
EXECUTIVE INSIGHTS VOLUME X, ISSUE 7

# Reaching for Value: Grow your business without leaving your competitive stronghold

Picture a leading manufacturer of sophisticated medical equipment for kidney dialysis. Now picture a successful chain of stores selling appliances and electronic goods.

What might they have in common?

Both have a high market share of a defined strategic segment. Both enjoy the benefits of a strong reputation with customers (nephrologists and dialysis centers in one case; homeowners and their families in the other). Both enjoy the benefits of large scale in their respective operations (precision design and manufacturing in one case, national network of large scale stores in the other). In other words, they are in a competitive stronghold: high walls, deep moats, and above average profitability.

But what about *beyond* that point? What if they want to accelerate growth beyond the bounds of market growth in their existing businesses. In particular, what if they want to grow faster without triggering a market share war that collapses prices and drains profitability for everyone?

Let's suppose it's *your* business that finds itself in this sweet-and-sour circumstance. So how do you break out of your comfortable (but constrained) niche, and build for the future? If you venture outside your core-strength segments, you almost certainly will enter markets in which you're at a competitive disadvantage, vis a vis the established players. So what's to be done?

One solution – often talked about, but far less often delivered upon – is to *expand the functionality of your product offering* to include services that provide a more complete solution to your customer's needs.

Take, for example, the amazing story of the company that today is called Fresenius Medical Care (FMC), which dates back to the 18th century, when the Fresenius family took over the Hirsch Pharmacy in Frankfurt, Germany, and expanded into a variety of medical products and services. By the mid 20th century, FMC had carved out a strong market niche in the specialized field of dialysis machines and dialyzers, and in 1999, the 100,000th dialysis machine rolled off the company's production line in Schweinfurt.

But by the mid-1990s, change was already in the air. Industry giants like Baxter and Gambro were tough competitors in FMC's core markets. Rather than digging deeper moats or trying to throw up higher walls – almost *never* a sustainable strategy – FMC decided to build on its core strength (manufacturing high-end medical devices) by venturing into the world of related services. FMC knew that the market for dialysis services was many times that for the equipment alone. They also recognized that while many nephrologists liked the idea of sharing in the revenues for dialysis services, they lacked the business discipline to run clinics cost effectively. Through a combination of acquisitions and internal development, they built a network of dialysis

*Reaching for Value: Grow your business without leaving your competitive stronghold* was written by **Stuart Jackson**, Vice President of L.E.K. Consulting and author of *Where Value Hides: A New Way to Uncover Profitable Growth for Your Business* (Wiley 2007). This article is © Emerald Group Publishing Limited and first appeared in the Journal of Business Strategy.

clinics, to which they would sell both equipment and related supplies, and through which they would offer dialysis services. At the same time, they have deepened their relationships with the nephrologists serving the patients of those clinics, and created a close community with the doctors who are the ultimate decision-makers regarding care for kidney disease patients.

Today, FMC has a worldwide network of 2,238 clinics (about three-quarters of which are in the U.S.) which provide treatment to more than 170,000 patients. In many cases, those clinics are located next to established nephrologists' practices, almost guaranteeing a steady stream of patients. Through its Spectra Laboratories division, it provides bodily-fluid testing to patients in clinics in and out of the FMC network – some 49 *million* such tests were administered in the U.S. in 2007 alone.

The result? In FY 2007, FMC's revenues from *product* sales amounted to just under $3.3 billion, while its revenues from dialysis *services* added up to some $6.4 billion. Since making its big push into dialysis services in September 1996, FMC's stock price has risen well ahead of the overall stockmarket, even as competitors, like Baxter and Gambro have struggled with their renal products businesses.

What about our retail example? Are there ways that it, too, can offer a more complete solution to customers' needs? Consider the example of Best Buy Company, the consumer and electronics retailer. By 2002, Best Buy was starting to see the limits of its geographic expansion, but the company's excellent track record had created expectations for continued double digit growth. Best Buy recognized customers' unmet needs for installation and set-up of computers with internet connectivity, and understood their dissatisfaction with most of the independent computer service technicians serving the home market. In 2002, Best Buy acquired the then tiny business of Geek Squad for $3 million. With the benefit of customer referrals from the Best Buy store chain, the size of the Geek Squad business has grown more than 500-fold to around $1.5 billion in revenue, and now accounts for a large proportion of Best Buy's profits (some estimate more than 100% depending on the accounting).

Is there something unique about these two sectors – some factor that makes them conducive to companies seeking to build outward from their product bases into new realms of related products and services? Not at all. Consider the following real-world examples, from a range of different industries:

- Companies like Xerox are selling not just photocopiers but complete outsourced document management solutions, including everything from ID badges to customer billing statements.

- Shipping companies are providing value-added services for warehousing, returns, customer service, packaging, financing and billing services.

- Processed-food companies are providing ready-to-serve finished food items for restaurants, eliminating labor and improving consistency. In some cases, they restock the restaurants at night, eliminating the need for those customers to manage time-consuming deliveries during busy daytime hours.

- Dental products distributors such as Henry Schein are not only acting as supply-chain middlemen, but are also providing a full portfolio of services for dentists starting and building their practices. These services include location selection, practice management software, equipment financing, equipment repair, IT solutions, and electronic claims-processing.

- Computer companies are offering not just hardware, but also broader IT-implementation services. Today, some computer-makers are even venturing into the BPO (business process outsourcing) arena, taking on entire functions like billing and customer service for their clients.

Let's assume that this blizzard of examples has inspired you. If so, you may well be asking, *Does this always make sense?* What questions should my company ask when it begins to contemplate a step "sideways" into related services?

I can suggest four such framing questions:

1. Is there an unmet need out there waiting to be solved? If it's clear that the average nephrologist is not particularly good at running a dialysis center, is this something that we can do better? With the majority of married couples juggling two jobs and a host of other responsibilities, is it reasonable to expect them

to figure out how to install in a home wireless network, or a home entertainment center, on their own? (Answer: no!)

2. Can we help improve our customers' business? Another challenge you may need to overcome is persuading customers that they are really better off working with an outside service provider rather than simply doing it themselves. It is critical to have convincing arguments. The "yes" answer may lie in the economic realm ("we can help reduce the average length of a hospital stay"), in the performance realm ("we can help reduce medication-related errors"), or along some other key dimension. You'll need to get potential customers to see the world your way – and the shortest path to that end is to see the world *their* way.

3. Who's the competition? Many service businesses are served by fragmented competitors competing in one city at a time. If that's the case for the business you are thinking about, and if you're a national-scale enterprise, that's *good news*, because your national customer base creates the potential to rapidly overtake existing competitors. The challenge in this case will be to find new ways of competing which deliver national economies of scale. If there are already strong incumbent competitors, then the business may be tough to enter organically, but an acquisition could be attractive.

4. Can we leverage our existing capabilities to provide a "best-in-class" solution to the problem? Most service businesses are tough to manage. They typically involve thousands of people, often working in customers' homes or offices. Every day, there will be thousands of opportunities to let a customer down and potentially lose them for good. If you don't have the appetite for this kind of management challenge, go no further! But keep in mind that if you can get it right, then you have the chance to develop much closer and deeper customer relationships than competitors who are not willing to take this step.

*If you do not change direction,* the philosopher Lao Tzu observed, *you may end up where you are heading.* In business, "where we are heading" is rarely a safe enough destination. You need to keep envisioning new destinations, and steer in those new directions – and the best time to do so is well before you need to!



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