Executive Insights

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The Search for Good Growth

Value creation, the mission for every commercial organization, requires a business to generate returns above its own cost of capital. This does not, strictly speaking, require growth. Yet in spite of this, almost every CEO on the planet would list growth as one of the highest priorities on his or her agenda.

The reasons for this are not hard to find:

- Growth can offset the longer-term risks of current propositions becoming obsolete
- It is hard to attract talent into a stagnant or declining business
- Growth leads to scale advantages over competitors, which increase returns
- Investors reward companies showing credible growth prospects with higher valuations

However, not all growth is good growth. In the battle to expand, particularly when businesses are mature and demand is static, many companies reach for an M&A solution that can often result in value destruction for the acquirer. Others, especially those in technology-led sectors, spend more than they should on growth initiatives that fail or destroy value in other ways.

So how can your business, reliably and systematically, find ways to identify "good growth"? In this *Executive Insights* we explore 10 simple steps that, taken together, offer a proven way to uncover good growth opportunities.

1. Examine your portfolio to identify strategic growth initiatives

What is at the very core of your business portfolio? What makes up the rest? How can you use this thought process to identify growth opportunities? These questions lie at the heart of an effective portfolio review, and getting to the answers is essential in the search for good growth. The framework below provides a clear portfolio categorization that is straightforward to complete (see Figure 1).

Core

Identifying the "heart of the brand," your "reason for being" that will never be compromised or neglected, is relatively easy for most businesses. The core will generally be located close to the business model that drove the early success of the company and / or is the driver of a significant proportion of the cash-flow generation today. Investment and a focus on growth are appropriate here to achieve or sustain market leadership, but often the scale of growth opportunities found in this category will be constrained by the maturity of these businesses and the competitive constraints that apply to them.

Protecting the core

A cluster of activities may surround the core but not be large, or important, enough to belong in the core category itself. Closer examination will often reveal that these elements of the portfolio are actually protecting or sustaining the core business, so we refer to this category as "Protecting the Core." Investments here should be subject to robust cost-benefit screening, but if a major effort is required to protect the core, some of the initiatives may well fall into the next category of Strategic Growth Initiatives.

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Figure 1
Portfolio review framework

"Core"

Legacy heartland to the brand / group

- Retain and defend
- Invest long term
- Should be a major driver of shareholder value

Protects or sustains the existing core

- Invest short term
- Evaluate cost / benefit

"Strategic Growth Initiatives"

Scalable strategic opportunities

- Invest to grow or build to sell
- Evaluate potential and monitor milestone achievement

"Non-core'

Non-strategic businesses

- Hold only if stand-alone Net Present Value exceeds disposal value
- If not,
  - Invest / prepare for sale
  - Sell / Joint Venture now
  - Shut down

Source: L.E.K. analysis

Strategic growth initiatives (SGIs)

These are the opportunities destined to deliver the majority of the growth over the next five to 10 years. The initiatives may be in various stages of development, ranging from "option plays" still in the incubation period to fully commercialized businesses in the early phases of market adoption. Identification of the opportunities can be through dialogue with those responsible for business development at all levels of the firm, along with general encouragement for all employees to share their long list of ideas. A screening and filtering process may then be required to home in on a shorter list of growth initiatives that are genuinely strategic.

Non-core

Non-core activities are self-evidently not strategic or essential to the survival of the business. This does not necessarily mean that they need to be disposed of or closed down. It does imply, however, that they ought to be managed and run in such a way as to maximize cash flow for investment elsewhere. These are not generally areas for growth and investment.

A portfolio review using this framework can be used to clarify the handful of initiatives that really deserve management's attention in the search for growth.

2. Take a long, hard look at what you are good at — and invest close by

The grass may always be greener on the other side of the fence, but you will probably enjoy the peace and quiet of the garden you know and love, once developed to its full potential, more than attempting a takeover bid for your neighbor's garden!

Investing to grow in SGIs that leverage your core competence is a good idea because branching out beyond your proven areas of expertise often ends in the destruction of value. Being honest with yourself about the difference is one of the keys to finding good growth prospects. So what is the best way to uncover your core capabilities? Testing your hypotheses about your expertise against the four types of capability shown in Figure 2 below is a very good place to start. If the capability you are considering does not fall under one of the four headings, it probably is not a truly sustainable competitive advantage.

