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Unit

Canback

Creating growth in a flat world

How to identify, quantify, and capture new growth opportunities

A report by The Economist Intelligence Unit





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Corporate growth is of paramount importance for senior management, as it contributes 40% of shareholder value on average.¹ However, finding growth opportunities over and beyond a company's existing plans is difficult. Moreover, growth tends to be less profitable than business as usual, at least in the short term. Finally, there are organisational barriers to growth that may mean that even the best growth plans come to naught.

In this paper, EIU Canback, a management consulting firm recently acquired by The Economist Intelligence Unit, puts forward a structured approach to identifying, quantifying and capturing growth opportunities. It is based in part on our managing director's multi-year research into what drives corporate performance, and in part on our growth-focused consulting and thought-leadership work with some of the world's largest corporations.

In our experience, it is possible to find 20–60% gross growth opportunities over a five-year period, over and above existing plans. Capturing a significant part of this potential can dramatically increase shareholder value. However, the most important part of an effort to grow is not finding the opportunities, but rather working out how to overcome corporate obstacles to growth. In the end, achieving high growth is an organisational issue.

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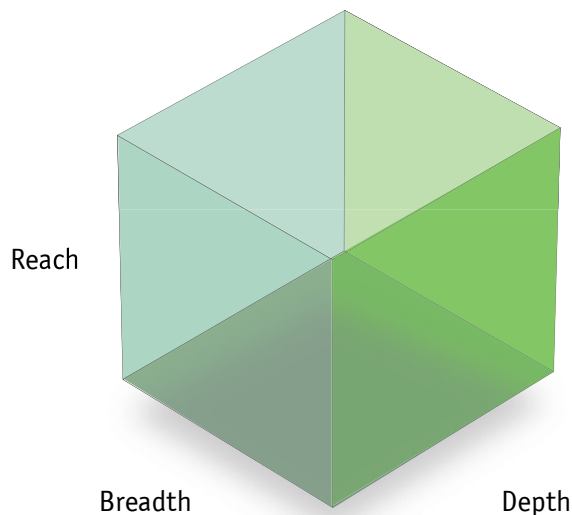
Introduction: The nature of growth

Many commentators talk about “growth”, but what do we actually mean by it in the context of corporate expansion? Growth should be defined as growth in value added, not in revenue (any company can achieve high revenue growth by becoming a trader).

There are three types of growth opportunities:

1. *Reach*: geographic – international, or within a country
2. *Breadth*: adjacent categories or new products/services
3. *Depth*: forward or backward integration in the value chain

The Growth Cube



The Growth Cube allows us to classify the most common growth opportunities that we encounter:

Reach

- Geographic expansion is one of the most important drivers of growth, especially for products that are not culturally embedded. A recent EIU report on corporate overseas expansion found that the aims of opening up new markets and gaining market share are the main drivers of corporate expansion abroad (see chart, below).² If a company has an appreciated brand in one market, this brand strength more often than not carries over into new markets, be they new countries or regions within a single country. Apple’s introduction of the iPhone in China is a good example.

- Strengthening distribution coverage is another major lever of growth. If consumers cannot gain access to a product, it will not be bought, no matter what its benefits. This seemingly self-evident rule

