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Three levers for profitable growth

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Growth is the only way to create value in the long term.

A company that does not grow by more than 7.5% per year (i.e., a doubling of revenue every 10 years) loses its attractiveness and independence in the long term.

Growth is a strategic decision that requires concentrating resources and time on key priorities. For profitable growth, three growth levers must be activated: strategic targeting, resource concentration, and choice of business model.

It's the result of investing more than the competition (*resource allocation*), leveraging that investment for revenue and profitability (*superior business model with a specific lever mix*), and applying it to the most advantageous mix of businesses, geographies, customers, distribution channels, etc. (*strategic targeting*).

The reallocation and concentration of resources across domains and growth levers remain key to achieving growth and long-term value creation.

1. Strategic targeting. Where to find growth? In which segments to invest?

We must look for growth where it exists. A portfolio in which high-growth countries or activities experiencing strong growth account for at least 35% of the business, and in which the company grows significantly faster than the market in those countries or activities, is the only way to achieve sustainable 10% annual growth.

For instance, the digital content creation and software publisher Autodesk has experienced significant value growth in recent years. It has made significant investments in software tailored for architects, construction, and building management. Conversely, it has underinvested in computer-aided design software for automotive and video game industries in order to broaden its offerings and increase penetration in the construction segment, which offers high potential for penetration and productivity improvement. Initially focused on building design (using Autocad), its offerings have expanded to include pre-construction, construction, and maintenance operations (BIM 360). It now offers a comprehensive digital model solution for all these needs. The value of the company has grown from 9 Bn$ to 43 Bn$ from 2013 to 2020.

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Profitable growth = **Strategic targeting** X **Resource allocation** X **Business model**

- **Strategic targeting**
  - The most favorable mix of businesses, geographies, customers, distribution channels...
- **Resource allocation**
  - Higher investment than competitors
- **Business model**
  - Greater impact of this investment on revenue and profitability through a better business model

KEY TAKEAWAYS

- Growth is the result of investing more than the competition and applying the impact of that investment to the most favorable mix of businesses, geographies, customers....
- This raises three critical questions:
  - How much is actually being invested in new or fast-growing businesses, geographies and customers?
  - To what extent is it significantly different from that of competitors?
  - To what extent are the levers of action used similar or different to those of the competitors?

2. Resource allocation. Where to focus investments? On what scale?

To grow faster and outperform competitors in growing markets, investments must be more substantial. In growing markets, no player sustains long-term growth merely at market average rates. Either they grow significantly faster and dominate the market, or they grow slower and are forced to exit due to lack of competitiveness and profitability.

This means investing more effectively than competitors in assets, CAPEX (capital expenditures), working capital (for better product availability), OPEX (oerarting expenses), R&D, public relations investments (especially online), sales resources, product quality or functionality levels, and customer relationships…

Moreover, if one invests heavily, twice as fast as the market, in growth activities that represent one-third of the business, the remaining investments in other activities should be optimized so that half of all investments are dedicated to growth.

Home Depot, for example, invested over 15 Bn€ in the last five years to unify its in-store and online customer experience and deliver a best-in-class customer and employee experience. This initiative reinvigorated the company's growth momentum. Its online sales (direct sales) have grown by more than 20% p.a., its click & collect sales have grown by more than 40% p.a., and its pure store sales have returned to growth after declining over the previous 5 years (from 82 Bn$ in 2006 to 75 Bn$ in 2012 to 108 Bn$ in 2019).

3. Choice of business model and optimization of levers. Which levers to choose? With which organization?

Developing business models and optimizing levers for growth is critical. Investing for the sake of investing is worthless. Scale provides the means, but intelligence is essential. The strength and resilience of a model over time are the best weapons for growth.

Often, the simplicity and strength of a model and its associated products are more valuable than the over-optimization and the multiplication of functions that are often undervalued.

For example, Dyson revolutionized the economics of the vacuum cleaner industry by introducing breakthrough innovations heavily supported by advertising. Traditional players had built business models based on a wide range of products to cover all customer needs, with average prices around 100 € and optimized investments in R&D (4 €/cleaner) and communication (7 €/cleaner). Dyson positioned its innovative products at over 300 €, investing over 20 € invested in R&D and over 35 € in marketing per cleaner. Over 10 years, this successful strategy of differentiated investment allowed Dyson to capture 30% of the market value.

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Dyson revolutionized the economics of the vacuum cleaner industry by introducing groundbreaking innovations heavily advertised innovations

	Avg. vacuum Cleaner market	Dyson	Dyson/Market ratio
Average Consumer Price	100 €	320 €	X 3
Cost structure			
Cost of goods sold	35 €	99 €	X 3
Production	21 €	45 €	X 2
Gross margin	**44 €**	**176 €**	**X 4**
Logistics	4 €	5 €	X 1
Marketing & advertising	7 €	35 €	X 5
Sales	12 €	40 €	X 3
R&D	4 €	22 €	X 6
Structure	6 €	16 €	X 3
Operating income	**16 €**	**58 €**	**X 4**
As % of sales	10%	18%	

Competitive costs within a business model allow reinvestment in features, brands, and price levels that are most attractive to the market, gradually concentrating market share at the expense of competitors. Speed of execution is critical in this process.

It also requires the implementation organizations, teams, and ways of working that are inherently different from those in mature markets.

What to conclude?

Three simple rules. The first is to regularly and proactively review the mix of businesses and geographies. The second is to make focused resource allocation decisions, setting strong and distinctive investment priorities (*CAPEX and OPEX*), often against established organizational norms. The third is to develop new approaches and work differently. It is easy to see why few companies sustain strong growth beyond the average economic growth rate (5% p.a.) over the long term. Beyond the strategic challenges, the real barrier to overcome is cultural. Growth begins as a strategic decision at the highest level.

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Strategia Partners *is an international strategy consulting firm based in Europe (Paris & Zurich), the United States (New York & Seattle) and China (Shanghai). It assists Boards, CEOs, Executive Committees of major European and North American groups in their growth strategy. His approach integrates 3 perspectives: strategic and financial performance, environmental performance and human performance.*

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