GROWING PAINS

Business growth becomes taken for granted, especially in public companies. It can serve so many interests. But is it right for every business?

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HAVING MADE A GREAT SUCCESS out of re-focusing its stores, a few years ago the David Jones department store decided to embark on a growth plan. This 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. It was back to core business. The financial result, as announced in the 4 June 2003 *The Australian Financial Review,* was $117 million in write-offs and operating losses in the past three years.

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

A recent examination of the growth strategies of 24 high-profile Australian companies concluded that their losses totalled $40.3 billion (*Business Review Weekly,* 5-11 June, 2003). News Corporation alone lost $11.1 billion on its Gemstar venture. And this is shareholders' wealth!

AT A GLANCE

- If based on a successful business model, franchising and licensing can be a quick fire approach to growth
- The key to international success is in managing the differences between Australian and overseas cultures
- A strategic alliance is an arrangement between organisations where each party benefits. The key is to find the mutual benefit and to clearly articulate and continuously refresh the business model.

WHAT STRATEGIC OPTIONS ARE AVAILABLE TO ACHIEVE GROWTH?

The pressure to grow a business comes from its key stakeholders, one being the shareholders or, in a small-to-medium enterprise (SME), the owners.

But pressure can come from customers whose demand for products or services forces a company to keep expanding — not necessarily profitably.

A third pressure comes from employees, especially management. Employees gain from growth through its effect on career prospects.

To grow or not to grow?

Many businesses simply don't want to grow. Sure, they'd like a bit of extra income, but significantly expanding their operations — that's another matter.

The majority of SMEs are in this position: convenience stores, specialty shops of all kinds, medical and dental practices, small accounting firms and manufacturers, to name a few. Stability has been achieved between the pressure from the owners for growth and that from management; often they're the same people.

Once you separate ownership from management, owners and managers almost challenge each other to come up with the grandest growth plans. We see this especially in public companies, whose shares are traded openly. In the case of David Jones, pressure was applied on management by the board to grow DJs and start a chain of gourmet food stores. Management could also see benefits in pursuing growth. And so the escalation began.

Once a company has decided growth is the objective, in what ways can it grow?

GROWTH OPTIONS

1. Expand the existing business

This is the first and most obvious way. Hire more employees, buy more plant, expand operations. It's also relatively risk-free, provided the basic business is financially sound. But it can be slow. David Jones, now expanding its existing business, estimates that the department store market will grow by about 3% a year for the next 10 years.

One analysis of Lend Lease's failed growth plan in the US contrasts with Westfield's parallel success. Lend Lease stripped $5.3 billion off its shareholder value between 1999 and 2003. It chose the fast way to grow in the US: spend $2.7 billion buying six separate US businesses. In 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 $7 billion, Westfield's rose by $4 billion (*The Bulletin,* 17 June 2003).

2. Clone the business

If based on a successful business model, cloning (eg, franchising and licensing) can be a quick-fire approach to growth.

Walmart, the 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 3,400 US stores, but plans to have 5,000 in five years. The stores outside the US currently

number 1,200 in nine countries and account for 16% of the chain's total sales.

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.

Jim's Mowing and other franchises in the Jim's Group have grown from zero to over 2,100 in 14 years. There are now 750 franchise systems operating in Australia and generating more than $75 billion annually. But to make a success of this form of expansion, the basic business model being cloned must be sound and profitable.

3. Expand internationally

Some businesses have nearly exhausted the growth prospects in their home markets. Australia's largest FM radio network, Austereo, has done just that in the local radio market. It, like many companies in a similar position, has two basic choices: diversify locally or expand internationally.

Pioneer Concrete, which makes and sells pre-mixed concrete, is an example of a firm that many years ago decided to take its business model overseas. So it designed a standard concrete batching plant composed of a plant manager, batcher, dispatcher, silos, weigh bins, trucks, etc. and established plants in the US and several European and Asian countries.

One key to international success lies in managing the differences between Australian and overseas cultures. The Foster's Group's achievements overseas 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.

4. Diversify

This can be a trap because in nearly every case 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 judgement; they were misled by those who stood to gain from the diversification; they paid too much – and all this is just for starters.

Semco has a different approach to diversification that has some merits. This Brazilian do-anything company, led by Ricardo Semler, 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 including cleaning, security and general maintenance. One secret to its success has been to take on partners with the industry knowledge that Semco didn't possess.

5. Establish a strategic alliance

A strategic alliance is an arrangement between organisations where each party benefits. For example, some years ago Kentucky Fried Chicken formed an alliance with Mitsubishi in Japan to get established there. The 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 thus 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.

6. Acquire another business

A recent article on mergers and acquisitions in the *Harvard Business Review* (June, 2003) estimated that 70-to-80% of acquisitions fail, that is, they did not create wealth for the shareholders of the acquiring business. Look at the disasters of late: Daimler Benz's purchase of Chrysler, Time-Warner's acquisition of AOL, National Australia Bank's buy of HomeSide, AMP's procurement of Henderson, and the list goes on. It keeps happening, fundamentally because of the pressure to grow and the need for this growth to be quick.

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

7. Lobbying

What if you could grow your business by limiting your competitors? Lobbying can do precisely that. Look at the way European beef producers have lobbied their governments to slap tariffs on Australian beef imports, or the way US agriculture has obtained subsidies from its government. In both cases, organisations within these industries continue to grow in the face of stiff competition. The playing field certainly isn't flat, and the rules of the game and consequent growth opportunities favour the lobbyist. Lobbying is also an option for smaller enterprises, via their trade and industry associations and directly with their local councils.

CONCLUSION

Before reviewing any of these growth options, carefully examine 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, speed, resource requirements, loss of control and any criteria relevant to your situation. In this way you're more likely to make a success of business growth. CA

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