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The Challenges of Attaining Growth:

The Blenheim & MGSM Insight Series

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"Superhuman effort isn't worth a damn unless it achieves results"

Sir Ernest Shackleton

Chapter 6

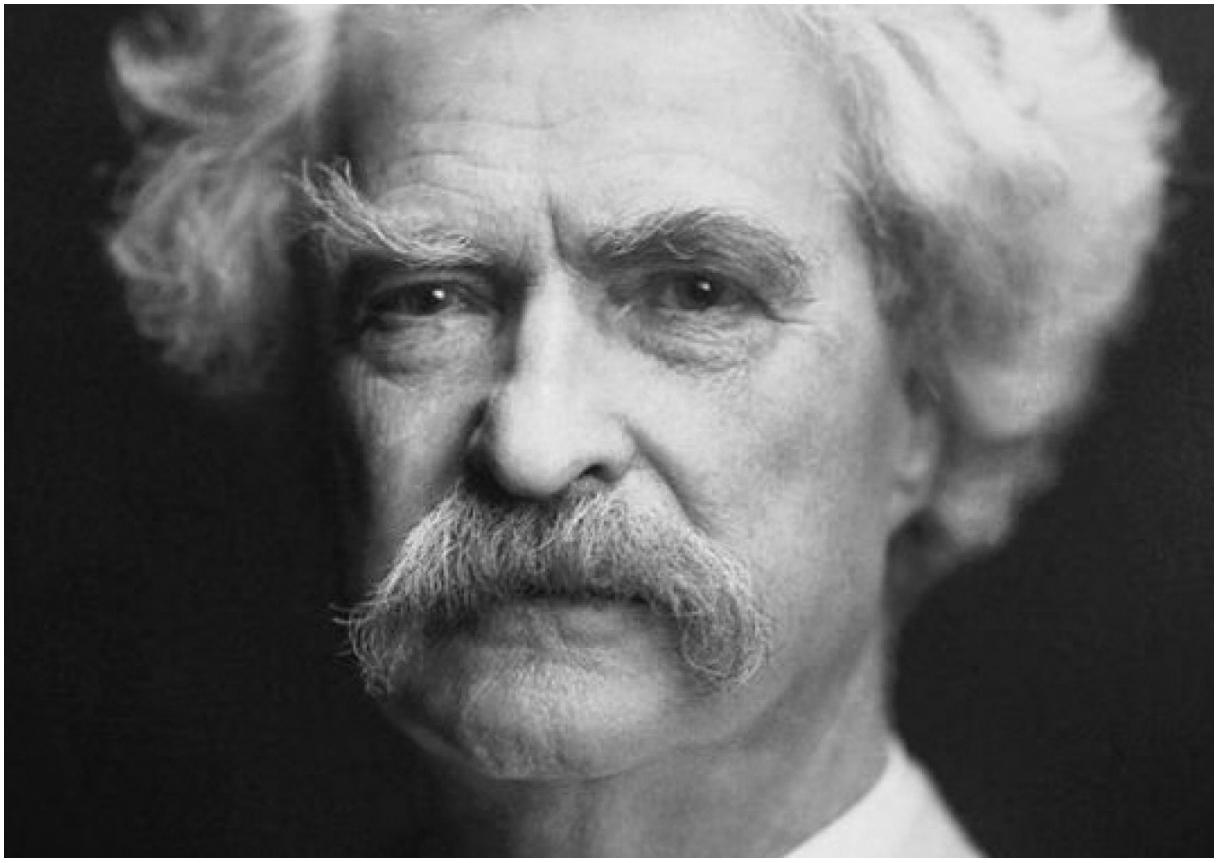
Generic Growth Strategies

"There's 10 times the population of Australia in Indonesia alone."

The generic growth strategies most often mentioned were:

1. Cutting costs;
2. Increasing share in existing markets;
3. Entering new geographic markets; and,
4. Expanding the industry portfolio.

Chapter 6: Generic Growth Strategies



"Sail away from the safe harbor. Catch the trade winds in your sails. Explore. Dream. Discover"

Mark Twain

Directors suggested that cost cutting would always be useful as fat develops in organisations but other means of profit growth are essential. Cutting costs only gets the business just so far as a ***"growth"*** option. It was really talked about as more of a short-term option for bottom-line driven growth, rather than a genuine strategy for growth.