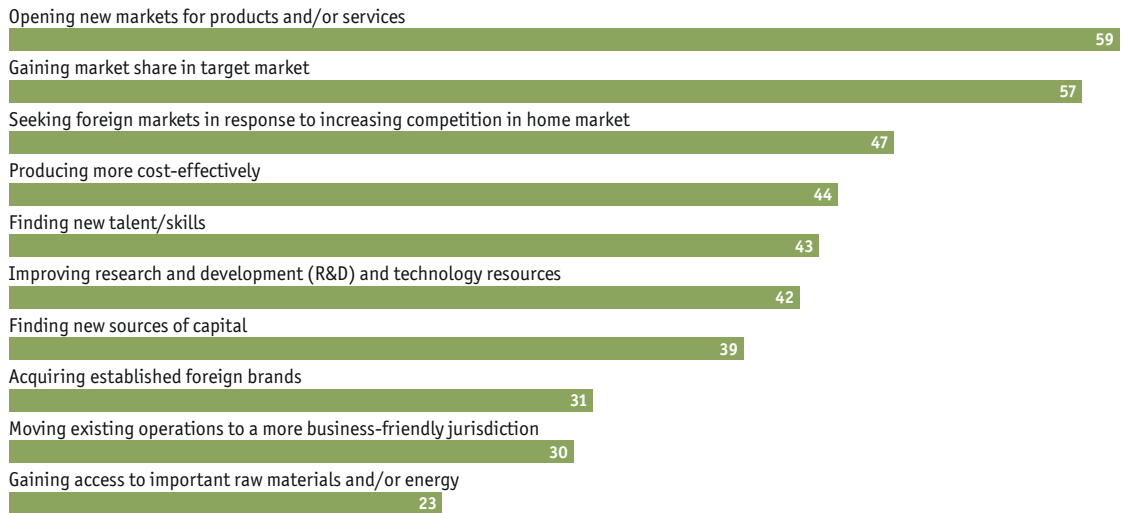


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Top drivers of expansion

(% respondents, multiple answers allowed)



Source: Economist Intelligence Unit survey, August-September 2015.

is often violated by consumer-facing companies, especially in emerging countries. For example, in fast-moving consumer goods, companies look to serve both modern and traditional outlets.

- Reaching new consumer segments, occasions or need-states is another important driver of growth. In established markets with stable competitive positions, this is the most important reach driver of growth. “Expansion has been—and will always be—driven by customer requirements,” says James Kidd, chief financial officer at a UK-based multinational information technology company, AVEVA.³

Breadth

- Expanding into new product categories to build economies of scope in distribution is perhaps the most powerful lever of growth. Companies that do not do this are likely gradually to become uncompetitive and be acquired or go bankrupt. The most successful category expansion is Apple’s addition of smartphones to complement its computer range. Another example is luxury-goods companies that are strong in one area (such as handbags) that have become full-range clothing and accessories companies. In 25 years, LVMH has transformed into a conglomerate that controls more than 60 luxury brands across multiple product categories.

- Conversely, prioritising the highest-potential existing brands, products or stock-keeping units by strategically reducing their breadth is also important. Procter & Gamble’s recent focus on power brands is a good example. Doing this can lead to higher growth because resources are allocated more efficiently.

- Capturing multiple price points is a significant driver of growth. If a company has earned the trust of consumers at one price point, it will often have the ability to capture other (and especially higher) price points. Witness how premium carmakers are expanding in the super-premium segment, or how beer companies “premiumise” their portfolios.



Depth

Vertical depth is a more problematic growth driver. Although value added can be increased through forward or backward integration, it is unlikely to be profitable. There are exceptions, however.

- Forward integration makes sense when a product's brand power is intimately linked with the shopping experience. Luxury-goods makers such as Prada and Apple have used this factor to their advantage. (Note, however, that the argument that "we'll capture more margin" is often fallacious. A capital cost is associated with the new margin, and only when the return on invested capital improves is the argument correct. Otherwise, every company would work hard to achieve forward integration.)
- Backward integration rarely makes sense. Only if a supplier's negotiating power is too strong should it be considered.
- A more effective way to increase depth is to add features to a product, such as increasing functional or emotional benefits (for example, adding vitamins to food or going organic). This will result in higher price points and thus increased revenue, if price elasticity is favourable. Kellogg's Kashi range of "wholesome" cereals is an example.

