Finding Opportunities for Growth

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Going Beyond Cost Cutting to Growing the Business

During recent decades, organizations in both the private and public sectors have worked hard to improve their efficiency and effectiveness by reducing costs and waste, and by working their assets harder. These efforts have been associated with the implementation of rigorous management programs that have gone under the names of quality management, business process re-engineering, outsourcing, financial engineering, capital management, etc.

However, recently we can see a growing emphasis by leading executives on "growing the top line" rather than striving to further cut an already lean and mean, financially optimised bottom line. A growing number of books and journal articles and media stories have been appearing on such topics as innovation, creating new growth platforms, knowledge management, customer/stakeholder relationship management, etc. These articles focus on how to grow the business in one way or another.

Different Types of Growth Initiatives Have Different Business Outcomes

Harvard Professor, Clayton Christensen, in his ground-breaking series of books on innovation has reminded us that most proposed growth initiatives in large organizations have to promise the potential of generating significant revenues in the reasonably short term in order to be of interest to senior managers and boards of directors who are used to dealing with large numbers and with investor demands for immediate financial payoffs. Hence, the initiatives that get approved are typically what Christensen calls "sustaining innovations"; i.e. they extend the features and the attractiveness of existing products and services offered to major customers in existing markets.

Sustaining innovations have the big disadvantage that they target the same customers that are being targeted by all of a company's big competitors. Hence the costs of winning and keeping the extra sales that may come from sustaining innovations can be quite high – and any short term gain in profit margins from the upgraded products is usually quickly eroded as competitors introduce their own versions of the sustaining innovation. Moreover, sustaining innovations do not tap new and potentially high-growth markets of people who are trying to get an important "job" done in their lives (to satisfy an important need or want) but who are unable or limited in their ability to do so by the inadequacies or high costs of existing product/service offerings.

While sustaining innovations may be able to deliver an absolute increase in revenue, they rarely achieve increasing <u>rates</u> of growth in an organisation's revenue and profits. In order to create new platforms for future growth that are capable of increasing the rate of growth of profit and revenue (which will then drive share price appreciation), companies must find and nurture what Christensen calls "disruptive innovations". These are new products or services that other companies are either unwilling or unable to compete against for one or more of the following reasons:

- They do not have access to the skills and resources needed to match your new offering
- They lack the technology and business processes needed to produce and deliver a competitive product or service
- Their values, priorities and corporate culture and their historical momentum mean that it is too big a shift for them to offer a competitive product/service.

Most successful disruptive innovations "seek to *compete against non-consumption* and establish a completely new market (new-market disruption), or they can *attack from the low end* by deploying a business model that profitably serves the less demanding customers whom market leaders are happy to shed as they themselves move up-market (low-end disruption)" (Christensen , Anthony and Roth 2004, p. 279).

An example of a new-market innovator is the international women's fitness centre franchisor, Curves. Its founders had the insight that large numbers of women who wanted to get fitter were put off going to male or youth-oriented fitness centres that required attendance for significant blocks of time and which were intimidating to many women. So in 1992, they opened their first women-only fitness centre that promised results from 30-minute sessions three times a week. This obviously suited many women juggling work and family commitments. By appealing to women who had previously been non-consumers of a fitness centre product, Curves now claims to be the fastest growing franchise in the world and the largest fitness franchise, with over 9500 centres.

An example of a low-end disruption is the entry of Aussie Home Loans into the Australian home lending market by targeting the lower "quality" borrowers that the big banks were initially happy to shed in order to focus on the more profitable customers who sought the perceived security of dealing with (and paying a premium for dealing with) an established bank. However, as they survived and grew and learned more about the competitive weaknesses of their larger competitors in servicing the low-end market niche, Aussie Home Loans developed the low-cost infrastructure, the skills and the corporate culture and fleet-footedness that enabled them to subsequently move up-market in the housing loan business and also into a range of other financial market segments.

Building Very Different Strategic Planning and Budgeting Infrastructure for Different Types of Growth Initiative

Professor Clayton Christensen's research found that it is virtually impossible for disruptive innovations to get approved and supported by the management processes that exist in almost all established, successful organizations. The very attributes that have made them successful (their mix of resources, processes, systems and culture) act to screen out the disruptive innovations that offer the best potential for creating the growth platforms that boards and senior executives say that they are searching for. For example, a decision making logic that seeks the potential for significant short term revenue dollars and large profit margins before approving a new business proposal will never approve a disruptive new-market or a low-end disruptive innovation. The new-market proposal will be killed when it can't present reliable estimates of future market potential because the market does not yet exist. The low-end disruptive proposal will be killed when it proposes the adoption of a much lower cost business model and the organizational infrastructure and values and culture that go with it.