"Cost cutting is a way of increasing profit. If you are doing this then I guess you're heading down the path of a lot of companies. This path is doing what I call sustaining innovation and efficiency innovation to try and make their profits, as opposed to creating new opportunities."

"I think we've been a little cost and scale focused. … There's some messaging around cutting costs that can be useful, but as a process in itself, cutting costs doesn't really impress me. "

Views were mixed on increasing share in existing markets as a growth strategy. Not all participants agreed that establishing market share was fundamental to pursuing growth. One Board Director described top-line growth via increasing market share as not really growth at all. In his view this kind of 'incremental' growth cannot sustain a company in the long run.

"If you're in the business … your company still grows, or your sales go up or you add new ranges. That's just incremental growth, that you should be doing that as a business itself. But growth would be to my mind ... a major leap. So it's do we go and buy another business or start another division? … If you've got eight hundred stores and you open thirty, ugh, that's not growth."

But others seemed to view this kind of growth as the only essential option available to them.

"So, turn to me and say how are you going to grow the business? I've got to nick customers from competitors predominantly, and other players. Competitors are our target … there are many simpler customer bases out there to buy, because I can't grow inorganically. That's how we've done it in the last 6 years. I've got to grow organically. I've got to perfect the art of stealing customers from competitors."

More specifically, participants pointed to economies of scale driving success in many industries, noting that a company's market share position can be a direct determinant of success in such cases.

"To be successful at pretty much anything you've got to be number one or number two in the industry."

"We've got to remain the dominant player in our home markets."

"We were about a distant number four in the marketplace. As they say one is wonderful, two is terrific, three is threatening and four is fatal."

Although it is easy to think of market share growth in terms of ***"stealing customers from your competitors",*** astute Directors often pointed out what, in retrospect, seems like an obvious point – companies can increase market share by keeping competitors from stealing their customers!

Cutting Costs

"A competitor loses customers at three times the rate that we do. They play on price and are very aggressive on price."

Being ***"very aggressive on price"*** may indeed allow you to steal your competitors' customers, but if you're losing your own customers at an even faster rate, market share shrinks rather than grows. Participants effectively viewed the competitive structure of entire industries in terms of relative customer churn rates.

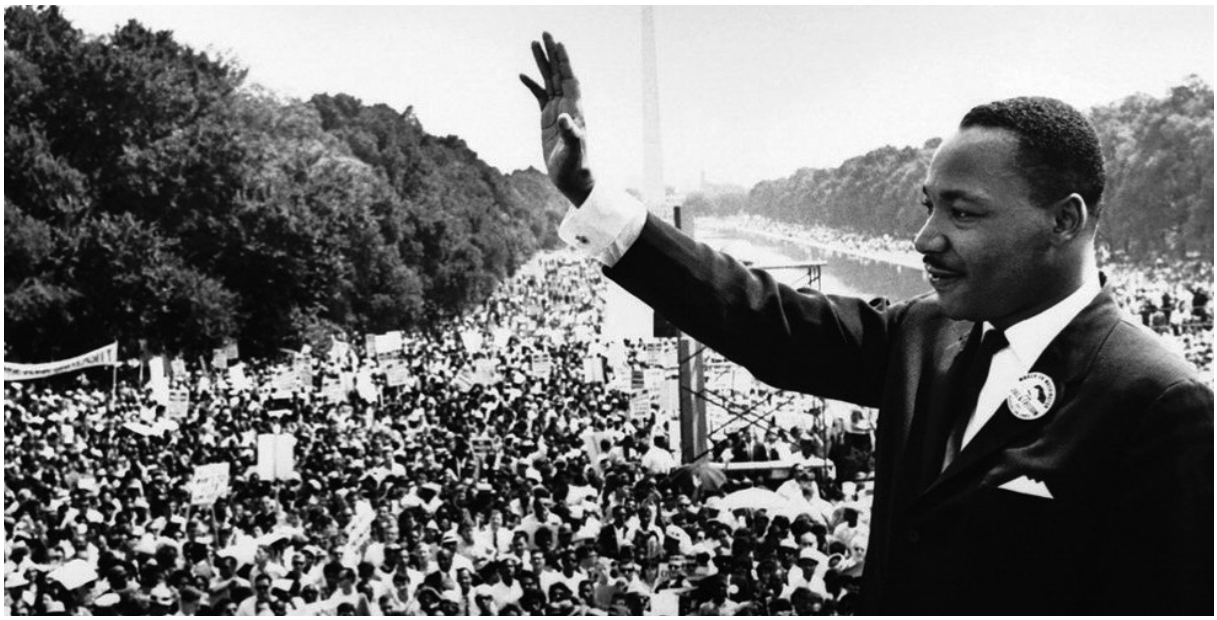
Another ***"generic"*** growth strategy was expansion via entry into new industries or product categories. This could be achieved via product innovation – essentially creating a completely new product category via R&D initiatives, acquisitions, or partnerships. As with geographic expansion, entry into new industries or product categories was viewed in terms of balancing the risk portfolio of the business.