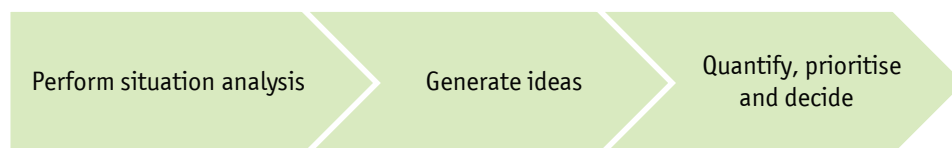
Given the existence of such apparently easily identified growth opportunities, why do companies not go for all of them? The answer is that high growth is rarely as profitable as doing more of the same.

In Chapter 1, we discuss how a company can identify and quantify such growth opportunities. In Chapter 2, we explain how it is possible to capture them.

Chapter 1: Identifying and quantifying growth opportunities

We have found that it is easy to identify growth opportunities, but there will not be agreement on what to do about them until they have been quantified and calibrated against other corporate or business-unit priorities. There is a clear and logical three-step process involved in making sure that identification is exhaustive and that quantification is precise and credible. Here are the three steps in our Sources of Growth methodology:

Identifying and quantifying growth opportunities



1) Perform situation analysis

This is the crucial first step. Rather than stumbling into idea generation, it is important first to understand the market landscape and the company’s competitive position by category, brand, channel, consumer segment, occasion, package and other factors.

Sometimes this has already been done as part of the strategic planning process, but often situation analysis is weak, especially at the “edges” of the company. These edges are where many growth opportunities lie.

2) Generate ideas

With the situation analysis as a base, the next step is to generate growth ideas that far surpass current goals. The focus is initially on ideas, not realism: there is nothing more destructive than when executives start judging ideas early in the process.

The goals in the idea generation phase are, broadly, to find 20% volume growth opportunities and 30% value growth opportunities in affluent countries, and 40% volume growth and 60% value growth opportunities in emerging countries, within a five-year horizon. The exact goals will vary by company and category; estimates of growth are by necessity rough at this stage.

There are two ways to generate ideas: 1) by management teams, and 2) by consultants. The first approach is based on brainstorming sessions, while in the second the consultant project team generate ideas in collaboration with the client.

Often, management teams struggle to generate ideas—if they had them, they would probably already have been captured. Thus, bringing in outsiders to dispassionately generate ideas tends to be a more powerful approach.

In an interview with the EIU, Jose Papa Neto, the chief executive of a global fashion-trend forecasting company, WGSN, highlighted the importance of expert advice: “It may sound clichéd, but

