

# Desperately Seeking Growth

In a world of turbulent economies and scarce resources, are you wondering where your next wave of profitable growth will come from? Perhaps your industry is changing in a way that makes you wonder whether it might be time to redefine the business model that has been so productive for so many years. Or maybe your resources are spread too thin and you are fighting competitors on too many global fronts. Perhaps you suspect that your core business still has untapped profit growth potential, but you are not sure where it is.

If you can see your company in any of these situations, the findings of this book may surprise and interest you. The most important issue faced by all management teams is how to grow their companies profitably over the long term. Today, the odds for winning the long-term growth game are worse than ever. Many management teams need to reconsider and even rediscover their real core. Consider how the goal posts have moved for management:

- Investors are giving management teams less time than ever to prove themselves. For instance, shareholders are shifting in and out of stocks at five times the rate they did a few decades ago, demanding not merely growth, but growth each and every quarter.

- Even in the best of times, our analysis shows that nine out of ten management teams fail to grow their companies profitably. Given investor expectations of quarter-by-quarter growth, ninety-nine out of one hundred management teams will fail to meet shareholder expectations.
- Shareholders tolerate failure less than ever before. Between 1999 and 2006, the average tenure of departing CEOs in the United States declined from ten years to just over eight. One study of departing CEOs in America found that the 40 percent with the shortest tenure had lasted an average of fewer than two years. The lower half of this group had stayed on the job for only eight months.

The rules of the game are continually changing. As we demonstrate later in this book, turbulence in industries has increased by a factor of more than three over the past few decades. An unprecedented two-thirds of businesses and more than 50 percent of profits (reinvestment funds) in the world are in turbulent industries such as telecommunications, media, newspapers, airlines, and automobiles.

It is no wonder, then, that participants in a game that's impossible to play, much less win, are now particularly receptive to the soothing, dulcimer tones of pundits who suggest deceptively simple (and consistently incorrect) strategies for winning an extremely complex, multifaceted game. Their siren song seduces with its revolutionary appeal: "Discard the old, leave your historic core business behind, and set out for the promised land." Sometimes this advice leads to the right course. Yet, as we argue in this book and demonstrate with examples and extensive empirical data, it usually *does not* solve the fundamental problem and can even aggravate the underlying cause of inadequate profitable growth. Like the ancient mariners of the *Iliad*, those managers who respond to the siren song of growth can experience brief periods of euphoria. But when they finally awaken to reality, they often find themselves heading straight for the shoals.

Moreover, during and following the world economic crisis that started in 2007, the weaker businesses are proving to be the “shock absorbers” of the system. These businesses face far greater swings in margin and drops in valuation than the leaders, and they risk losing it all. During such times, it is especially incumbent on each management team to understand its core and remember that in strategy and the application of force in business, it is the choice and depth of focus—and not the breadth and speed of expansion—that lead to sustained, profitable growth.

We have found that the key to unlocking hidden sources of growth and profits is usually not to abandon the core business but to focus on it with renewed vigor and a new level of creativity. We have also found that often the most successful businesses are at greatest risk of succumbing to the siren song. Ironically, our research shows that the management teams running the strongest core businesses are the ones who most consistently underestimate their full economic potential. Consider the following examples of four companies that moved away from a core business in search of greener pastures.

### **Case 1: Bausch & Lomb**

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Bausch & Lomb got started in the ophthalmic business in 1853, when German immigrant Jacob Bausch opened a small store in Rochester, New York, to sell European optical imports. Over the next 120 years, the business developed slowly and carefully, step by step, just like the work of the meticulous eye doctors whom it served. By 1973, Bausch & Lomb had grown to \$235 million in sales and was the leader in its instrument and lens businesses.

Then everything changed. In the mid-1970s, Bausch & Lomb obtained from an independent Czechoslovakian scientist the patents for *spin casting*, a process for making soft contact lenses. Spin casting not only produced lenses that were more comfortable than those on the market but did so at a lower cost. At the time, the standard

procedure for creating a lens was to lathe it from a button of hard plastic. With spin casting, a drop of polymer is spun in a shaped dish and then stabilized under ultraviolet light to make the lens. The lenses created are “soft” because the liquid polymer sets in a form that is softer and more flexible than that of the hard plastic used in lathing. These more flexible lenses have proven to be better for the health of the eye and are easier for the optometrist to fit. They have also allowed for greater productivity throughout the value chain, from manufacturer to end user.