Figure 2
Good SGI fit with core capabilities creates competitive advantage and synergy

Reputation

Brand strength and / or word of mouth reputation

Innovation

Demonstrated ability to innovate (products, services or processes)

Internal architecture

The network of relationships within the firm or across suppliers and customers. Includes people, organization, processes, data and analytics

Strategic assets

Unique physical assets or locations and / or intellectual property

Source: L.E.K. analysis

Reputation

Reputation takes a long time to create (and a much shorter time to destroy). It is not easy to copy and almost impossible to fake. A good reputation sustains higher pricing levels for any given cost of input and is one of the most powerful levers for the creation of value. It therefore makes good sense to invest for growth in places where your hard-won reputation will support your pricing and help you win market share.

Innovation

Innovate or die! This is a hard but ultimately inevitable truth about business. It may take a long time to destroy the "cash cow" that you or your predecessors created, but eventually fashion, habits or technology will overtake your proposition and render it irrelevant to the marketplace unless you find ways to renew it. Investing directly in innovation, or indirectly by developing the talent and processes required to innovate, will generally pay (the) dividends.

Strategic assets

The exception to prove the rule above … strategic assets are the gift that keeps on giving. You can rely on them to underpin your business for as long as they remain relevant to your business model. Investing to expand your collection of these valuable assets will usually be a good growth strategy as long as you do not overpay.

Internal architecture

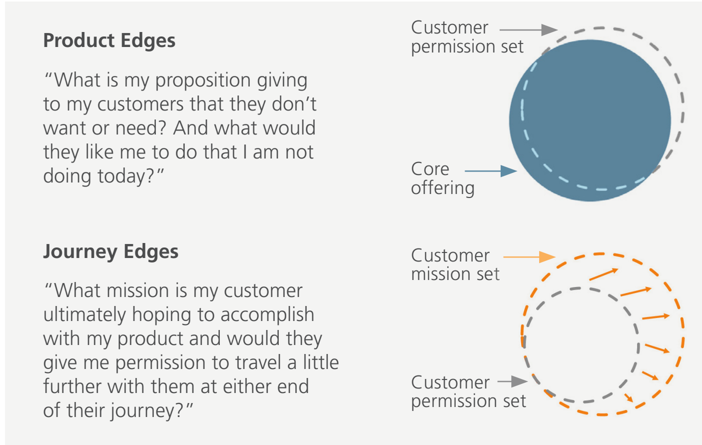
These capabilities are a little harder to define and identify, but elusiveness and obscurity allow you to defend them from copycat competitors. Typically, they revolve around relationships with customers and suppliers and / or the way in which your people and internal processes develop skills and behavior. Can you identify what sets you apart from your direct competitors and explain where those distinctive elements of your business come from? If so, you can begin to think of ways to exploit those elements further in your growth ambitions. If not, it may be time to consider taking the third step outlined below.

3. Find out, directly from your customers, how well you meet their needs

This step is obvious, easy to do and extremely powerful as a route to growth. In spite of these things, rarely is it taken as often and as seriously as it should be by many businesses. Which group of people can tell you what you are doing well or badly as effectively as your own customer base? This is not just about net promoter scores, focus groups and market surveys. It is about in-depth, intelligent dialogue with the people who pay money for your products and services on a regular basis. If you need any help with the type of questions to ask them, L.E.K. Consulting's recently published Edge Strategy® has some useful suggestions (see Figure 3).

Figure 3

Edge Strategy thinking provides a framework for customer research



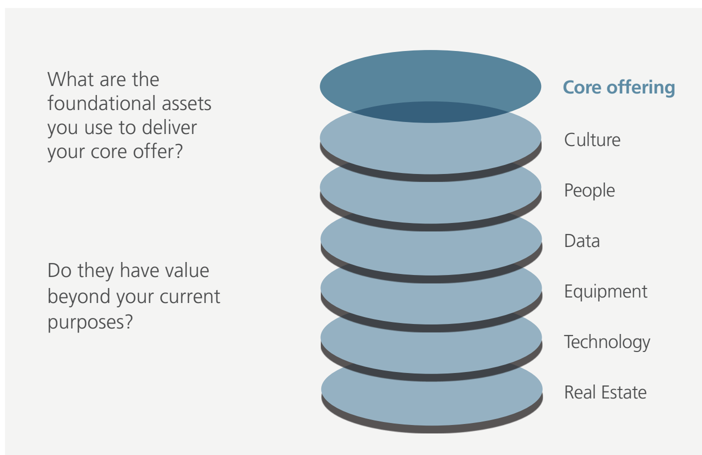
Source: L.E.K. analysis

4. Find ways to make more money from things you have already paid for

Those of you who have read the Edge Strategy® book written by L.EK.'s Dan McKone and Alan Lewis will be aware of the concept of the Enterprise Edge. Your business has already invested to create what they refer to as "foundational assets" — from real estate to data. The growth question is: What value can we create by using those assets for roles and applications beyond their current purpose?

