

Growth Strategies

What and how to choose

To grow or not to grow your business, that is the question. Is it smarter to drive additional profitability through rapid expansion or by slower but more assured organic growth? Consider these strategy options.

Somehow the announcement that an organisation intends to concentrate on extracting sales from its existing activities and return excess capital to shareholders doesn't have the same buzz to it as one in which a company announces a 'growth strategy' that involves expanding its activities and acquiring other enterprises.

David Jones, with its 35 Australian department stores and \$1.9 billion in sales, has been to hell and back with its growth strategy. Having made a great success out of re-focusing its stores, a few years ago it decided to go for growth. The plan involved acquiring an online retailer, which would see DJ's goods sold via the internet, and establishing a chain of gourmet food stores. Neither worked. The food outlets have been sold, and the online activities have been downgraded. It's back to core business. The financial result, as announced by the *Australian Financial Review* back in June, is \$136 million in write-offs and operating losses in three years.

The David Jones story would be unremarkable if it weren't so typical of many public and private companies' experience – on both sides of the Tasman. The list of failed growth strategies by public companies is huge – Burns Philp with its expansion into spices and antibiotics, AMP in insurance, Amcor in packaging, BHP Billiton in a range of ventures, Boral in construction materials.

A recent examination of the growth strategies of 24 high-profile Australian companies concluded that their losses totalled \$47 billion (*Business Review Weekly*, June 5-11, 2003). News Cor-

poration alone lost \$12 billion on its Gemstar venture. Kiwi companies like Air New Zealand have suffered similarly. And this is shareholders' wealth!

What is going wrong here, and what are the strategic options available to achieve growth?

Pressure for growth

The pressure to grow a business comes from the key stakeholders, one of the latter being the shareholders or, in a small-to-medium enterprise (SME), the owners. Shareholders hope that growth means increased wealth.

But growth pressure can also come from customers. Their demand for products or services forces companies to keep expanding – not necessarily profitably. I recently suggested to the manager of a manufacturer of steel silos that it might cap its growth, as its rapid expansion was putting huge financial pressure on the organisation. His response was that he'd

"love to", but his customers "wouldn't allow" him. "Turn down any orders, and they're likely to take the whole of their business elsewhere," he said.

Pressure to grow also comes from employees, especially management. Employees gain from growth through enhanced career prospects: a growing business delivers opportunities for promotion and accompanying salary increases. If a bonus system is tied to growth, the connection between growth and personal gain is even more explicit. A client in the electricity industry complained recently that lack of growth was stifling the organisation. Why?

Because no turnover in management and supervisor ranks meant no openings for younger employees – and their frustrations were showing.

It's easy to see why business growth becomes taken-for-granted, especially in public companies. It can serve so much self-interest. But is growth good for 'every' business?

To grow or not to grow

You wouldn't guess it by looking at the financial press, but many businesses don't want to grow. Sure, they'd like some additional income, but significantly expanding their operations – that's another matter. These businesses have reached equilibrium with their environment.



The majority of small-to-medium enterprises are in this position: convenience stores, specialty shops of all kinds, medical and dental practices, small accounting firms and manufacturers, to name just a few examples. In these cases, stability has been achieved between the pressure from the owners for growth and that from management; often they're the same people. The business serves the owners' needs for wealth, and the owner-managers can't see any benefit from the increased hassle. Here's a specific:

Barry is general manager of a medical centre of 33 doctors, most of whom are partners, and 30 nurses and administrative staff. He's not a medical practitioner. Over the years he has been frustrated by the partners' lack of interest in growth. Sure, each would like to grow his or her income. But, as a partnership, this depends on each partner growing his or her part of the practice, or on adding new partners or employed doctors – thus spreading overheads. The partners don't want to work more hours, so the business can only grow by bringing in new partners or employing more doctors. Since the practice is already providing the full range of services required by a medical practice in the area, this step won't advantage the business competitively, nor will it benefit patients. The existing partners feel that growth wouldn't significantly advantage them financially, either. In the general manager's view, the business has reached a stalemate. From the owners' (partners') perspective, things are okay.

