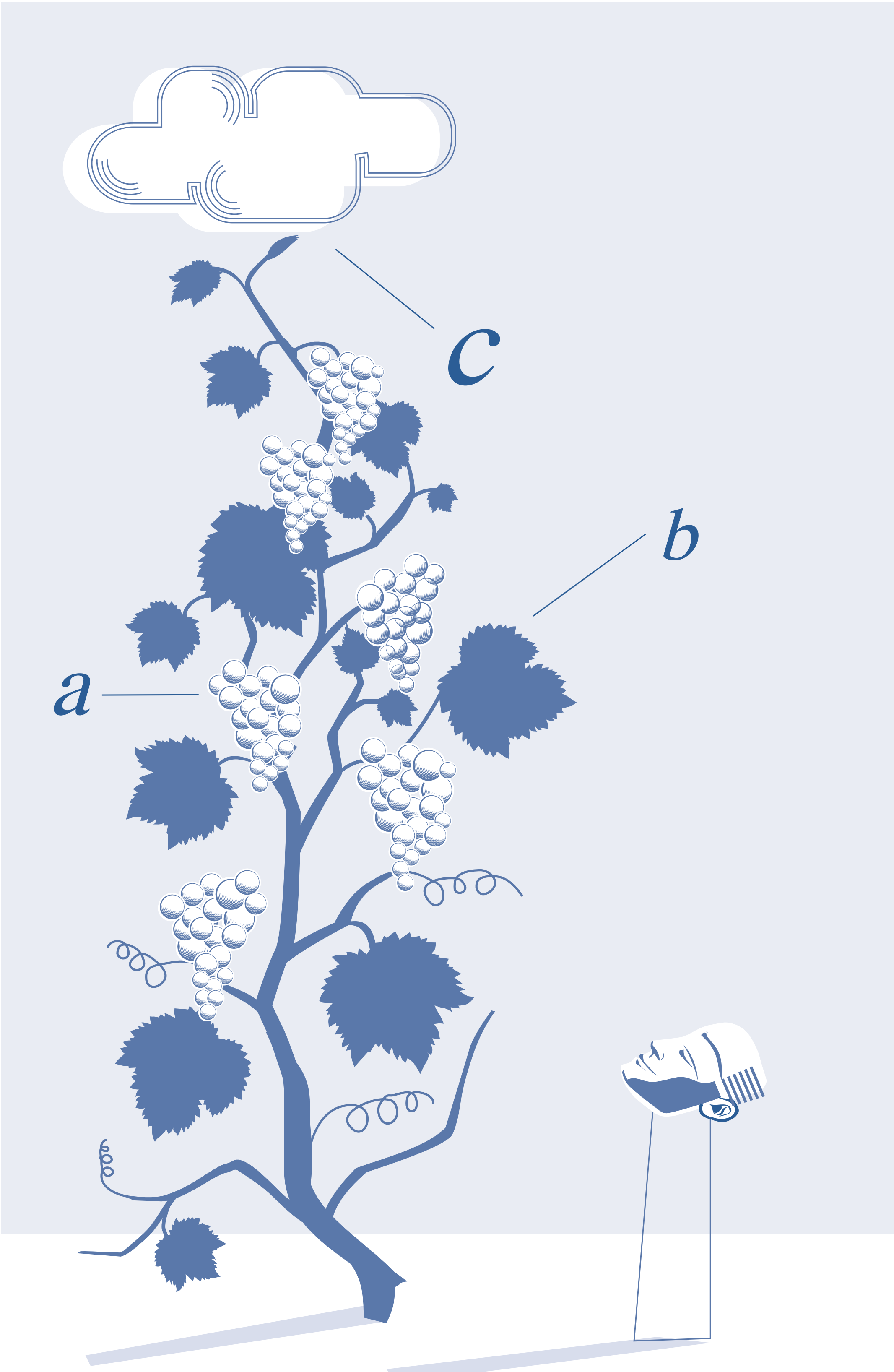
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Smart Growth: A Road Map for Executives

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The economic slowdown that has hit the Americas, Europe and many parts of Asia since 2000 appears to have been reversed. But while today's buzz is again about growth, old "grow to be biggest" avenues seem not to lead in the right direction. Shareholders and executives prefer to pursue sustainable rather than giddy revenue growth. In other words, today's sentiment is that "smart growth" is wise. Successful strategies for smart growth are industry- and company-specific. However, from our conversations with business executives we have distilled 10 questions that every company should have answers to.