"How much capital do I allocate to different asset classes or sectors, where I can optimise returns? And then I say to myself over what time horizon and what's my risk budget?"

Increasing Share in Existing Markets

One specific example of this growth strategy cited by Directors was forward vertical integration of distribution channels to capture more of the margin in natural resource markets that we have previously given away.

"I do think we can do some more processing in this country. And I think we've still got some industrial segments that we could perhaps reclaim a little bit. I'm not sure that the flight of steel fabrication, for example, into China was necessarily something that needs to be a permanent trend. … I don't see a real reason why, if we're smart with our technologies and we get efficient and competitive energy."



"Nothing pains some people more than having to think"

Martin Luther King, Jr.

Entering New Markets

Some Directors had negative views about growth prospects via industry/product portfolio expansion, arguing that companies that leave their 'comfort zone' by moving into new, unrelated industries run an unacceptable risk of failure.

"I would say in my experience 9 times out of 10 that moving outside your areas of understanding turns out to be complete disaster. People who do this usually mess it up. I think it really depends on the nature of the business. If you're in a situation where you dominate your market then I think you concentrate on running that business, continuing to hold your position and grow where you can."

"It can be very sexy, very exciting to move into something new, but there is usually so much more wealth that can be garnered from within the existing core business."

Others felt that Directors and executives had to earn a mandate for that kind of (high risk) growth. A lot of Australian companies have no track record of growth. As highlighted previously they have ***"diligently tended to their own garden"*** so ***"do not have a good record outside the garden".*** Therefore the view of investors is ***"I have invested in the garden – keep tending to the garden I have invested in"*** before they allow for expansion into new industries.

Off Shore

In addition to providing an opportunity for growth, expansion into multiple geographic markets was viewed from the perspective of risk management. Changes in the political (e.g. nationalisation of privately-owned companies), economic (e.g. GFC in Western countries), technological (e.g. increased purchasing via mobile phone), and competitive (e.g. entry into Australia by strong foreign firms) environments were identified as potential threats to company performance. Hence, having a more ***"balanced" geographic portfolio"*** of revenue was seen as a way of mitigating the impact of a sudden change in any country or region of the world.

"We're really multiple domestic businesses in a way. Intellectual property is shared across the group and there's definitely economies of scale but the businesses are largely each domestic. We have natural hedges everywhere, we have cross-border exposure so it's unique in that way so it's a little bit easier here."

Some participants suggested that Australian Boards are ***"terrified"*** to go offshore as a means of pursuing growth, perhaps never even considering it as a growth strategy.

"Terrified, yes, because of the role of the media. That was the big fight that I had with the Board, and they would always be able to recite the companies by name that had failed overseas, and not one success. And then when you would mention Australian companies that were extremely successful overseas … the Board would say no because they were risk averse."

"But I've said to many people down through the years have you ever thought of export, and most of their eyes light up and say, 'No,' and I say, 'Why not?'"

"The (industry) for domestic growth is pretty much saturated simply because of the supply and import competition. So growth in export markets is critical, and that's fraught with a lot of risks around competitive products having positions, the ability to find your segment in the market."

But others offered more considered explanations for why geographic expansion was risky.