The soft contact lens was one of those breakthroughs that crack open and transform the competitive dynamics and market size in an industry. Throughout the mid-1980s, Bausch & Lomb developed and executed brilliant strategy, driving one competitor after another out of the market and causing others, locked into high-cost lathing methods, to disinvest in the business. The company’s share of new lens fittings rose to 40 percent of the market, several times larger than that of its nearest competitors, American Hydron and Coopervision. Bausch & Lomb continued to invest in the business, buying the leading manufacturer of gas-permeable lenses, Polymer Technologies, to round out its product line. The company became a darling of Wall Street, outperforming the market over this period by more than 200 percent, with high, growing, and consistent earnings reports.

Then, as competitors began attacking its position with new technologies such as cast molding (also a low-cost method), Bausch & Lomb began to divert its attention from its core business, spending the cash flow from its lens and solutions businesses in new areas. “The core business is eroding, margins will erode as competitors enter . . . Use the cash to find new sources of growth,” sang the sirens. The management team invested in products sold by other health professionals, such as electric toothbrushes, skin ointments, and hearing aids, but they established no obvious linkage between these products and the core lens business.

Slowly but surely, with resources and management attention distracted, Bausch & Lomb’s contact lens business flattened out. The stock that had risen from \$3 per share in 1973 to \$56 per share

in 1991 plummeted to less than \$33 per share in 2003. Moreover, Johnson & Johnson entered the contact lens business by heavily funding a new acquisition, Vistakon, with a new product idea: disposable lenses. Of course, disposable lenses are not much different from regular lenses, except that they are sold at a lower price in packages of twelve or twenty-four. What better company to have introduced this product than the one-time cost and technology leader, Bausch & Lomb? Instead, Bausch & Lomb's market share declined to 16 percent, which put the company in third place behind Johnson & Johnson and Ciba Vision.

With its core strength squandered, Bausch & Lomb never really rebounded. In 2006, the company recalled one of its key eye-care products. The following year, Bausch & Lomb faced 344 product liability claims. Sales were again slipping, leading one analyst at J.P. Morgan to comment: "Returns across all of Bausch & Lomb's businesses are poor and notably behind competitor averages." By May 2007, when Warburg Pincus agreed to purchase the company for \$4.5 billion, Bausch & Lomb was completely focused on eye care again, but it was now up against well-funded competitors like Alcon, Johnson & Johnson, and Novartis. If the company had not lost its focus on the core, it probably would not have turned out this way.<sup>1</sup>

## **Case 2: Amazon.com**

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Amazon.com began as the poster child of the Internet economy, and ended up as one of the few lasting success stories of that era. Most of the dot-com businesses that began during the heady years of the Internet bubble have not survived. But a few, such as eBay and Amazon.com, have successfully navigated the dual challenge of retaining focus even as they faced pressure to constantly adapt and redefine their core.

Amazon.com got its start in 1995 with the online selling of a product with a notoriously inefficient, multitier distribution channel: books. The typical offline bookstore returns more than

40 percent of the books that appear on its shelves for credit. The reasons returns are so high are that it is impossible for bookstores to predict which titles will become bestsellers and that a large number of “standard” books must be stocked in inefficient lots of two or three. The Amazon model bypasses this inefficiency by centralizing distribution and by getting its money from the consumer up front, often before the publisher needs to be paid. Moreover, Jeff Bezos, Amazon’s founder and CEO, recognized that Amazon had the potential to be more than just a low-cost channel for book purchasing. With the introduction of book reviews written by customers, Amazon made itself a community website through which consumers could voice their views about the books they were purchasing. Based on the power of this business model, market capitalization rose to more than \$30 billion in 1999 on \$500 million of sales. During this period, Amazon raised the stakes, trying to become what Bezos calls “a place where you can buy anything and everything.”