Figure 4

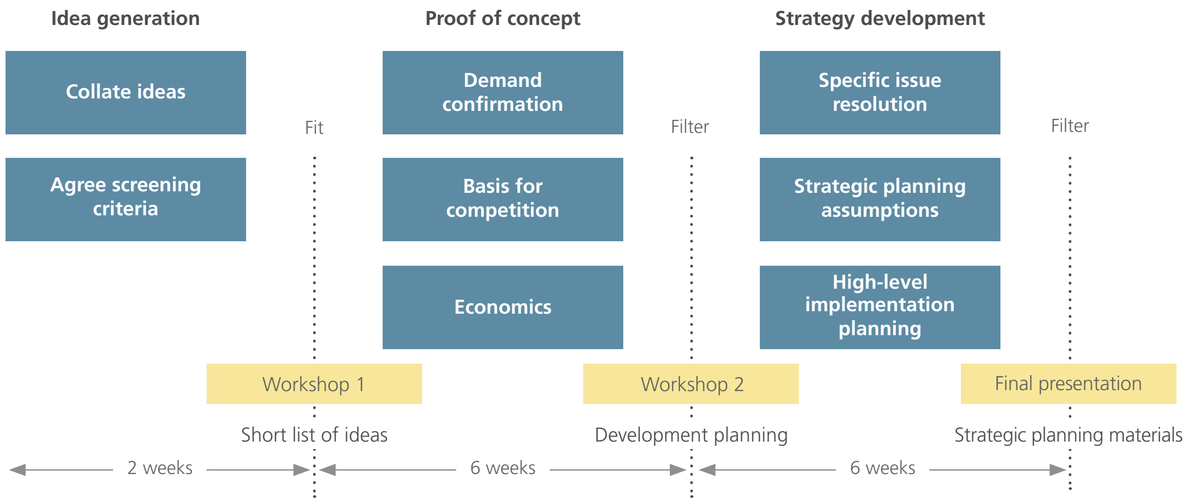
Identifying growth opportunities from foundational assets



Source: L.E.K. analysis

Edge Strategy® is a registered trademark of L.E.K. Consulting LLC

Figure 5
Growth strategy planning process



Source: L.E.K. analysis

5. Ask your own people where and how they believe you should grow

Each of your business leaders should develop a growth plan for adjacent and "step-out" ideas outside the normal cycle of business-as-usual (BAU) planning. Following the process outlined in Figure 5, you can lead them through all the steps (1 to 4) above to create a long list of ideas for growth that also incorporate the excellent initiatives that they already have in their minds or in the early stages of development. A workshop to screen the long list using agreed-upon criteria leads to a "proof of concept" phase in which confirmation of demand, basis for competition and the rudimentary economics are researched. The growth ideas that make it through the scrutiny of the next workshop will need further work to create a realistic set of planning assumptions and a high-level implementation plan. At the end of these three phases of activity, each business unit team should present its short list of growth initiatives with rough estimates for the revenue, margins, capex and timing associated with each. The aggregated result of such an exercise will be a substantial growth plan based on real opportunities and fully owned by the management team. Best of all, this revenue is fully incremental to the growth expected from the BAU planning round, which can then be layered on top.

6. Set out to learn from your failures

We are all familiar with the tech industry's techniques for agile development that include "failing fast" and creating cultures that make it "acceptable to fail." However, how many of us examine our failures in the old world in sufficient detail? How much time do we spend on the examination of failed bids, lost customers, product launches that do not deliver expected results and growth initiatives that peter out? There is enough valuable information in those examinations to inform a raft of good growth initiatives that would then succeed by avoiding pitfalls that we should already know about. It is very good practice to investigate failure.