Once you separate ownership from management, owners and managers almost challenge each other to come up with the grandest growth plans. It is most obvious in public companies where shares are openly traded. Here shareholders' views are expressed via the board. In the case of David Jones, management was pressured by the board to grow David Jones and start Foodchain, the chain of gourmet food stores. Management saw some benefits

in pursuing growth and so the escalation began.

Having decided to grow, the next question is how to go about it?

Growth options

Expand existing business First and most obvious, it's the way most businesses approach growth. Hire more employees, buy more plant, expand operations. It's also relatively risk-free, provided the base business is financially sound. But it can take time. Public companies often see it as too slow, which is why they favour acquisition. David Jones estimates that the department store market will grow by about three percent a year for the next 10 years – perhaps too slow for some shareholders.

One analysis of Lend Lease's failed growth plan in the United States contrasts it with Westfield's parallel success in New Zealand and Australia. Lend Lease stripped \$6.2 billion off its shareholder value between 1999 and 2003. It chose the fast way to grow in the US: spend \$3.1 billion buying six separate US businesses. By contrast, Westfield Holdings chose a slower route and expanded its existing business over a 20-year period. In the same period that Lend Lease's value dropped by \$8 billion, Westfield's rose by \$4.6 billion.

Clone the business Cloning involves taking a process or business within an organisation and repeatedly reproducing it in identical form. The obvious examples are franchising and licensing, but it can also be a special form of the first option, which is to expand the existing business. If based on a successful business model, it can be a quick-fire approach to growth.

Walmart, that huge US low-priced department store chain, is in the process of cloning its stores worldwide. It is already the world's largest retailer, with 3400 US stores, but plans to have 5000 in five years. There are now 1200 stores outside the US in nine countries and they account for 16 percent of the chain's total sales. They are also targeted for expansion.

Licensing and franchising allow a business to expand by using a franchisee's capital and by transferring employee supervision issues to the franchisee. The fast food industry has done this to perfection, McDonald's being the classic example. But Dymocks in bookshops and Jim's Mowing in domestic lawn care are others.

McDonald's, for instance, has used franchising to become America's second-largest employer and, until recently, achieved 140 quarters of uninterrupted profit growth since its 1965 sharemarket float. Jim's Mowing and other franchises in the Jim's Group have grown from zero to over 2100 in 14 years. There are now 750 franchise systems operating in Australia, generating more than \$87 billion annually. In New Zealand there are now more than 300 franchise systems generating well in excess of \$10 billion in annual revenues, according to the New Zealand Franchise Association. But to make a success of this form of expansion, the basic business model being cloned must be sound and profitable. Also the franchise fees mustn't bleed the franchisee's business to death, and all franchisees must be genuinely supported.

Expand internationally Businesses can exhaust growth prospects in their home markets, particularly when the market is as small as New Zealand's. Reach this point and there are two basic choices: diversify locally or expand internationally.

Both the New Zealand and Australian markets have plenty of examples but perhaps Fisher & Paykel is among the best locally.

One key to international success lies in managing the differences between homegrown and overseas cultures. The overseas achievements of Australian brewer, Foster's Group, have been partly put down to employing local management and not flooding their overseas operations with Australians. They try to keep the existing management team intact to run the business under Foster's ownership.

Diversify What a trap this can be – particularly when combined with a large acquisition. Why? Usually because managers didn't know what they were getting into. They didn't understand the strategic factors for customers and other key stakeholders in the industry to which they were newcomers; they rushed to judgment; they were misled by those who stood to gain from the diversification; they paid too much for the business – and this is just for starters.

The Brazilian do-anything company, Semco, has a different approach to diversification. Led by maverick owner Ricardo Semler, the company continually spreads its wings into other industries. It manufactures pumps, industrial mixers, dishwashers, cooling towers for large commercial buildings, conducts cooling tower maintenance and manages a complete maintenance service for its customers. One secret to its success has been to take on partners with the industry knowledge that Semco didn't possess.