Suddenly, Amazon no longer confined itself to targeting the inefficient, multistep value chain of the bookseller (and, somewhat later, the video store); it began to compete with Wal-Mart and The Home Depot. Amazon moved with lightning speed into power tools, consumer electronics, garden furniture, and even cosmetics. By 2000 cumulative losses had mounted to \$1.2 billion, and investor nervousness was high, reflected in a 70 percent stock price decline.

But, unlike Bausch & Lomb, Amazon parlayed this period of turbulence into a view of its “core of the core” that was even more compelling than the product itself. Its unique online software—the commercial engine of the company—proved much more fundamental than a new model for selling books. In 2008, the company hit \$19.2 billion in revenue, with a 23 percent return on invested capital. Though media (books, movies, music) still remain a highly profitable 58 percent of revenues, other areas have grown. Yet a closer look reveals that 30 percent of Amazon’s total sales come from its third-party seller business.

Amazon’s journey has led it to a strong and stable core, despite the dangers it has had to navigate along the way. In Jeff Bezos’s

words: “It helps to base your strategy on things that won’t change . . . I very rarely get asked, ‘What’s not going to change in the next five to ten years?’ At Amazon.com we’re always trying to figure that out.”<sup>2</sup>

### **Case 3: Cooke Optics**

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Cooke Optics was founded in England in 1890 for the purpose of creating the highest-quality lenses for still photography, a new and fast-growing market at the time. Cooke quickly became the gold standard in the industry, and the camera taken to the South Pole in 1907 by explorer Sir Ernest Shackleton and his crew was fitted with a Cooke lens. During World War I, Cooke lenses were critical for high-resolution aerial photography. The advent of silent films put Cooke lenses on the front of many cameras in leading movie studios. As the small company evolved, it expanded into specialized zoom lenses and even higher-quality “prime” nonzoom lenses. In 1946, Cooke was sold to the Rank Group, a company with no related holdings or interest in preserving Cooke’s quality image. Over the next few decades, Rank moved into postproduction studios, resorts, and casinos, leaving Cooke at the end of the line when it came to getting attention from management or resources for investment. Cooke stagnated. Comparing this state of affairs with the company’s proud history, a thirty-seven-year employee lamented, “The place was so run down that sea-gull feathers would float down through the holes in the roof.”<sup>3</sup> The company was finally rescued in 1998 by Les Zellan, a theater-lighting specialist who had kept an eye on Cooke for decades, watching its once-valuable core business erode. In 1998, he got his chance and took it, buying Cooke for only \$3 million. Since then, the core lens business, neglected for nearly five decades, has been brought back to life with a new lens that has superior focusing technology. The lens caught on almost immediately and has been used for shooting such hit films as *Hairspray*, three of the Harry Potter movies (*Prisoner of Azkaban*,

*Goblet of Fire*, and *Half-Blood Prince*), and *The Bourne Supremacy* and such television series as *Bones* and *Grey's Anatomy*. The company's continued success and growth show the potential to profit from and renew a once-strong core.

#### **Case 4: The Gartner Group**

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The Gartner Group was founded in 1979 by Gideon Gartner, a stock analyst at the securities trading firm of Oppenheimer who specialized in tracking IBM and its few competitors in those days. The original purpose of the Gartner Group was to sell information about IBM to investment bankers and stockbrokers. Shortly after the founding of the company, its focus was broadened to include customers deciding on equipment to buy or starting negotiations with IBM for hardware. In the burgeoning market for business computers, consumer need proved to be large, and Gartner focused entirely on becoming, in a sense, a consumer clearinghouse for customer data and expert opinion on products.

Saatchi & Saatchi purchased the company in the mid-1980s as part of its attempt to unify consulting and advertising services in a single company—a misconceived growth strategy in itself that soon imploded. Saatchi became disillusioned with the consulting business in 1989 and sold Gartner to Bain Capital, a private equity firm specializing in buying noncore or undermanaged corporate assets.