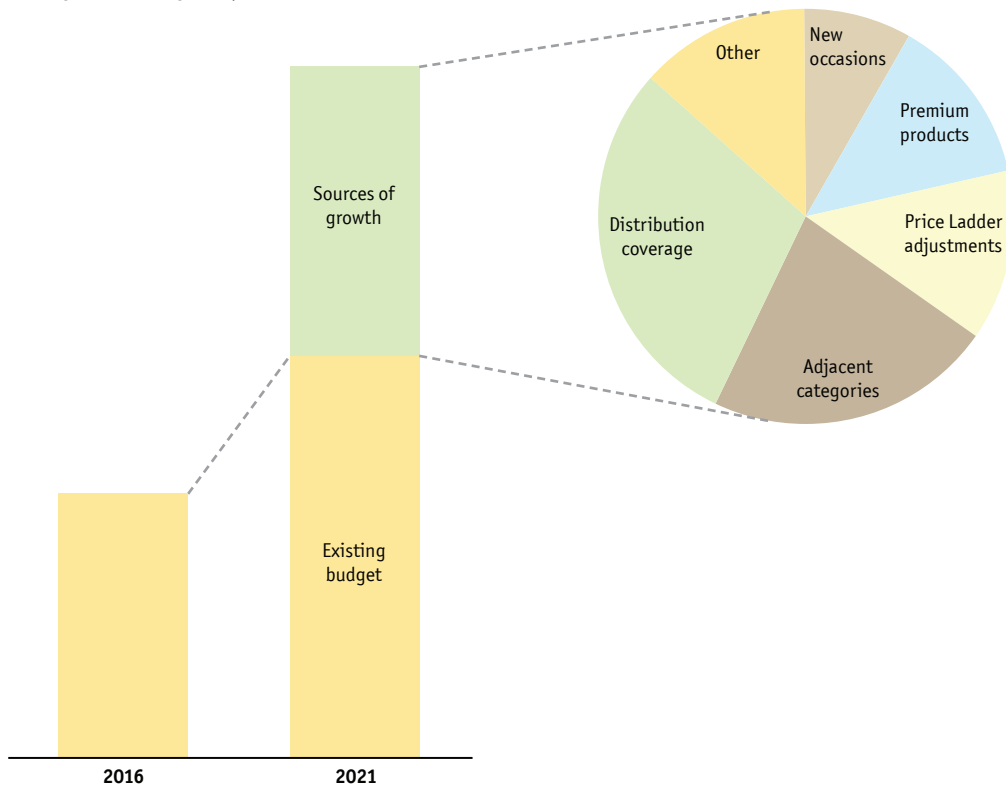


we have learned from historical expansions, where we did not respect the need to look at all factors, particularly not investing enough in expert advice to create the right conditions for expansion.”

3) Quantify, prioritise and decide

To enable the merits of ideas to be judged, they have to be quantified. This includes estimating the profit impact, and if possible also the impact on shareholder value. To get to this point with many ideas, it is important to standardise the analytical approach. This also makes it easier for senior executives to compare various growth ideas. An example is shown below.

Sources of growth example (Fast-moving consumer goods)



An important consideration is the need to project realistic profits. It is unlikely that the sum of the growth ideas together will have better profit characteristics than the current business—after all, the goal is to generate growth ideas, not to maximise profitability. Another profit issue is when estimated profits from growth ideas are above the cost of capital but below current profitability. Such opportunities are good, but are nevertheless often rejected. An example would be expanding beer sales into modern trade, where profitability, although good, is lower than in traditional trade.

Another aspect of quantification is risk assessment. What is the likelihood of the growth opportunity being captured? The road to growth is littered with failed projects. The reputational risk of failure can be considerable, both for a company and for the executives involved, although it is important to note



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that the reputational risk of sticking to the status quo is usually even higher.

Opportunities can be captured organically or through acquisition. In mature markets (for example, fast-moving consumer goods in affluent countries) acquisitions are often a better solution than capturing growth opportunities organically.

Finally, resource requirements—including both human and financial resources—have to be documented. Often, the largest obstacle to capturing growth opportunities is a lack of executives with the right skills profile. Nothing is free in this world, so expecting employees to perform their regular duties and also to capture growth opportunities is unrealistic.

At this point, the task is to prioritise and decide. This is most properly done in formal executive committee meetings. It is important that this process is robust and procedurally correct. Impromptu decisions lead nowhere.