"Have you saturated your capacity and strategic direction to be able to deal with the markets that you're in? … What is your core competency you are taking offshore? If it's only scale in this market, then it's probably not a great core competency somewhere else when someone's got greater scale. So you've really got to work out what is it that you are taking off-shore that is likely to be successful and if you can't articulate that, or you can't frame it that way, then I think it's dangerous to go off-shore."

Not surprisingly, Directors articulated several criteria for assessing risk in geographic expansion opportunities.

"Only about 25% of our profit comes from Australia these days. So we have a very global aspect. The way we look at it, it gives us a broad palate if you like. There are sectors in the world that we can compete in, and also where we shouldn't compete."

These criteria are designed to create a ***"balanced portfolio"*** of geographic markets that allow a trade-off between managing risk and pursuing growth.

"So we get to look at those levers, one growth, and two, where we have confidence or a proven capability that we can out-perform others in that segment. But we look at those together with the profit, cash profile of those segments. Are they established or emerging and then based on the … risk profile we tend to build our investment cases."

"I mean if there's a moral to that story it's the more international you can be the better because you can get through periods like this and you've got a chance of showing growth overall."

Much of the academic research on corporate growth strategies involves fitting real world data to growth taxonomies like Porter's generic growth strategies[24], Ansoff's growth matrix[25], the BCG growth-share matrix[26], and Mintzberg's six generic strategies[27].

The general aim of the research is either to compare two models to see which fits the available data better[28], or to amalgamate multiple models into a comprehensive framework that best accounts for the patterns in the data[29].

The amalgamated frameworks are generally consistent with the generic growth strategies expressed here[30].

There is some indication that companies that follow one specific strategy outperform those that attempt to combine multiple strategies[31], though this general rule may not hold in less competitive, market-oriented contexts[32].

In terms of the specific financial indicators used by businesses to '***keep score",*** the academic literature recommends, and provides evidence to support, a ***"balanced score card"*** approach involving multiple measures[33].

These measures fall into the general categories of financial (i.e. ROA, ROI, ROE, NPAT), marketing/customer (i.e. market share, revenue growth), process/efficiency (i.e. order fill cycles, new process development, time to market for new products), people development (i.e. training hours, career development program participation rates, retention rates/employee turnover), and future planning (i.e. R&D expenditures, new global alliances, technology/infrastructure investments)[34].

Overall, the views expressed here regarding generic growth strategies accord well with actual company practices, as indicated by academic research.

Directors' Skin in the Game

An interesting area of debate which provided polar responses was around the notion that Directors would perform better or have a greater alignment with shareholders by having skin in the game.

It would be fair to say that the majority of participants believed Directors should have skin in the game. The arguments were numerous and included it brings clarity, a clear understanding and sharing of what the shareholders are experiencing as well as providing greater focus than otherwise. The counter argument was that as a professional Director I don't need to have skin in the game to do a better job or to make better decisions. My integrity and my professionalism are absolute. Surprisingly those who argued for skin in the game agreed with the counter argument's points, but said based on their experience having skin in the game led to greater discussion in the Boardroom, greater accountability and confirmation they were representing the shareholders by sharing equally in their pains and their gains.

The topic provided the following comments from participants:

"Having skin in the game might drive better growth, particularly for the long term. It focuses the mind on the long term strategy. One of our greatest challenges at the moment is short termism. Skin in the game may offset the effect."

"Yes, I am a believer. Make it significant enough to create value."

"Skin in the game shows commitment and is an alignment of management and the shareholder."

"Not necessarily required. Prefer to ensure the Board has true independence. However, as long as it's not mandated I am comfortable with voluntary."

"Hugely important. You look at the company a little bit differently. It forces you to have more than an active interest."

"It aligns management with the shareholders interest and I believe in it."

"I don't believe you need skin in the game. It shouldn't be a driver in how you behave. You shouldn't be a better Director because of skin in the game."

"Absolutely should have. It aligns with the shareholder value."

"Must have. Sends a good message."

"Boards should be leveraged. They should have options that encourage growth."

"Having skin in the game means you really do think a little more about the shareholder and are more aware of the shareholder when making decisions."

"I don't think it makes any difference. It is actually a cosmetic approach but markets like it. To me, your reputation is the most important thing."