For \$60 million, Bain Capital purchased a company that was growing at about 15 percent annually, had reached \$55 million in revenues, and had margins of only about 10 percent, a disappointment to its former parent. But Bain Capital saw something more in the Gartner Group than a small, low-margin consultancy. The more Bain managers studied the company's core business, the more they began to believe that Gartner would have a much greater opportunity for growth and for margin expansion if they looked at it not as a consulting business but as a vehicle for collecting, packaging, and distributing high-value syndicated data.



Under the ownership of Bain Capital, Gartner refocused on becoming a consumer clearinghouse for customer responses and an honest broker of advice on hardware and software purchases. Gartner's growing company subscriber base gave it proprietary access to thousands of companies whose managers were willing to comment for the record on their experiences with buying and installing computer systems. No longer did a corporate management information system department need to commission expensive outside consulting studies for the purpose of obtaining objective data; it could rely on Gartner studies, which were less costly and more timely than its own. Gartner built strong barriers to imitation through its subscriber base and its database of benchmarks that allowed it to expand its margins from about 10 percent to 30 percent.

Bain Capital had a three-part growth strategy for Gartner:

1. Turn Gartner into a syndicated data and research company with a much more scalable model than consulting.
2. Expand geographically beyond its high East Coast customer concentration into the West and Europe by adding salespeople.
3. Deepen the product line in the most leveraged, vertical, industry-focused application markets.

The suggested strategy of looking at the original core business in a new way was successful. The company grew from \$55 million in 1980 to \$295 million in 1995 under Bain Capital's ownership to \$734 million in 1999 as a public company. Over this period, Gartner solidified its hold in its core business. Bain Capital sold the company to Dun & Bradstreet for approximately a twenty times return on its equity, and Dun & Bradstreet subsequently sold Gartner in an initial public offering at an additional twenty times multiple. Ten years later, in 2008, Gartner continued its momentum, achieving 40 percent share of the IT research market (four times the size of its nearest competitor), \$1.3 billion in revenues, and \$213 million in

earnings before interest and tax—growing at a healthy 12 percent through the period.

What is notable about this growth story, other than the four hundred times return on equity invested, is the fact that the new owners had a different take on the core business, seeing it as a syndicated data and research enterprise rather than a consultancy. The ability to creatively see the core in a new light and act on it is a theme that we will return to throughout this book.

### **Our Mission**

In each of the above cases, and hundreds of others that we have examined, we see a tendency for strong core businesses to lose momentum by virtue of premature abandonment, miscalculation, or overreaching in search of new growth. Our intention in this book is not to suggest that we have a one-size-fits-all solution for problems with growth. Rather, our intention is to suggest that many of the common cures prescribed in the popular business literature need to be balanced against the weight of evidence on real company experiences. What we offer is a set of practical and proven principles, diagnostic tests, and questions for management teams to use as tools for reexamining or revising their strategies in search of the next wave of profitable growth. In our quest to understand the dynamics of growth, we drew on the following fact base:

- About two hundred case studies in Bain & Company and in the public record
- Interviews and discussions with about one hundred senior executives
- A database of 1,854 public companies in seven countries followed for more than ten years
- Numerous pieces of focused empirical analysis concerning sources of profitable growth

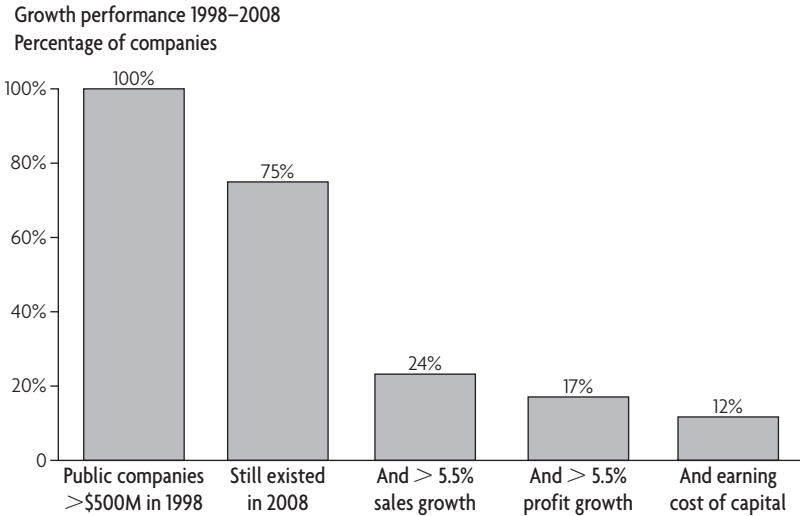
- The records of many private equity firms—including Bain Capital, which generously shared many of its case studies with us
- Extensive examination of the existing literature (cited throughout the book) and of secondary data