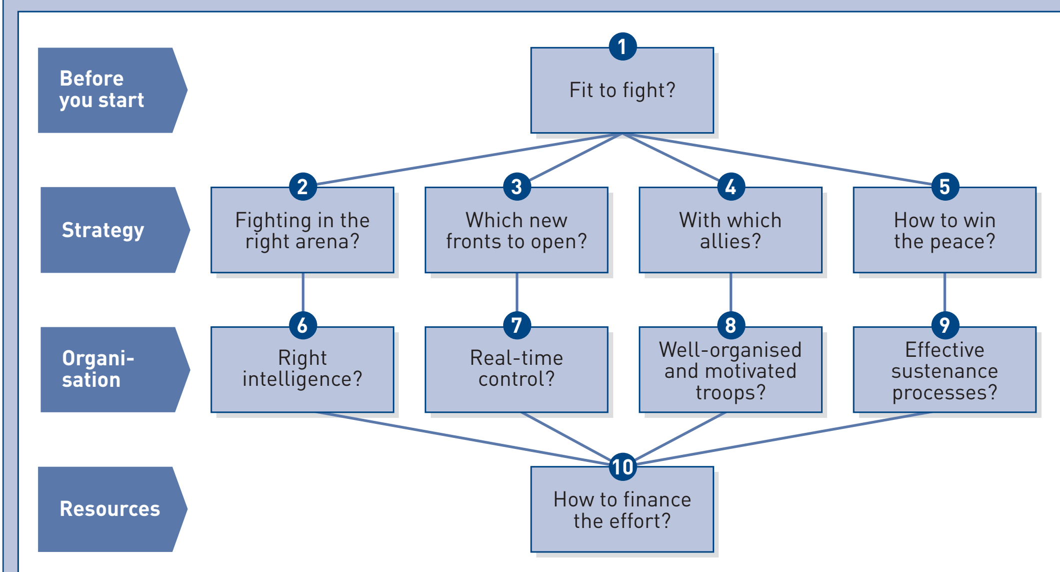
It has been impossible not to hear the sighs of relief coming from executives all over the world for the last six months. The economic slowdown that has hit the Americas, Europe and many parts of Asia since 2000 appears to have been reversed. While growth rates in Europe are still lagging behind those in America and Asia, there is a renewed confidence that, after quite a few false starts, we can look forward to a period of sustained growth and stronger profits.

But while today's buzz is again about growth, old "grow to be biggest" avenues seem not to lead in the right direction. Shareholders and executives who experienced the boom-bust of the 1990s are sceptical about the return of the roaring nineties – and the resultant bust. They would prefer to pursue sustainable rather than giddy revenue growth, and stable rather than rocky financial results. In other words, today's sentiment is that "smart growth" is wise.

Successful strategies for smart growth are industry- and company-specific. We would not want to claim that there is a universally applicable and time-tested magic recipe for success. However, from our conversations with business executives we have distilled 10 check-up questions. When you're in the boardroom with your management team, looking into the mirror on the wall, these are the questions you should have an answer to. Not all of them will necessarily be new to today's executives. In fact, the majority – as our chosen metaphor of ancient battlefield strategies implies – are not. Yet they are important, and possibly more important today than when raised originally.

While formulating the 10 questions, we have used a military metaphor, illustrating our points with insights drawn from well known battlefield strategists. Smart growth, after all, is about fighting against competitors to win the minds and hearts of customers. Of the 10, the first question is a precursor; then there are four dealing with strategy; another four with organisation; and a final one with finance (see Exhibit 1). While this article will try to highlight certain practices that might be of interest to today's business leaders, obviously it is not about simply translating warfare practices into business principles. For one thing, business is about value creation – not value destruction.

Exhibit 1 | **Smart Growth**



Source: Arthur D Little analysis

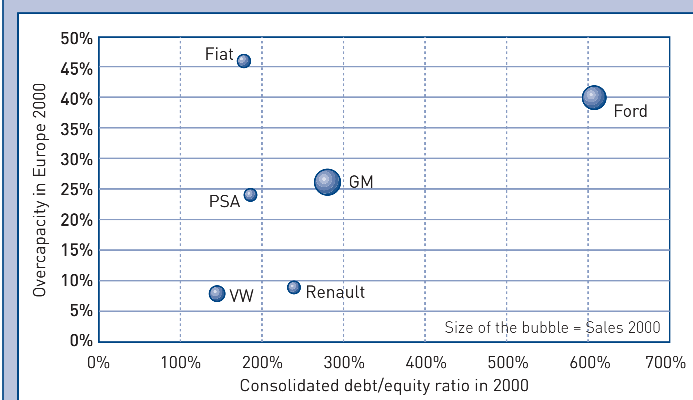
1. Are we fit to fight?