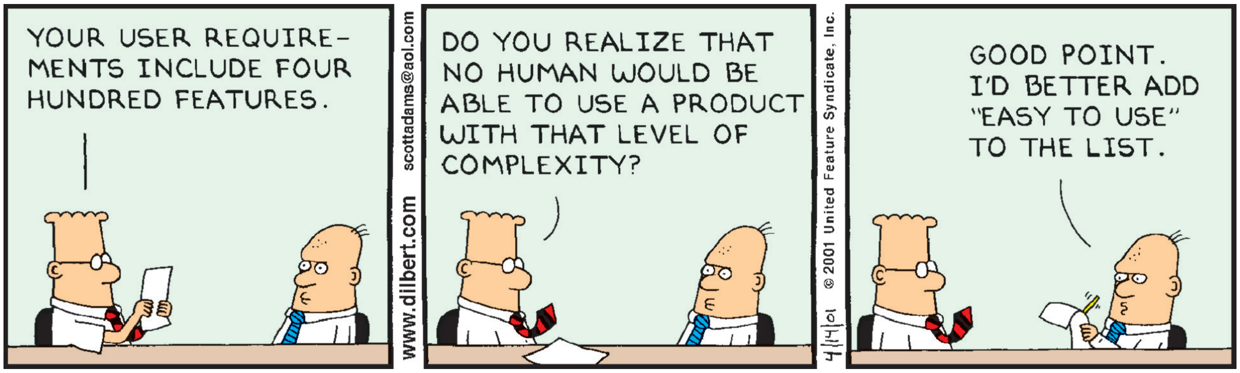
7. Identify the great ideas developed by your competitors and adopt them

Never be afraid to gain inspiration from your competitors' successes — they will not hesitate to return the favor. It is important to keep a keen eye on the developments by others in your industry, not only because your market share might be temporarily affected by them but also because some proposition changes can shift the boundaries of your strategic segmentation and cause major movements in demand for your products. Particular attention should be paid to the innovative competitors, the advanced regions and the early adopter customer communities. We will talk about true disruptors under Step 10 below, but you will find many good growth ideas with a simple and regular scan of your existing competitor set.

8. Take a walk in your customers' shoes

How well do you understand what it really feels like to be a customer of your business? We are sometimes surprised to find that senior executives of businesses that we advise have rarely, or perhaps never, experienced their own products or services. There are businesses that send senior management to the front line of customer service regularly — and this is a great thing to do. However, actually wearing the customers' shoes and going through the process as one of them simply adds another dimension. This is the "reality-reality" experience of being the customer rather than the "virtual-reality" experience of asking the customer (as in Step 3). New ideas that can create, improve, extend and expand your propositions are more likely to succeed if they have been born out of genuine empathy with your customers.

Figure 6



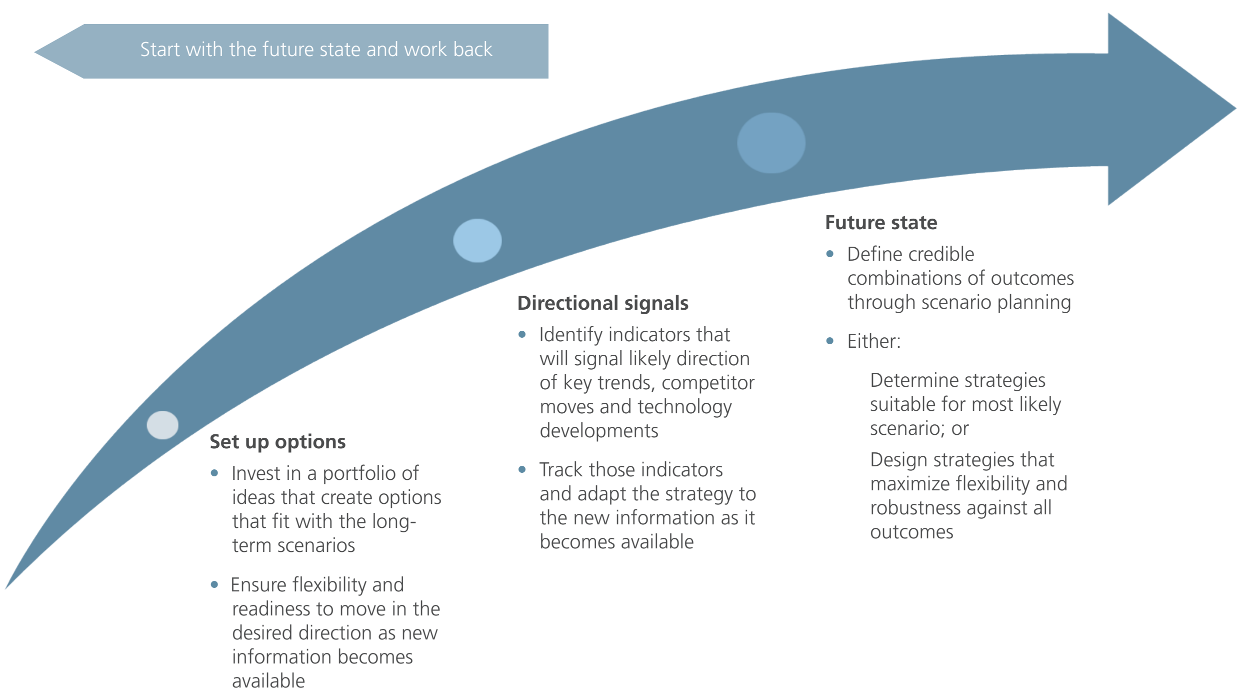
9. Take the time to develop the best view of your 'future state' (10-15 years on)