The lack of empirical data behind many business “cure-alls” has prompted one Oxford don to proclaim management science a “phony academic subject, a shallow contemporary shibboleth promoting a noxious cant.”<sup>4</sup> We are not that cynical. We consider management science to be highly productive, but we also understand that it is in its infancy. More important, we maintain that there do exist a few lasting principles of business strategy that have clearly driven results year after year, that apply across a wide range of industries, and that explain the results of both success and failure.

### Defining Profitable Growth

We explored many definitions of profitable growth and settled on one that involves several dimensions. Throughout this book, we define *sustained growth* as growth in both revenues and profits over an extended period of time while total shareholder returns (share price and dividend reinvestment) exceed the cost of capital. Empirically, few companies in the long term create shareholder value without earning their cost of capital.

When we looked at the data, we identified targets that were at or below most of the strategic planning targets we found in a survey of strategic plans. These targets are (1) achieving 5.5 percent real (inflation-adjusted) growth in revenues and earnings and (2) earning one’s cost of capital over an average of ten years. We examined the data company by company to control for accounting anomalies and one-time charges. The results of our screen are depicted in figure 1-1, showing the percentages of our full sample of companies that meet our revenue criterion, income criterion, and shareholder value creation criterion. Even with these relatively conservative and modest targets, we found that only about one company in eight, or



### 1-1 Few Companies Achieve Sustainable Growth Strategies

Source: Worldscope database; Bain analysis.

Note: Earning cost of capital defined as above average total shareholder return. 5.5% required growth rate is in *real terms* (i.e., after correction for inflation). Analysis of 2,000+ companies in 12 developed and emerging economies.

12 percent, or about one in ten companies, achieved sustained and profitable growth (or could be classified as a sustained value creator) over a decade that many would rank as among the best for the world economy. In contrast, our internal sample of targets from strategic plans showed that more than 90 percent of the companies examined had aimed at returns well in excess of these levels.

When we tightened the criteria a bit more, requiring 8 percent real growth (about 11 percent to 12 percent nominal currency growth in most of our major countries in this period), the percentage of sustained value creators declined to only 9 percent. In a survey of strategic plans, we found that the target of more than two-thirds of the businesses examined was at least at these levels. Yet the reality is that fewer than one in ten achieved it.

We found that companies that grew revenues but not profits did not create economic value in the long term (though they can

create shareholder wealth in the short term in the stock market). Companies that grew profits but not revenues were on an unsustainable growth path that eventually petered out. Companies that grew both revenues and profits but did not earn their cost of capital eventually (recall that our period of analysis is ten years) lost their ability to find investors.<sup>5</sup> An extensive body of work on investor value creation supports this point of view.

Other measures of profitable growth that we considered are worth noting, along with their specific limitations. Stock price growth (adjusted for splits) is alluringly simple, but is dependent on the specific company's pay-out policy in dividends or share buy-backs, which have, in the short term, only an indirect relation to operational or financial performance. Total enterprise market value growth is somewhat better. However, it is possible to grow total market value through mergers that neither help earnings nor create a sustained growth trajectory. Moreover, putting together several poorly performing companies to create a new one is not what our project was about.

Share of total industry profits or share of total industry value is an interesting measure of relative competitive success. However, it does not take into account absolute levels of growth or profitability, which could be declining. Moreover, it begs the question of the business boundaries, of what to include or exclude.

High total shareholder return is critical to sustained, profitable growth. Yet a company that did not grow, had no assets, and had positive cash flow would have infinite returns. Looking at returns in the absence of growth is as limiting in the context of our study as looking at growth in the absence of returns.