Before even thinking about engaging in war, it is safe to wonder whether one is fit to fight. Companies faring worst in the boom-bust of the 1990s were those with high debt levels and/or over-capacity. Most of the sometimes huge losses in the early years of this decade were not due to poor operating profits, but extraordinary items such as the write-off of goodwill, bad debts (including vendor financing), one-off charges for plant closures and redundancy costs, divestments below acquisition price, and the like.

Delving into our archives, we found a telling illustration of the eventual impact of excessive debt and capacity. Exhibit 2 shows the debt/equity ratio and over-capacity of six European car manufacturers in 2000. The two companies with the least favourable position at that time, Ford and Fiat, have been showing disappointing financial results for the last couple of years.

So, the first question is: have we cleaned our house sufficiently structurally to be fit to fight – no more overweight soldiers, no more obsolete gear, so to speak. As highlighted by the often-quoted General Carl von Clausewitz (1780 - 1831), a commander's knowledge of the strengths, characters and capabilities of the people as well as the resources at his disposal is of utmost importance. Only by knowing this will he be able to understand how they will perform in various conditions. In business terms, this is about factors such as the health of the balance sheet, the efficient use of capital, the leanness of overheads and the complexity of the product and brand portfolio. In modern business, as in war, there seem to be times to fight and times to consolidate.

Exhibit 2 **Matrix Debt/Equity - Overcapacity**



Source: Annual reports 2000; Automotive News Europe, January 28, 2001

2. Are we fighting in the right arena?

The fundamental strategic question is whether we are fighting in the right arena. Only when we have defined where we will fight can we know whether we are fighting against the right enemy, for the right cause and with the right strategy. This holds true for business as for war. Among the most prominent battlefield leaders to have understood this to its full extent was Alexander the Great (356 - 323 BC). He showed a remarkable understanding of the two most critical elements of success by always trying to determine the place and time of the battles he had to fight, thus altering the odds to his benefit well before he went into combat.

In today's business life, for example, Nike does not merely position itself as a sports shoe manufacturer, but sees its mission as "bringing inspiration and innovation to every athlete in the world". Coca-Cola does not fight for market share in the soft-drinks business – it competes for the consumer's "share of throat". All this is more than mere wordplay and marketing talk. It fundamentally affects the choice of customer groups that such companies compete for and how they beat their competitors.

Innovation is about being sustainably smarter and faster than competitors in chosen areas. It is about using the right weapons to hit the target, time after time.

Even more fundamental arena shifts take place when a company changes its business scope entirely. For example, the German company TUI AG has become the world's largest tourism group through a wholesale transformation of the former steel company Preussag AG in the past seven years. Likewise, Mannesmann transformed itself from a steel pipe manufacturer to a leading mobile telecommunications company before being taken over by Vodafone.

3. Which new fronts shall we open?

Standing still is rarely an option, since competitors are all too eager to encroach on your terrain. Even though one may have achieved an important victory on one battlefield, one should not yield to the temptation of assuming that the final battle has been fought. As Napoleon Bonaparte (1769 – 1821) is quoted as saying: "The most dangerous moment comes with victory." Continuously breaking out and capturing new ground is imperative to winning the war. This is where innovation strategy comes into play. Innovation is about being sustainably smarter and faster than competitors in chosen areas. It is about using the right weapons to hit the target, time after time (see the article on "Product Alignment" in this edition, p. 22).

Successful innovators know how to combine different shades of market-pull and technology-push to create value. They know how to:

- Use incremental technology improvements to reinforce an existing value proposition to their market (e.g., improvements in TV picture tube technology to achieve better viewing);

- Use radical technology developments to achieve a breakthrough in cost reduction, and thus open up the market without fundamentally changing the value proposition (e.g., the steep downward curve in the cost of plasma displays);

- Exploit an existing technology to launch a disruptively new value proposition in the market (e.g., the use of radio frequency tags to track individual product items from factory to retail);

- And, finally, deploy a radical technology for a disruptively new value proposition (e.g., the distinctly low-cost digital camera used in mobile telephone handsets enabling MMS).