Chapter 2: Capturing growth opportunities

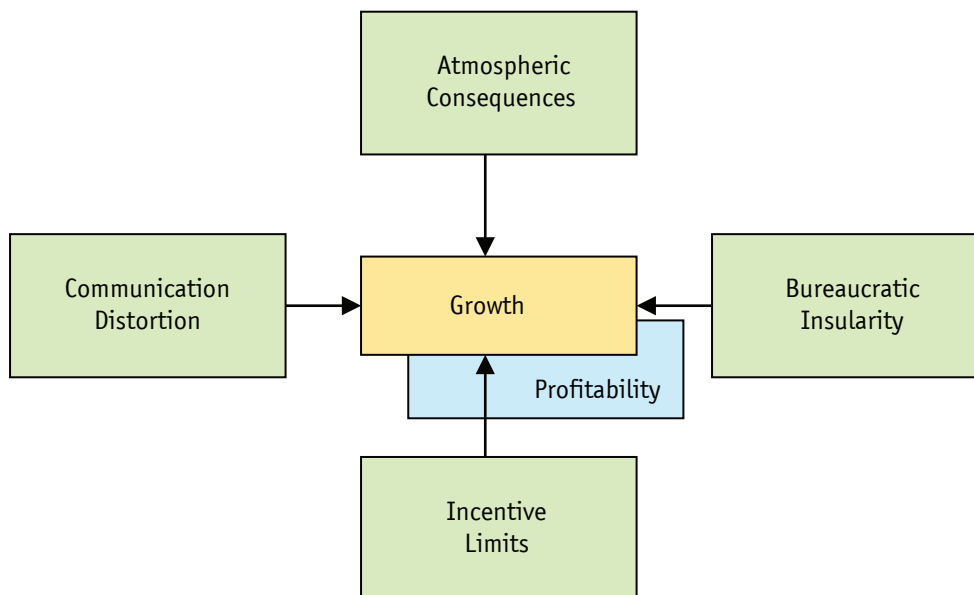
So far, we have described the logical process of pursuing new growth opportunities without regard to organisational inertia and diseconomies of scale. In fact, if a company follows the process described above correctly, it is still unlikely to achieve more than moderate success. Why is this?

Obstacles to growth

Corporations exhibit diseconomies of scale. This is especially true when there are more than 20,000 employees, but such diseconomies can set in at as few as 400 employees.

Oliver Williamson, one of the world's most renowned economists over the past 50 years and the winner of the Nobel Prize in Economics in 2009, identified these diseconomies.⁴ Our managing director, Staffan Canback, quantified them in his doctoral dissertation,⁵ for which he won the prize for best European dissertation in management in 2002. Such diseconomies affect both profits and growth.

Drivers of diseconomies of scale



There are four types of diseconomies that have to be overcome (the nomenclature is by Williamson):

1. *Bureaucratic insularity*: Senior executives of large corporations tend to be insulated from their own organisations and from the market. The problem is most acute in organisations with well-established procedures and rules and with long-tenured management.
2. *Atmospheric consequences*: As companies grow, there will be increased specialisation but also less commitment on the part of employees. Employees often have a hard time understanding the



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purpose of corporate activities, as well as the small contribution that each of them makes to the whole. Thus, low levels of motivation are common.⁶

3. *Incentive limits:* By necessity, large companies have weaker incentive systems than small ones (if a large firm had proportionally the same incentive system as a Silicon Valley start-up it would face a shareholder revolt). This factor has an especially large impact on product development and new initiatives, such as the growth agenda.

4. *Communication distortion:* Companies unavoidably have hierarchical layers. This makes it difficult to communicate ideas and plans deep into an organisation. What started as a big idea may be changed beyond recognition by the time it is fully syndicated within the company.

Of these diseconomies of scale, bureaucratic insularity has a strongly negative impact on growth and atmospheric consequences have a moderately negative impact. The other two factors are negligible from a growth perspective, although they are important from the perspective of profitability.

An example of bureaucratic insularity would be an executive saying: "I like the idea, but it is too small compared with our existing business." The argument may have merit (maybe an acquisition is appropriate to achieve scale quickly), but often it is an instinctive response based on the personal comfort of management more accustomed to business as usual thinking.

If the current management team is strongly entrenched, then it will be imperative to insert new executives (bringing them in from outside the company, or promoting up-and-coming stars) as part of the growth agenda. Further, the entire management team will need to be involved in the growth journey: the process cannot be delegated to lower levels of the organisation.

In addition, some procedures will need to be scrapped even though they may be well intentioned. Strong procedures more often than not make large companies manageable, but they also tend to weaken creativity and ambition. It is a delicate balance, but something has to yield.

To alleviate atmospheric consequences, a good starting point is to run growth efforts as independent business units whose employees have a clear understanding of what is going on. This also allows for growth specific incentives to be offered to staff. Over time, such units may be folded back into the parent business.

The capture process

Given the headwinds from organisational inertia and diseconomies of scale, how should a growth effort be set up? On one hand, there is a need for a logical and robust process. On the other, organisational inertia has to be overcome, and this is not a linear or entirely logical task.