Finally, there are more specialized or exotic measures of profitable growth. One such measure is profit or value creation per employee. But this is at least as much a function of labor and capital intensity of the business as it is of sustained, profitable growth. A derivative measure of this is growth in value per employee. This, however, could be as much a function of shifting to more capital intensity as it is of performance and growth. These are interesting measures, but not what we were after.

Using the screen of earning the cost of capital in the long term and growing both revenues and profits worked well for us, though we urge management teams to supplement this metric with others, both short term and long term, in considering their own growth pattern.

### Defining the Core

It is our thesis in this book that the foundation of sustained, profitable growth is a clear definition of a company's core business. A business can be defined from two related perspectives. The first (outside-in) is from the point of view of the outside world, with natural business boundaries defined by underlying market economics. The second (inside-out) is from the point of view of those inside the company, with the company's business boundaries defined by its unique core.

Here is an example of the distinction. Enterprise Rent-A-Car, Dollar Thrifty, and Avis are clearly in a business that external criteria define as car rental. The business involves purchasing and managing fleets, running automated reservation centers, managing a branch network, and serving customers who rent cars for various purposes. Within this business, however, the three companies have different cores. Enterprise is the market leader for insurance replacement and repair rentals. The company got its start in this distinct segment, building its suburban locations and business model to meet the needs of body shops and insurance companies. Dollar Thrifty's core business comes from leisure renters who don't mind having to pick up their rental cars and in conditions with minimal amenities. Avis's core is airport rentals. It sells heavily to corporate renters requiring speedy service, newer cars, a variety of business amenities, and, obviously, a network of prime airport locations. Each of these companies would view its core differently, and each would be right. Yet each participates in a rental car business that external economics is treating more and more as one competitive arena.

A different type of example is Gillette, which has had men's shaving products as its core business since its founding nearly one hundred years ago. After achieving a 70 percent market share in its core, Gillette sought growth in an unconventional way, looking beyond the limited shaving market. It redefined its core business more in terms of control and share of the checkout-counter displays at retail stores, leading it to expand into writing instruments, Duracell batteries, and other distribution-related products. The jury is out on the full success of this strategy. However, it is a case in which a company has redefined its core such that it no longer sits within the external boundaries marked on the map held by the rest of the business world.

To identify your core business, first identify the five following assets:

1. Your most potentially profitable franchise customers
2. Your most differentiated and strategic capabilities
3. Your most critical product offerings
4. Your most important channels
5. Any other critical strategic assets that contribute to the above (such as patents, brand name, position at a control point in a network)

When we begin a consulting assignment at Bain, we almost always ask first: "What is the business definition of where you compete?" "What is your core business and source of potential competitive advantage?" The answers to these questions require an understanding of each of the five dimensions.

A *Wall Street Journal* article in a past downturn announced "Corporate America Confronts the Meaning of a 'Core' Business." The article went on to recognize the complexity inherent in this task, noting: "Focus is in these days, both on Wall Street and in boardrooms across America, and this raises a surprisingly complex question: What constitutes a core business? Is it a product? A cache

of intellectual property? A process? Or, is it a business design . . . that can be deployed across multiple industries?”<sup>6</sup> That complexity has only increased over time.

For some companies, the definition of the core business is not overly difficult; for others, it is extremely vexing. For all, it is important to have the clearest definition possible. In the case of Gillette, the core business would appear to be men’s shaving products. This part of Gillette’s business was its fastest-growing and most profitable component in 1910, and it remains so today. The key assets that constitute this core include some deep areas of competence such as expertise in the manufacturing of high-precision miniature items, proficiency in blade-sharpening and -handling technology, and skill in brand management. Gillette has used these assets to enter a variety of related businesses ranging from hair care products (Toni) to small electronic appliances (Braun) to toothbrushes (Oral-B) to batteries (Duracell). In some cases, as we discuss later in the book, these expansions were successful and drew on Gillette’s core strength; in others, they proved unrelated distractions.