The key question is: how can we pull these moves off profitably? What it takes is to understand how customer demands along the value chain are likely to evolve or can be influenced; to define a development path for product and technology platforms from which a multitude of new value propositions can be drawn economically; and to make a plan that dynamically synchronises potential technology developments with emerging market opportunities.

Alliances are as old as war itself. From the early days of mankind, the gathering of coalition partners has had a strong influence on the progress of a war.

4. With which allies shall we go into combat?

Alliances are as old as war itself. From the early days of mankind, gathering coalition partners has had a strong influence on the progress of a war. Indeed, as illustrated by such examples as the conflicts of the Athenian and Spartan coalitions in 460 BC, war often has not been one party against another but a combat between coalitions. Parties have joined forces for a variety of reasons: to combine sheer manpower, leverage the other's infrastructure, discourage a strike against one of them by a third party, preempt one of the parties from joining the enemy, co-finance the effort, obtain privileged access to the enemy's

Partnering is evolving from announcing strategic partnerships to pursuing a partnering strategy. Partnering becomes a competence in its own right.

citizens, demonstrate the war's good cause, set up a joint weapons programme, etc.

Alliances in business have also been around for a long time. The influence of some, such as the Hanseatic League (founded in the 12th century) and the guildes (founded in the 8th century), may still be observed today. Today, partnering comes in all shapes and forms, ranging from the straight merger to corporate venturing. The pharmaceutical industry, for one, is famous for partnering throughout the value chain. In R&D, big pharmaceutical companies may have alliances with smaller ones to screen new drug substances (e.g. AstraZeneca allies with Array Biopharma and with Abgenix in the area of oncology), and they keep an eye on promising new technology through their corporate ventures (e.g. Eli Lilly set up the Lilly Bioventure Fund and the Lilly MedTech Venture Fund to facilitate the success of companies in its areas of focus). They may establish agreements with contract manufacturers (e.g. Aventis divested one of its manufacturing sites to Famar and several sites to Patheon in the US, France and UK). In distribution, medium-sized companies may rely on a competitor's sales force to market a new drug in certain geographic markets (e.g. the European company UCB Pharma has an alliance with Pfizer for marketing and distribution of its anti-allergy blockbuster Zyrtec in the US).

What's new, however, is that partnering is evolving from announcing strategic partnerships to pursuing a partnering strategy. Partnering becomes a competence in its own right. For example, Eli Lilly has institutionalised a process called the Lilly Alliance Management Process (LAMP), consisting of three elements: find it, get it, and create value. Since leading companies may have hundreds of alliances, partnership portfolio management becomes a critical skill. Siebel Systems, for example, has a portfolio of 750 alliances, and uses a scorecard to track their health.

Partnering in innovation in particular is on the rise. A recent example is the BeerTender appliance, an innovative solution that allows consumers to experience a high-quality draught beer at home. Groupe SEB is responsible for the production, marketing and future development of the BeerTender appliances; Heineken will focus on developing the kegs even further and takes the lead in producing and distributing the kegs (see also the article on “Co-Innovation” and the interview with Heineken CEO Anthony Ruys in this edition, p. 110).

5. How do we win the peace?

Winning the war is one thing. Winning the peace afterwards is another – and ultimately the only thing that counts. Again, one may draw on Alexander the Great to illustrate this point in a historical context. Alexander, being taught by Aristotle, clearly understood that, in order to build an empire, it is necessary to demonstrate respect to former enemies and to convince the population that the new reign is just by showing nobility rather than vindictiveness. For example, Macedonians fighting under Alexander were strictly forbidden to pillage. After all, a lasting peace can only be established when the sovereign is respected.

In business terms, it’s about customer strategy and management. It’s about convincing customers to abandon old loyalties and buy your product or service instead. It’s about knowing your customers so that you understand their desires and frustrations, creating emotional bonds so that customers will spread the word and convince others to do as they do: buy your product. It’s about broadcasting consistent messages and capturing the largest share-of-voice, and about creating a unique combination of features and pricing it such that your product is irresistible – without losing your shirt.

Winning the peace in business terms is about customer strategy and management. It’s about convincing customers to abandon old loyalties and buy your product or service instead.