We recommend three steps—jolt, consider, and act—playing out over several years:

1. **Jolt the organisation.** This step consists of the identification and quantification of growth opportunities. The result should be ambitious, exciting and slightly hyperbolic. Although it should be a logical process, it should also speak to the emotional side of the company.



2. Consider and decide. Once the organisation has been jolted, it is time to be realistic and thoughtful. Allow adequate time for these considerations, and have them result in a set of decisions.
3. Act in a sustained manner. Too much too soon will kill growth initiatives. Early wins are important; big wins will follow in due time. If possible, prioritise acquisitions, as their signalling effect is strong and they will materialise much sooner than organic growth efforts.

Conclusion

Generating high growth is difficult. On average, a company can expect to grow at the same rate as GDP. The best growth opportunities usually lie in categories or countries that are growing fast, but they are the kinds of opportunities that are most difficult to capture. Following a sustained growth agenda that covers what to do but which also addresses organisational inertia is the only way to succeed.

Based on our experience with creating growth strategies in more than 50 countries, this white paper outlines a systematic approach to capturing profitable growth opportunities. The central themes are that:

- growth opportunities abound, even in managed companies
- the process for deciding on growth opportunities should be rigorous and robust. It should be driven by the corporate centre and supported by the company's most senior executives
- There are major organisational obstacles to be overcome beyond the logical plan of action. These hurdles are anchored in diseconomies of scale and organisational inertia, and take the form mainly of leadership insularity and the lack of a clear understanding on the part of employees about what needs to be done.



Endnotes

- 1 Canback, S., *Bureaucratic Limits of Firm Size*, 2002. Available at SSRN: <http://ssrn.com/abstract=2429984>
- 2 The Economist Intelligence Unit, *Corporate overseas expansion: Opportunities and barriers*, November 2015. Available at: <https://www.eiuperspectives.economist.com/strategy-leadership/corporate-overseas-expansion>
- 3 *Ibid.*
- 4 E.g., Williamson, O., *Markets and Hierarchies*, 1975; *The Economic Institutions of Capitalism*, 1985.
- 5 Canback, S., *Op. cit.*
- 6 E.g., Scherer, F. M., *Industrial Structure, Scale Economies, and Worker Alienation*, 1976.



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About EIU Canback

The Economist Intelligence Unit's consumer practice – EIU Canback – is a management consulting firm working with senior management of the world's largest consumer-facing companies. We offer a new type of management consultancy more deeply rooted in science and predictive analytics. Our ability to apply scientific theory from economics, statistics and other fields, is married with deep in-country experiences. This creates a competitive advantage for our clients.

At EIU Canback the aim of being “managerially relevant--analytically robust” is central to what we do. We are experts in translating the results of complex models into strategic recommendations that often challenge the norms. We help to create a compelling, data-driven narrative for change, and typically convey the results at the most senior level within our clients' organisations.

We travel the globe to understand markets and deliver our work. Our consultants have worked on the ground in around 80 countries. In our analysis, we never look at markets or categories in isolation, instead always placing our findings in a regional or global context. We also draw on the heritage of the EIU in understanding the economic and political forces that shape our world.

Our work is underpinned by our own proprietary data. The Canback Global Income Distribution Database covers GDP, population, household income, socioeconomic class sizes, and income brackets data for every country (213), large subdivisions (696) and all cities with more than half a million inhabitants (997) in the world.

We work with our clients on multi-year efforts to enhance strategies and build organisational capabilities. From a growth perspective, this includes geographic expansion, identifying new markets, optimising portfolios, and improving revenue and profits through pricing decisions. We also provide operational due diligence support when growth opportunities are inorganic.

EIU Canback was acquired by the Economist Intelligence Unit in 2015 and is based in Boston. As part of the Economist Group, we share the principles of independence and intellectual rigour.



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