So far we have been talking about proposition modifications and adjacencies that offer growth opportunities that are fairly close to your current business. The probability of successful outcomes is usually higher for those types of growth initiatives than it is for the blue-sky, step-out ideas. However, there is a place for longer-term visions in the growth story. There are several ways to stimulate your future state. Brainstorming with the right people in your organization, perhaps facilitated and provoked by some input from futurologists, is a common approach. Relying on regular stimulus from your technologists, digital specialists and R&D experts is another. Whichever method you use, it is important to be diligent about describing the future state in enough detail to allow the path back to today to emerge clearly. Unless you take the first steps toward the future state in the present day, and then continue to take steps in the right direction over subsequent years, the vision will always remain the same 5-10 years away and you will never arrive at the destination (see Figure 7).

10. Examine the opportunities offered to you by 'disruptive' technology

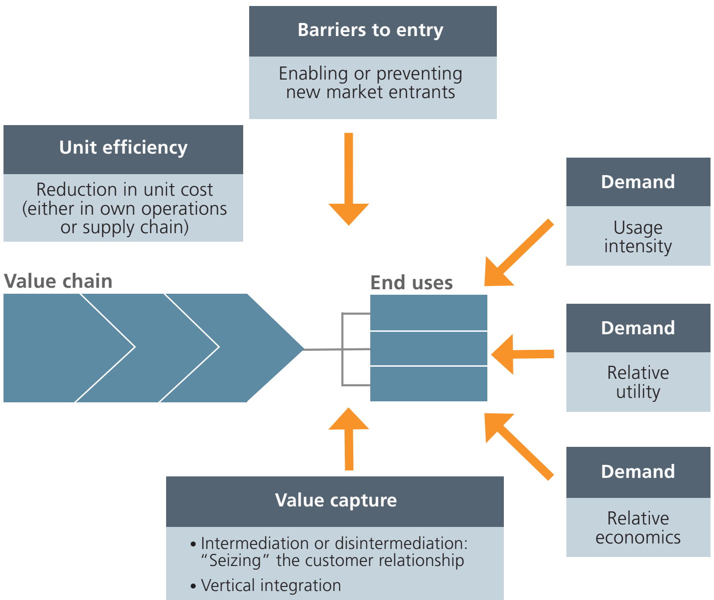
Disruptive technologies are generally regarded as threats to businesses, but they can also offer opportunities for growth. Using

Figure 7
Three phases to developing a future state vision



Source: L.E.K. analysis

Figure 8
Identifying potential opportunities from disruptive technology



Source: L.E.K. analysis

the ideas that are often brought up in the context of future state discussions, it is worth spending time to consider the positives relating to new technology and innovation. This requires some work, because it is only meaningful to consider one technology at a time across one value chain. The framework explained in L.E.K.'s *Executive Insights* "Why Disruptive Technologies Matter" covers this in detail (see Figure 8). The direct and indirect impacts on demand are particularly important in this growth review process and may be easily overlooked.

Concluding thoughts

Good growth opportunities frequently flow from a series of seemingly small improvements and modifications to what is already being done by someone, somewhere in the world; it may stem from your business or from a competitor's business, but genuinely new ideas are rare and potentially risky. Occasionally, circumstances will dictate the need for a bigger-picture, longer-term perspective for which steps 9 and 10 above will be helpful.

Each of these 10 steps represents only a small part of the overall search for good growth, but taken together they will ensure that the subject is approached from many different angles.

We hope you enjoy the journey.

About the Author:

Peter Smith is a Partner in L.E.K. Consulting's London office. He has led a series of assignments in the aerospace, defense, aviation and travel sectors, and also has deep experience in industrial products and services. He has been with the firm for more than 27 years and is mainly active in the corporate strategy side of our business and leading performance improvement work in Europe.

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