"Boards need skin in the game that helps with governance, media, and short termism. Something closer to the private equity model."

"I like to see more skin in the game, more management and Directors having alignment in shares."

"We should have more skin in the game, and measure performance on shareholder return and the returns of our customer growth."

Chapter 11

Many of the participants believed a Chapter 11 (under the Bankruptcy Code in the US that permits reorganisation under bankruptcy laws) or greater safe harbour legislation would encourage Companies to take sensible risk as well as give them comfort that there were opportunities to trade out of challenging circumstances. Whilst the US style Chapter 11 has its faults it was readily argued that in Australia we are too quick to call in the receivers and that a better way is needed to help encourage companies to take risk and support them through difficult times. No one was supporting poor business ethics but many felt different approaches could be adopted if we are to encourage business growth and Australian economic growth. The Chapter 11 safe harbour provision was seen as a positive encouragement to supporting a growth agenda. There were also numerous conflicting views as to the merits of the introduction of a Chapter 11 style safe harbour provision into Australia:

"Good idea, it encourages risk."

"We need to review voluntary administration. We are too quick to close. We invented limited liability to take risk."

"We need safe harbour legislation broadened so business can regenerate. We place companies too quickly into insolvency such that companies are becoming scared. If we look at risk we need to look at exposure. Small companies which are the growth of our nation and our greatest employers face the greatest risk of insolvency. Our current insolvency rules are too restrictive a regime. Whilst I wouldn't go all the way with Chapter 11 we need to make business entrepreneurial with the opportunity to trade out rather than be closed out."

"Chapter 11 is a good idea as it provides an opportunity to re-organise rather than close a business."

"I don't like Chapter 11 – it removes accountability."

"No, I don't like Chapter 11 as it allows you to trade while you are insolvent, potentially liable for debts. Smaller companies if they had Chapter 11 may not have the management capability to fix their problems."

"No, can jam out creditors."

"Chapter 11 gives time, allows for rehabilitation, definitely worth investigating."

"Chapter 11 gives companies a chance to trade out and we want to create a business culture to encourage risk taking and trade. Yes, I believe there is a need for investigation of Chapter 11."

"Chapter 11 would help enormously. It would help restructure and rebuild under a monitored approach or allow some companies to go private where they can make rapid change."

"With Chapter 11 compliance costs are very high, even in the US it only works for large companies due to the cost. However, there should be some form of safe harbour."

"In the US it means business is still running. In Australia it means administration is running."

The argument against this is that a Chapter 11 type mechanism artificially alters the market economy. One participant put the view opposing Chapter 11 type legislation quite clearly:

"I understand the logic of having a form of safe harbour support to encourage companies to take risk and in difficult times to help them trade their way out. It sounds very reasonable. However I have been successful in analysing my competitors and watching those who are struggling and unashamedly acquiring them and turning them around. I therefore support the market economy and argue if these companies had Chapter 11, I would have missed out on an opportunity and quite frankly I don't think they would have achieved the success that we have taken them to under the previous management."

Should our Business Leaders have International Experience?

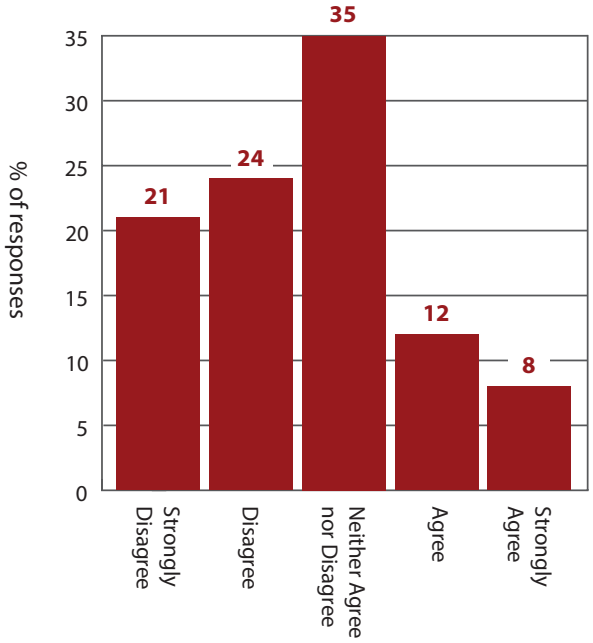
One of the more controversial ideas put forward was based on the fact that growth would come from offshore where Australian companies would have to compete in huge markets with many more competitors than they are accustomed to. An example given was in one particular industry, where bidding for a job in Australia might attract 3-4 bidders while in the Middle East the job may attract 16-20 bidders. This fact together with the percentage of revenue and profit derived from within Australia over time diminishing, led to the question being asked should our future CEOs come with experience in larger and hence overseas markets. This experience would be essential for Australian companies to compete. As seen from Figure 5 (over page), opinions were split on this question, leaning more towards Australian managers being up for the job.