Establish a strategic alliance An arrangement between organisations whereby each benefits. Some years ago Kentucky Fried Chicken formed an alliance with Mitsubishi in Japan to get established there. Software provider Peoplesoft has a strategic alliance with PricewaterhouseCoopers. Both benefit from the association: PWC in extending its product range to clients and growing its revenue, and Peoplesoft in linking its brand to PWC's and increasing sales. The key is in finding the points of mutual benefit, in clearly articulating and continually refreshing the business model and in nurturing the relationship. Otherwise, strategic alliances tend to wither over time and not deliver.

Acquire another business A recent article on mergers and acquisitions in the *Harvard Business Review* (June, 2003) estimated that 70 to 80 percent of acquisitions failed to create wealth for the shareholders of the acquiring business. Here are just a few recent disasters: Daimler Benz's purchase of Chrysler; Time-Warner's acquisition of

AOL; National Australia Bank's buy of HomeSide; AMP's purchase of Henderson; Air New Zealand's purchase of Ansett. The list goes on. It keeps happening, fundamentally because of the pressure to grow and grow quickly.

David Jones, after its bloody growth experience, has announced that acquisitions are off its agenda for the next three to five years.

So what is the conclusion? It is difficult to successfully acquire another organisation and thereby build shareholder wealth, the measure of any acquisition's success. This is especially so if the target is large and in a different industry and country. Some suggest changing the conventional approach to evaluating an acquisition, not seeing it as a set of products, services and functions, and more a collection of customers. This requires an assessment of customer profitability. It might help an acquirer to take a more realistic view of a target's worth.

Lobbying What if you could grow your business by limiting your competitors? Lobbying can accomplish that. Look at the way European beef producers have lobbied their governments to slap tariffs on our beef imports, or the way US agriculture has managed to obtain subsidies from its government. In both cases, organisations within these industries grow despite stiff competition.

The playing field isn't flat, and the rules of the game and consequent growth opportunities favour the lobbyist. Closer to home has been the intense lobbying conducted by Qantas and Air New Zealand over a proposed alliance. Qantas wanted to buy 22.5 percent of Air New Zealand to grow its business, and Air New Zealand was happy with this idea to satisfy its survival instincts. The NZ Commerce Commission and the Australian Competition and Consumer Commission were not inclined to let the purchase proceed and in late October the NZ Commerce Commission ruled against the alliance.

Lobbying is also an option for smaller enterprises, via their trade and industry

associations or directly with their local councils.

Growth dilemma

To grow or not to grow is truly a dilemma. Growth is not taken for granted, despite what the media says. The assumption is only validated when certain pressures apply. Pressures come from key stakeholders, and especially, shareholders, customers and employees. The majority of businesses turn their back on significant growth once the needs of their key stakeholders are met, particularly in the case of owner-managed businesses.

Many scales can be used to weigh the available options, once a business has decided that growth is the way to go. On a most-likely-to-fail scale, acquisition of another business stands out. This is especially so if the acquisition is large and involves diversification and expansion into another country. At the other end of this scale sits expansion of existing business. But this can be a slow process, less certain in its growth outcome than the quick quantum leap promised by acquisition.

Cloning stands out on a fast-simple-safe scale. The idea that a business could reproduce a part of itself repeatedly and thereby grow is hugely attractive. It offers, for instance, repeated opportunities to learn, monitor, refine and improve. Many businesses, however, don't lend themselves to this form of expansion.

So before reviewing any of these growth options, consider the question: is growth for me? If the answer is "yes", then evaluate each option against your business objectives, weighing up each according to risk, growth speed, resource requirements, loss of control and the criteria relevant to your situation. In this way you're more likely to make a success of business growth. **M**



Graham Kenny is managing director of Strategic Factors and author of the book *Strategic Factors: Develop and Measure Winning Strategy*.
Email: gkenny@strategicfactors.com