Companies such as Coca-Cola, UPS, Toyota, SAP, Nokia, Wal-Mart, and even Bain & Company have relatively well-defined cores that most executives can understand and use as platforms for profitable growth. In some companies, such as PepsiCo, there may be several different and distinct cores—in this case, the cola business and the salty snacks business of Frito-Lay.

For other companies such as AOL Time Warner, 3M, General Electric, or Siemens, however, the core business is much more difficult to define. These companies are the exception. Moreover, these types of highly complex or conglomerate-like companies less often appear in the ranks of sustained value creators.

Most conglomerates have not been able to manage multiple strong cores successfully. Conglomerates are underrepresented among our sustained value creators, consistent with the findings of many past studies on diversification. Moreover, we find that, overwhelmingly, the strongest performing multi-industrials, like Danaher or United Technologies Corp (UTC), exploit leadership positions in a few



strong core businesses, which they drive into adjacent territory step by step, extending them to new customers, channels, products, or applications. Moreover, they often create value across these businesses with a relatively well-defined *repeatable formula* that is proved over and over and becomes central to the corporation in three ways:

- The way the company describes its strategy
- The way managers view the core of the company
- The way analysts perceive the company's distinct advantages and opportunities for growth

For the purposes of this book, we define the *core business* as that set of products, capabilities, customers, channels, and geographies that defines the essence of what the company is or aspires to be to achieve its growth mission—that is, to grow its revenue sustainably and profitably. We recognize that this is a loose definition that can lead to significant debate among management teams. There can be tension between what a company is and what it aspires to or needs to be for competitive reasons. And there is often a lack of proportion in the number of customers overall and the number of customers who really support profits—the classic 80/20 rule, which states that less than 20 percent of a customer base accounts for 80 percent of a company's profits. Inversely, this implies that most customers often do not define the core business; that is, they do not contribute to the growth mission. The essence of a company's growth strategy is to define the core business as we have defined it and to pour company resources into this core business until it achieves its full potential.

### **How to Approach This Book**

In this book, we focus on a single theme: the extraordinary importance of creating a strong core business as a foundation for driving company growth.

We define the growth metrics that management should use precisely—the goal of management is to grow revenues and profits sustainably. Only this will create shareholder value over the long term. We define the core business as precisely as possible, emphasizing that the process of defining the core business is at the heart of what a management team must do and is inherently an imprecise science.

We fully acknowledge that the theme of seeking profit from the core is not new, and throughout the book we acknowledge extensive work done by others on this and related topics. We feel compelled to return to the theme for three reasons. First, the empirical data on the frequency with which management teams undervalue their core business is overwhelming. Why are their expectations so low? Second, focusing solely on a strong core business is necessary to but not sufficient for achieving sustainable growth. Management teams constantly meet with opportunities to move into related businesses, and at times such moves are absolutely necessary to strengthen the core and add new profit streams. How should management teams respond to this basic tension in business—when to focus on the core, when to pursue adjacent opportunities? Third, a management team must sometimes choose to make a fundamental change in the essence of the company's core business if it is to create new and sustainable growth. This is especially the case in any industry experiencing turbulent times. How should managers think about this decision—which involves more risk than any other they will make—to change the core in the interest of protecting the core?

To address these questions, we have structured this book around the three basic issues management must face in seeking profit from the core:

1. Build market power and influence in the core business or in a segment of that business.
2. Having done that, expand into logical and reinforcing adjacencies around the core.
3. Shift or redefine the core in response to industry turbulence.

In chapter 2, we discuss how to define a core business and illustrate how to obtain the full potential from a core business. We introduce the first paradox of growth: *The better performing of your business units are likely to be those operating the furthest below their full potential.* We have found that when most management teams seek to revitalize the growth of a company, they focus on the underperforming business units. We argue that growth requires focusing instead on increasing the performance of the best businesses, no matter how well they are doing at present. The best business is in the best position to deliver better growth.