"We still need to consider the potential lack of diversity in the experience of the Chief Executive and the executive team. This may include a lack of international background, subject matter excellence and experience over broad leadership capability. My thoughts are we need to step back and look at our initial hiring and encouragement and development of our employees. If I look at the banking sector traditionally a graduate was placed on a development path that gave them all round banking exposure. These days we seem to have people leading divisions with real depth of knowledge in that space but not overall for banking. So are we promoting all round capability with leadership or as I fear promoting subject matter expertise."

"We quickly run out of talent in Australia, whereas in Europe and the US there are multiple markets. We are constrained by the Australian market. Unfortunately Australians don't have the DNA to stay ahead. We have a small town mentality."

"Australian management is good at servicing markets overseas but not good at facing up to a lot of international competition. The issue is business management 101. There is a lot of work to be done at the lower level where there is a lack of real commercial and operational skills. There is not the right mindset. Management doesn't know what good looks like and aren't mentally wired with the model to continually improve. This is a major inhibitor to growth."

Figure 5: Participant Responses as a Percentage to the Question ***"Do you agree leaders from offshore (e.g. the US and UK) are better equipped to drive growth than Australian-developed leaders?"***



Some Directors were resigned to the view that the Australian market was fundamentally mature and that there would be limited opportunity for growth in the future. Australian-based businesses were characterised as ***"cash cows"***, with the potential stars being overseas subsidiaries.

"If you're an Australian businessman who has spent most of your career in Australian markets it's tough to accept that this is not a growth market, and that the future will not be as rewarding as the past has been unless you structure your portfolio in a way to have growth components built in. So our Asian position and US position, that's our growth markets."

The lingering effects of the GFC were also cited as a reason to explore growth in new geographic markets.

"So you haven't got consumer confidence. You've still got consumers de-leveraging in the case of debt, and so to get growth in this market you're going offshore."

In addition to describing the limited growth opportunities in Australia in terms of being a ***"mature"*** or ***"stagnant"*** market, some participants noted the rather obvious point that Australia is a small market.

"There's ten times the population of Australia in Indonesia alone. There's five times the population of Australia in Vietnam. There's four times the population of Australia in Thailand. We're only in these markets with maybe one or two customers."

"Is Australia big enough? No, that's why we went to Asia."

For some however where there are limited growth prospects going offshore is a reality they need to face.

"The first argument that is put forward is that it is risky to go offshore and the track record supports the argument. However, there is only so much we can squeeze out of the Australian lemon and therefore going abroad is only a matter of business sense."

However, not all participants agreed with this notion of limited growth opportunities in Australian markets. Some listed specific industries having substantial domestic growth opportunities.

"I think there's huge growth sectors in the Australian market. … health, education, agriculture, tourism, and those are all true growth opportunities. And we say that here because we're potentially exposed to all of those industries, one way or another. But I do think that there's plenty of growth for us."

Others pointed to the lack of the insights and lateral thinking limiting growth horizons for Australian companies. Insights were framed in terms of both customers and competitors.

"Business is not very good at understanding the customer – this is the way that markets are going."

"Need to continually look with customer insight and customer foresight to foresee changes."

"Need to be customer led – 'listen to your customers'."

"Deep customer insights is important – testing products with customers can achieve this."

"Deep customer insights are essential to lead a growth strategy."

"Need to drive deep customer insights as basis for forming relationships with customers."

"Competitor insights are also needed as they will cause customer change too."