The music industry provides a good example. Apple, essentially a manufacturer of desktop computers, saw an opportunity in offering a solution to the plagues of piracy, illegal online copying and declining sales besetting the record companies. Its iTunes is a digital music-download service that enables people to legally own single songs at a reasonably low price and burn them to CDs as many times as they like. With the combination of iTunes and the digital music player iPod, which can hold 4,000 songs, Apple appears to have found a hugely successful and profitable value proposition with which it is literally “winning the peace” with respect to both music fans and record companies.

6. Do we have the right intelligence?

The strategic value of knowledge management lies in the ability to respond to future events through the availability of appropriate knowledge.

Deploying intelligence agents, both before and during hostilities, in hot as well as in cold wars, is a practice of all times: putting the pieces together, seeing patterns, interpreting the signals and acting upon them. Battlefield control relies heavily on the adequacy and timeliness of information concerning the status of the actions demanded as well as the level of their execution. Most of the great battlefield strategists, including Napoleon Bonaparte, understood that the success of one tactical move ultimately depends on the correct and timely execution of the ones previously ordered.

In business terms, we talk not only about well known practices such as market and competitor intelligence but also about timely identification of topics of strategic relevance to the firm and about adequate knowledge-management support. The strategic value of knowledge management lies in the ability to respond to future events through the availability of appropriate knowledge. An effective knowledge-management approach copes with four dimensions. First, it establishes what is business-critical to know and defines a meaningful structure for the knowledge. Second, it puts into place a systematic process for creating, capturing, codifying, storing, distributing and using knowledge. Third, it overcomes behavioural barriers to knowledge transfer and sharing. Fourth, it provides for effective media and IT for knowledge transfer.

One company that has established a process to actively identify, prioritise, analyse and communicate topics of strategic relevance is the global reinsurance company Munich Re. In its Top Topics Process, the company identifies potential topics of strategic relevance related to industry trends, product opportunities and threats, regulatory issues and internal processes. From this knowledge the possible options as well as necessary actions are derived. If performed consistently, a process like this allows the company to identify important trends early on, develop contingency plans, and consequently act upon these more rapidly than its competitors.

Companies can no longer afford to be reactive. They need a management control and risk management concept that enables them to anticipate, act and learn.

7. Do we have real-time control of the battlefield?

War pigeons have long been replaced as a vehicle for sending information back and forth from one level of command to the next over long distances. What has not changed, however, are more subtle forms of control such as: sensing and influencing the mood of the folks back home; keeping the anti-war pressure groups at bay; using embedded journalists to shape media coverage; detecting and counteracting risks of desertion; preventing and punishing abuse of citizens and war crimes by soldiers or commanders; holding out the prospect of medals and promotions; etc.

In business-speak, the above translates as follows: corporate governance and contented shareholders; corporate social responsibility; public affairs; preventing poaching of prized staff by competitors; preventing dishonest sales practices and corporate fraud; maintaining balanced scorecards and performance management systems; etc. Indeed, especially in large companies, the psychological and social distances between different stakeholders and units can be great.

War, like business, looks simple if performed successfully. The most minor event, such as only half a message being passed on or a relocation of troops taking longer than expected, may create a friction that, together with its randomness, may lead to incalculable consequences. One should not expect real-life operations to run precisely as planned but accept that these give rise to a variety of risks. In such a dynamic environment, companies can no longer afford to be reactive. They need a management control and risk management concept that enables them to anticipate, act and learn.

Consider, for example, one of the UK's nuclear site licence-holders and the operator of a number of legacy nuclear sites, which formerly conducted R&D on fission. The company has been strengthening its safety and risk controls continuously for many years and achieves a high standard of performance. One aspect of its controls has been a system for managing the risks of adverse and inaccurate publicity. Media citations are closely monitored, with rapid rebuttal in the case of incorrect reports. Heavy emphasis is placed on communication of positive news, underpinned by a strong community programme and excellent relations with local press and other stakeholders. Positive media citations are given a high priority in corporate objectives. As a result, the company was able to avoid the drain on time and resources which, for example, the UK's rail industry has suffered as a result of poor media coverage and public perception of safety problems.

Another example is Microsoft, where financial risk management has been evolving since 1994. While risk management initially focused on financial risks, nowadays Microsoft's approach also covers business risks. Financial risk covers market risks, including foreign currency, interest rate and equity price risk, and the group uses value-at-risk measures and stress testing to quantify the risks. Business risk covers operational and decision-making risks, for which scenario analysis techniques are applied. A risk management group oversees all types of risks. With these initiatives Microsoft's risk management efforts have been recognised outside the company. Already in 1999, the company received the CFO Excellence Award for risk management, which cited Microsoft as a "pioneer of the enterprise approach to risk management".