We begin by presenting evidence that a strong core is the key source of competitive advantage and then go on to define core business boundaries, means for differentiation through gaining market power and influence, and reasons why many of the best core businesses often are performing below their full growth potential and have a set of classic sources of “hidden value.” In turbulent industry situations, however, the ability to define the boundaries of a core business becomes more challenged and the importance of traditional measures of market share, therefore, less relevant. In many traditional industries, competition among identical business models is the rule, yet more and more today we are observing competition among fundamentally different business models. Dealing with this increased competitive complexity is one of the primary issues facing business strategists in many industries.

In chapter 3, we shift to the topic of what we call *adjacency expansion*, moving into a set of new but related businesses around the core business. In discussing adjacency expansion, we introduce the second paradox of growth: *The stronger your core business, the more opportunities you have both to move into profitable adjacencies and to lose focus.* Chapter 3 examines the typical patterns exhibited by those companies with the best records of historical growth. Some businesses, such as Toyota, Tetra Pak, McDonald’s, Intel, Cisco Systems, and UPS, have grown for decades, if not longer, by systematically expanding into logical business adjacencies around a relatively stable core. We reinforce the findings of dozens of studies

with our own data showing how many of the most promising growth strategies were derailed by overexpansion or choice of the wrong adjacency. Industry turbulence, however, sometimes makes it necessary for managers to place more bets at the periphery of the business to hedge against uncertainties instead of marching forward on a planned path for growth, year after year, as seen in the expansion of stores in retail.

In chapter 4, we address when and how to redefine a core business, especially when faced with industry turbulence. Here we introduce the third paradox of growth: *The management teams that have been most successful in building a strong core business and that have benefited from adjacency expansion are also the most vulnerable to industry turbulence.* In some ways, this theme of redefinition runs *sotto voce* throughout every chapter of the book. The record of long-lived strong core businesses successfully redefining themselves and reasserting leadership is not an encouraging one for legacy companies.

Chapter 4 also examines the increasingly close linkage between organization and growth strategy. In these situations of turbulence and short response times, the popular epithet “structure follows strategy” is being rewritten as “sometimes structure *determines* strategy.” The ability to react quickly and refine strategy based on marketplace events is a major source of competitive advantage for many successful companies.

In chapter 5, we provide some guidelines for the process of developing and refining growth strategy. We also conclude with the fourth paradox of growth: *All organizations inhibit growth.* In today’s turbulent business environment, change—in company strategies, structures, and people—is crucial to achieving sustained profitable growth. To master change, managers must pursue it, not resist it.

While the message of profit from the core is simple, the challenges management faces in translating it into action are extraordinary. Each paradox of growth threatens to defeat management, to decrease the odds of achieving sustainable, profitable growth. The failure rate is as high as 99 percent.

We believe that the three elements of growth strategy listed above are as relevant to stable industries, such as food processing or

textiles, in a long-term equilibrium as they are to turbulent industries, ranging from electric utilities to online retail, careening from disequilibrium to disequilibrium. However, in turbulent conditions many of the common strategic rules of thumb need to be adapted.

A great deal of excellent work has been done by academic researchers and business practitioners on the topic of how traditional rules of strategy, first developed for a stable, capital-intensive industry, now must be adapted for businesses facing the need to redefine themselves (especially information-intense businesses) around economic turbulence. For instance, Clayton Christensen has described brilliantly how new competitors can emerge and thrive using “disruptive” technologies, building power in low-profit marginal customers as the incumbent helplessly watches on.<sup>7</sup> Carl Shapiro has described how the peculiar economics of information businesses require a new set of economic rules to develop robust business strategies.<sup>8</sup> Others have examined why large companies are slow to adapt to change or why market share is less important than it used to be. Throughout the book we gratefully acknowledge and build on this foundational work.

We have referred repeatedly to the paradoxical aspects of growth strategy in business. Certainly, the world is full of paradoxes. To hit a golf ball farther, you hold the club more loosely. To right a car during an icy skid, you take your foot off the brake. To make a plant grow stronger and more quickly, you cut it back.

Overlying all of the analysis in this book is a final paradox: *From focus comes growth; by narrowing scope one creates expansion*. It is remarkable to us how, despite the array of growth opportunities presenting themselves to most management teams, the most reliable and consistent solution is to profit from the core.