Both new-market and low-end disruptive strategies rarely are "discovered" fully formed but rather emerge from a period of experimentation, listening to feedback and learning about what works. Research cited by Christensen and Raynor suggests that "in over 90 percent of all successful new businesses, historically, the strategy that the founders had deliberately decided to pursue was not the strategy that ultimately led to the business's success". Consequently, the strategy-making process for new innovative businesses should be aligned with this reality and be constructed very differently from the typical planning process that is used with established businesses and with proposals for "add-on" innovations that promise to sustain them with incremental growth (see Tables 1 and 2):

Table 1: Deliberate Planning for Familiar Businesses and Sustaining Innovations	**Table 2: Discovery-Driven Planning for Novel Businesses and Disruptive Innovations**
1. Make assumptions about the future – assumptions are likely to be accurate if environment is familiar and stable 2. Define a strategy based on those assumptions and build financial projections based on that strategy 3. Make decisions to invest based on those financial projections 4. Implement the strategy in order to achieve the projected financial results	1. Make the targeted financial projections 2. Define the assumptions that must prove true in order for those projections to materialise 3. Implement a plan to learn – to test whether the critical assumptions are reasonable and under what sets of circumstances they might hold true 4. Invest to implement the strategy to maximise the projected learning

Adapted from: Christensen and Raynor 2003, p.228

Projects going to a board for approval to fund a sustaining innovation can be grounded in assumptions, numbers and traditional investment rules because the project environment is likely to be familiar and stable. However, projects seeking funding for disruptive innovations are much more likely to succeed if they are based on what Christensen calls "pattern recognition" and sound theory. This means that disruptive innovations should be funded when they fit the pattern of success for this type of growth initiative; i.e. when they target non-consumers or low-end market segments and when they embrace discovery-driven strategy development rather than targeting existing customers in existing markets and making assumptions about the future and proposing a business strategy that senior decision makers are likely to regard as familiar and comfortable.

Implementing Discovery-Driven Planning for New Growth Initiatives

The science of futures studies (see Saul 2001 for an overview) offers a variety of proven techniques for implementing a new growth initiative in ways that maximize the learning about what works in practice (i.e. Steps 2 and 3 in Table 2 above). For example, one possible approach would be as outlined in Table 3 below:

Table 3: An Example of Planning to Drive New Growth

1. ***Identify the major trends and emerging issues (social, technical, environmental, economic, political) that are likely to play a role in shaping the future of your industry and target markets.***
   This involves a mix of research, interviews and focus groups both within the organization and utilizing external stakeholders and other outside resources.

2. ***Analyse the inter-relationships between these various "future shapers" to identify those likely to have the greatest impact in shaping the future that will be faced by your organisation.***
   This involves short workshops with internal experts and relevant stakeholders.

3. ***Based on the results of Steps 1 and 2 above, develop several possible scenarios (both desirable and undesirable) that describe the future in which your proposed new product or service will have to deliver its required financial projections. The assumptions about the future that are embedded in each scenario can be made explicit.***
   The early drafts of the future scenarios are prepared by expert consultants experienced in integrating a wide range of data and information into a coherent and credible story about the future.

4. ***Evaluate and rank the various possible futures in terms of the likelihood of the desired financial projections being realized in each one.***

5. ***Identify the actions that the company can take to maximise the likelihood of the most attractive future scenario(s) being realised and of the desired financial returns from the new product/service being achieved.***
   This step will typically involve a commitment to test market a new product or service (and business model) that fits the successful pattern of a disruptive or low-end product or service innovation within a favourable future scenario.

6. ***Identify the indicators that will give early warning that each possible scenario is actually evolving.***
   Steps 4-6 are completed in workshops with representatives of all major parts of the organisation.

7. ***Develop a plan to implement and <u>test</u> the impact of (and <u>learn</u> how to amplify the positive impacts of) the future-shaping actions identified in Step 5; and to monitor the early warning indicators identified in Step 6.***
   This plan is drafted in a workshop with representatives of all major parts of the organization and finalized by the senior management team.

Senior management can then approve, cancel or modify the proposal to invest further in the new product or service on the basis of the learning gained from the actions described in Table 3 above.

Inertia and Obstacles to be Overcome
Previous experience and research have identified the following common sources of resistance to the timely and effective introduction of growth initiatives that offer the potential to lay down new platforms for profitable future growth:

- ***The "numbers" surrounding the proposed new business are uncertain and the level of risk appears to be unjustified.*** However, waiting until the numbers are certain may mean that you have waited until it is too late to capture a growing new market (c.f. Saul 2006). Risk is most effectively managed by ensuring that the new venture conforms to the patterns of success that have been found to characterize most growth initiatives (as outlined in this paper).
- ***The innovation requires a lower cost structure or, what is initially perceived as being, a lower status business model to that on which the current success of the organisation has been based.*** This obstacle may only be overcome by establishing the new business in a separate organization staffed with people who are excited by the opportunity of getting in on the ground floor of a business they believe in.
- ***The innovation requires a workforce (including senior managers) with different skills, different performance measures and different reward structures to those in the current organisation.*** A new corporate culture and set of business values and priorities will probably also be required. These obstacles are added reasons for establishing the new business in a separate organization with its own senior management team (and possibly its own board of directors). The workforce should have the skills and mindset needed for success in the new venture rather than those that have proven successful in the old business.
- ***The innovation may initially target a much smaller market (with lower margins) than the existing business.*** However, if targeted correctly, it is the much greater potential for future growth in this market that is the basis of its attractiveness. This obstacle is minimized if the funding for the new venture is made contingent on the business delivering early profits rather than early (revenue) growth.

In summary, top management teams must be innovative in the way they approach the whole business of evaluating and approving growth initiatives if they are to lay down the business platforms that offer the best potential for accelerating revenue and profit growth – thereby driving continuing share price appreciation.

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