a company's strategic business model, but carry high risk.

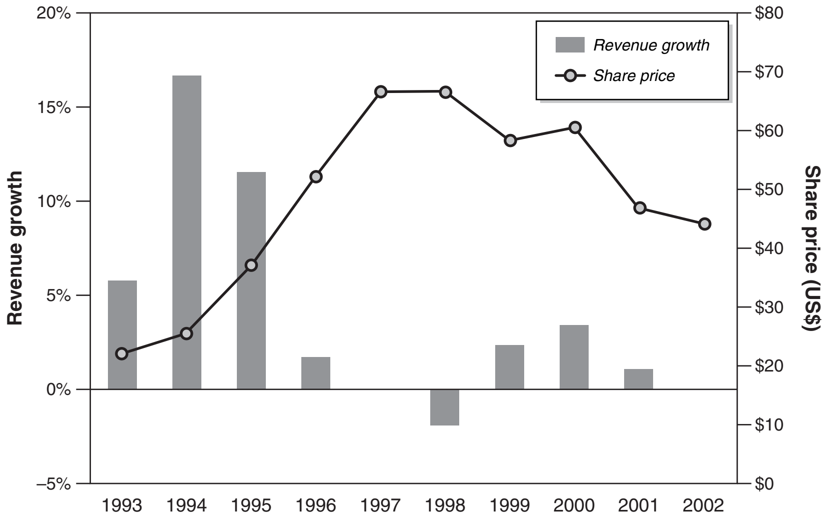
The moral of these stories? A growth strategy is not a plug-and-play module the senior management team can take off the shelf and use to deliver instant results to shareholders.

THE COCA-COLA CHALLENGE: GROWTH HURDLES AT THE TURN OF THE CENTURY

For a more in-depth example of how growth can present challenges to even the best of companies, look at the recent performance of Coca-Cola. As shown in Figure 1.2, Coca-Cola's revenue growth model has stalled, and its share price has declined over the past several years. Coca-Cola's revenue growth model ran out of steam in the mid-1990s, when it was hit with a confluence of issues including a succession in leadership, the Asian economic crisis, a product contamination scare in Europe, a racial discrimination suit in the United States, and a botched acquisition of the Orangina product line. In squelching the various fires, management took its eye off the company's long-term revenue growth engine to maintain its share price and higher levels of economic earnings.

The result was that Coca-Cola's senior leaders were quickly caught in the chicken-or-egg dilemma—once revenue started to fall, they began to cut selling, general, and administrative (SG&A) spending to maintain the company's high return on equity (ROE)

FIGURE 1.2 REVENUE GROWTH VERSUS SHARE PRICE FOR COCA-COLA



Source: The Coca-Cola Company 2002 Annual Report.

levels, EVA, and profit margins. For the first few years, the strategy paid off. In fact, 1997 proved to be a record year for Coca-Cola's ROE, which topped 61 percent. Also in that year, its economic profit reached US$3,325 million, and its share price rose to US$67. But the price for this success was steep. The same strategy that achieved these numbers also laid the foundation for years of future underperformance in growth and share price. By cutting the growth lifeblood of SG&A spending, Coca-Cola went through the latter part of the 1990s without major product launches, with largely the same advertising messages and campaigns, and with no new brand acquisitions or licenses with which to grow.

Since then, Coca-Cola has struggled to return to its profitable growth-generating roots. Coca-Cola CEO Douglas Daft has continually tried to reset Wall Street's expectations for long-term growth potential to rates of 3 percent or 4 percent. The company's financial objectives have also shifted from revenue and profit growth to an increase in cash flow, a metric more commonly used by mature businesses. Operationally, Coca-Cola has turned the focus of growth away from a headquarters-driven growth model and into the hands of its local market managers. This replicates the strategy of more successful growth companies such as Nestlé or Johnson & Johnson, which view local marketing execution as gritty trench warfare.

The lesson from Coca-Cola's experience is clear: A company's growth engine is difficult to build but easy to stall. Since the mid-1990s, Pepsi has gained ground versus Coca-Cola, particularly in international markets. Coca-Cola has had to reduce pricing in many markets to regain its competitiveness. Its financial performance has taken a beating, with revenue growth falling from rates of more than 7 percent to 3 percent and ROE falling from the range of 50 percent to 60 percent to current levels of 35 percent. Coca-Cola's new management team is beginning to make inroads against these challenges, but results take time to realize. In 2002, the company launched a number of popular, innovative advertising campaigns and signed several product licenses, leading to a US$2 billion growth in revenue. Coca-Cola is probably back on the growth track, but the consequences of its mid-1990s derailment have been severe.

CAN WE OVERCOME THE GROWTH CHALLENGE?

The growth challenge is greater than it initially appears. Growth that appears to be easy to realize is usually illusory or unprofitable. Tangible, formidable barriers to achieving lasting growth are in place in most companies. Chief executives are often rewarded in ways that are detrimental to building growth. Finally, many of the most popular metrics and management concepts and tools can stall growth rather than drive it.

Companies of all sizes face challenges in growing their businesses. Even companies with successful, competitively advantaged business models find their markets maturing and growth harder to come by, as underscored by Coca-Cola.

Nevertheless, growth opportunities continue to abound. There are winners and losers in every industry—why shouldn't the winner be your company? We believe that several big, global industries will consolidate rapidly over the next few years, causing immense shakeouts. The future landscape of these industries will be determined primarily on the basis of which competitors have sustainable growth engines.

In the next chapter, we elaborate on the challenges of growth. We look at the growth strategies of winners and losers in several industries and offer a perspective on how to forecast the growth prospects for your own industry.