"Know your customers customer. That's our job. That's what digital is helping us with because honestly, we have been weak in the past."

An example of the lateral thinking is to change the lens by which you look at your competitors – it may just create growth opportunities.

"A customer can also be the competitor; even though they may be a competitor doesn't mean you can't do business with them."

Participants indicated an obvious connection between increasing domestic market share, expanding geographically, and expanding the industry portfolio as generic growth strategies. Smaller players in an industry may tend to look at market share as the obvious growth strategy because it is relatively safe, and there is much room for expansion at the expense of direct competitors. Many big players are complacent in that they tend to concentrate on their big competitors, allowing the smaller players to get ***"under the radar"*** to ***"steal"*** share, and continue to do so for long periods before being noticed. Larger players, however, eventually run into market or regulatory constraints that may force them to think of

riskier growth opportunities involving new geographic markets and/or new industries.

"One of the things that I've seen over the years here in Australia for example is larger companies that dominate a particular sector and really don't have in this market a great opportunity to grow … If we're going to stick in this do we go overseas because we've either reached a point where either we can't grow or the competition commission won't let us grow within our own market. Do you go somewhere else or do you do what so often happens, well we do this well, maybe there's something else we can do well."

So what do growth orientated companies look like? They were seen to be:

- Constantly scanning for where the opportunities lie;
- Constantly scanning for where the disruption lies;
- Specific about geographies to go into, e.g. be definitive about Asia, such as China, India, Vietnam, or Thailand, all are unique markets;
- Be first in markets;
- Pick up adjacencies and build off deep expertise;
- Customer focussed;
- Focussed even further on the customer's customer;
- Base decisions on deep insight;
- Investing and innovating based on these insights; and,
- Know well what does well.

CEO Leadership versus CEO Sector Experience

The other determining factor stated was the calibre and orientation of the CEO, with the orientation being fundamental to driving a growth culture.

"Looking at the major Australian companies and just as a classic benchmark, how many have gone offshore to grow? Why when their opposites in the US and UK have gone offshore and been successful, why have our Boards and management taken the path of least resistance? Where is the vision? A further question is, what is the purpose of the company and does the CEO have the right competency? I see CEOs who may be experts in their industry but not experts in leadership."

Finally, what are some of the strategies successful growth orientated companies do?

- They can define their true source of competitive advantage and defend it to the hilt;
- When thinking of their competitive advantage they define it in terms of:
  - A global competitive advantage; and,
  - They invest against this ***"global"*** competitive advantage;
- Focus on markets where they have a strong competitive position;
- Recognise that growth is about leveraging existing relationships in Australia and following those relationships offshore; and,
- Recognise that growth in new markets is about long term persistence – especially offshore.

Capital for Growth

When we raised the question about innovation we had general agreement that it was somewhat lacking. Consistent comments were:

"Research and development requires funds. We watch the young innovators with ideas to bring to this country move offshore and never return because they couldn't get the capital."

"A major problem is there is no funding or risk capital available."

"Where are the banks to help? Where are the incentives to encourage risk? Where is the long-term thinking in R&D or innovation?"

Comment

There does appear to be numerous opportunities to achieve growth, both within Australia and globally, but they will be specific to the company and the industry they are in. Some companies will have enormous growth opportunities in Australia, others less so or not at all due to their history and positioning. Despite this, what the growth strategies look like and do can be quite generic as noted earlier. It is how these strategies are led and applied to the particular context of the company that matters.

Participants expressed that the common theme of growth orientated companies is they are constantly scanning for where opportunities lie, are first to markets and continually focused on the customer. This provides a good template for others to pursue.

For the Board and CEO, the view of the growth strategy in the context of the history and positioning of the company will be factors that determine the nature of the risk. If growth is difficult then the risk will generally be higher than if it is not. Thus a Board experiencing good growth currently will be less likely to be convinced of a high-risk strategy while to a Board with low or negative growth this will be more palatable. These will be factors that determine the risk appetite of the Board to support the eventual strategies put forward by executives for approval. Where this all becomes incredibly difficult and presents the biggest challenge for Boards and executives is when ***"the growth is not where you currently are as a business – this challenges the risk appetite of all!"***