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DRIVING SUSTAINABLE VALUE IN THE MIDDLE MARKET

Creating Growth: Article 2 of 4 in a Series

A Verto Partners White paper

The Company has the best EBITDA ever! How can we tell if they can grow? We have heard a number of similar comments after companies have reduced headcount, expenses and delayed capital expenditures dramatically affecting their ability to grow the top line. Here we offer a practitioner's guide to implementing top line revenue growth strategy for the middle market company and private equity community.

By Lance Wimmer and Dick Lindenmuth

The recession and current economy have caused a great deal of cutting. Dr. Donald B. Bibeault (a Verto Partner) in his book *Corporate Turnaround: How Managers Turn Losers into Winners* observed, "Like a human on the mend, after a serious operation, a corporation may outwardly have the appearance of total recovery without having its old capabilities intact". Companies that muster through this economy with the growth engine intact will be the winners!

Our last article (Self Funded Growth) talked about developing and implementing an internally funded "free cash flow" organic growth strategy. In this article we address how to establish a disciplined approach for defining a growth strategy.

The defining and development of a company's growth strategy requires a comprehensive strategic planning process which encompasses a broad range of descriptive characteristics such as products, markets, competition. facilities, financial and manpower resources, together with a myriad of internal and external constraints. A thorough assessment of all these factors and characteristics is essential for laying a sound foundation for a company's growth strategy.

Internal (Organic) Growth

Which way does a company want to grow? Internal or external? Internal growth, often referred to as organic growth, is usually given first consideration because it is a natural extension of a company's existing capabilities. Most companies already have products on the drawing board that have been under consideration. Companies often turn to external growth, typically acquisitions, because they want to score more significant incremental growth gains in shorter time frame.

The exercise of defining a growth strategy based on product line extensions begins with an examination of the industry, markets and customers currently served coupled with the products offered and their relative competitive strengths and weaknesses. For a company with a limited product offering to a narrow market segment this examination can be a simple task. However, as the product offering broadens to include multiple market segments or even different industries and different customers this examination becomes much more complex. As this complexity increases it becomes critical to segment and define each distinct market and customer base to determine its relative attractiveness given the competitive hurdles, the market development and plant and equipment costs and the financial returns for the expanded product offering. A careful analysis of these and other related factors will provide a critical assessment and validation process as the basis for a successful product extention growth strategy.

There can be significant benefits to an organic growth strategy based on product line extensions. By rigorlessly adhering to a disciplined product line development process, over time, a company builds a solid foundation and body of knowledge in its product offering that can provide significant competitive advantages. Take a look at Apple Computer as an example. Steve Jobs built an iconic example of the ultimate product line extension process by constantly and rigorously identifying what consumers want and designing and building it into one product line extension after another. By comparison, RIM's Blackberry, once the penultimate hand held communication device for the corporate world, has fallen on hard times as it lost touch with its customer's needs as newer, better technology eclipsed Blackberry's iron grip on the market.

Market Research

So how does a company stay on top of its customer's needs for its products and make sure its products stay in the forefront. The answer is a continuous monitoring of the market using market research to identify emerging trends and demand shifts. All too often companies adopt a "buggy whip" mentality of sticking with the tried and true. They fail to reach out to become aware of the subtle changes that are happening every day all around them and make course corrections accordingly. The fear of making a misstep and not understanding the messages that customers are sending destroys product innovation and, ultimately, the core value of any company.

External Growth

When and why should a company explore external, acquisitive growth? The most compelling reason to seek acquisitive external growth is when a company's products and markets have matured to the point of stagnation. As an example, the automotive market in the US leveled off almost overnight due to the economic downturn coupled with increasing foreign competition. Suppliers to the automotive market experienced dramatic revenue declines. Those that had the financial resources to do so sought acquisitive growth to replace the lost revenue.

The external acquisitive growth strategy requires very careful planning and execution to be successful. Is the company seeking ways to provide existing customers with new products and services that will enhance existing customer relationships? Or, does the company want to broaden its customer base to become less dependent on a single market segment and its associated customers? These and other questions about a company's overall strategic plan must be addressed prior to exploring the acquisitive external growth path

Acquisitive growth can be very costly. First there is the cost of the acquisition that must address what is being acquired at what cost. An often dangerous pitfall is the mistake of paying for the "synergistic" benefits that can be expected from the combination that subsequently never materialize. When this occurs, the acquisition capital invested does not achieve the expected return and the company's value is actually diluted, along with its stock price. These “synergistic benefits”, while apparently reasonable and practical are seldom achieved due to a failure to execute a disciplined post-merger acquisition integration process. (refer to our Verto article on the pitfalls of poorly executed Acquisition Integration)

Growth Strategy Implementation

Having defined the company’s growth strategy, whether internal, external or a combination of both, the key to its success is teamwork support at every level of management and in every organizational discipline. This requires the following steps:

- Developing a a well-defined set of objectives
- Establishing benchmark performance milestones
- Put together a plan to achieve the performance milestones and objectives
- Communicating the growth strategy plan throughout the organization

Developing Growth Strategy Objectives and Performance Milestones

A company’s growth strategy objectives must be realistic so that their achievement can be embraced by the management team. For example, for a company that chooses to follow an internal organic growth strategy with an objective of achieving 10% annual growth in an industry that is only expected to grow at a modest 3 or 4% per year, results might not equal expectations. If, however, the company has a well define product roll out strategy that is expected to surpass its competition the 10% growth objective, together with the capture of increased market share, might be reasonable.

As an alternative to internal growth alone, a company might augment growth with an acquisition plan blending internal with external growth. This blended approach for achieving greater than expected industry growth helps to insure that a company reaches its objectives.

Complementing the setting of growth objectives is the establishment of performance milestones. Assuming a three year strategic growth plan, a company might consider quarterly or semi-annual checkpoints to measure results and, if necessary, make course corrections. If the company is falling short of expectations product introduction plans may have to be ramped up or acquisitions may have to be more aggressively pursued.

Communicating the Growth Strategy Plan

A company’s growth strategy is its blueprint for success. A well thought out growth strategy plan must be embraced at all levels and across all functional disciplines for its execution to be successful. The growth strategy is the backbone of the overall strategic planning process and it defines the future definition of the company.

At the Board of Directors level the growth strategy communicates the definition of who and what the company is today, who and what the company will be tomorrow and how management intends to get it there.

At the executive management level it needs to clearly define the objectives and milestone expectations, the execution strategy and further interpret and expand this information into the specific contributions and expectation of every functional discipline.

From the executive level it is pushed down through every level of the organization in a disciplined process until it is satisfactorily understood and embraced.

This all sound easier said than done and nothing could be more true. In our corporate strategy assessments we seldom find that the critical elements of the company's growth plans have been adequately communicated throughout the organization. We find that this lack of understanding of where the company is going and how it intends to get there is often the most fundamental reason companies fail to achieve their performance expectations.

Summary

Developing and implementing a growth strategy is a critical management task. Performing a strategic assessment of the company's strengths and weakness and assessing the market conditions and competitive landscape are fundamental steps to enable the establishment of the foundation of a disciplined growth strategy.

Deciding on an internal organic growth strategy or and external acquisitive growth strategy will be dependent upon industry and market conditions, competitive barriers, available resources and, importantly, the need to grow to meet management, Board of Directors and investor expectations.

Once a growth strategy path has been determined it is essential to establish milestone benchmarks of performance communicate expectations to all levels and functional disciplines of the organization and to periodically measure performance and make course correction to stay on track.

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