In today's companies, the challenge is to reconcile the potentially conflicting objectives of "innovate and grow" and "improve efficiency and perform". A smartly designed organisation succeeds in doing so.

8. Do we have well organised and motivated troops?

In the Middle Ages iron discipline and unswerving loyalty may have been sufficient to keep the soldiers marching in unison but, as Niccolò Machiavelli (1469 – 1527) pointed out, when there is a substantial deployment of mercenaries who have joined up for monetary reasons, achieving that unison is a task not to be underestimated. These days, both organising and motivating the troops has become even more challenging. In today's companies, the challenge is to reconcile the potentially conflicting objectives of "innovate and grow" and "improve efficiency and perform". A smartly designed organisation succeeds in doing so.

Smart organisation design considers four elements. First, there is governance, which addresses the overall organisational architecture, the management councils, the key decision processes and the senior positions. Second, there are the stable structures: the formal hierarchical tree (be it organised by product, customer segment, function, or geography) and the corporate centre. Third, there are the lateral linkages to integrate the branches of the stable structures and make them more flexible (shared service centres, communities of practice, etc.), whether internally within the company or with outside partners. Fourth, there is the sustainability of the organisation as fashioned by its people, their competencies and their behaviour.

A good example of a smartly designed R&D organisation can be found at Tetra Pak, the world's leading aseptic packaging company. Since the introduction of a new way of organising for innovation five years ago, the number of new product introductions has tripled and the number of projects launched on time has improved from 13 percent to 80 percent. First, Tetra Pak revised the governance of its R&D, including the role of the Chief Technology Officer, the Innovation Process Board and the Technology Strategy Board. Second, it looked at the stable structures in R&D, i.e. the set-up of Corporate R&D and the R&D departments within the five Business Areas, totalling 14 centres worldwide and roughly 1,000 engineers. Then Tetra Pak took on the lateral linkages across the organisation, mainly by introducing a common innovation process. Last but not least, the company embedded the new way of working by measures such as the Tetra Pak Academy for Training and the Tetra Pak Innovation Network, a common web-based tool supporting the innovation process.

9. Do we have effective sustenance processes?

One aspect of warfare that may not be spectacular but can decide its outcome is the effectiveness of the sustenance processes: feeding the soldiers, supplying the kerosene, treating the wounded, etc. These processes often occur behind the scenes – and are sometimes outsourced – but are an essential requirement to keep the organism going. As Frederick the Great (1712 - 1786) instructed his generals: “Without supplies no army is brave”. Few historic examples are able to illustrate the importance of adequate sustenance processes as well as the French invasion of Russia in 1812. The French were defeated not on the battlefield but by the inability to live off the land and by the non-existence of sufficient supply of the necessary resources to their troops.

The same applies to companies. Paying customers visits, replenishing stocks, assembling widgets, handling customer complaints: these may be routine tasks, but flawless execution is crucial. No one notices when everything works as it should, but lo and behold when the slightest error occurs.

Benetton, a leading Italian apparel company, is an example of a company that has been refining its core processes relentlessly. In the fashion industry, one of the major challenges is to offer different versions of the same garment at a low price. Benetton's solution is to produce all garments in greggio (in grey) in low-cost countries with flexible production units. When the garments are ready for shipment to the stores they are coloured according to the needs of each market. In order to minimise the need for warehouses, the garments are stored in each shop, where they serve as colourful decoration. Late last year the company announced that it would cut another 20 percent off its lead-times by 2005.

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10. Can we afford to fight financially?

Sufficient financing of campaigns has always proven to be of central importance to the chances of success. More than once history has proven that the one best able to find the funds to pay his army is surest of success. Likewise, taking account of the unexpected in the planning process has proven to be wise: as many a besieger had to learn the hard way, a siege is far less resource-intensive for the defender than for the besieger.

Obviously, business is not just about managing cash flows but also about creating value. And that brings us back to the first question – are we fit to fight? – and the subsequent ones about strategy and organisation. To ensure smart growth, all 10 questions should be addressed in parallel. And some of the answers to one question may also apply to others.

Insights for the Executive

Smart growth is about strategy. It is about selecting the right arena in which to compete and finding the innovations that make a difference. It is about managing the right portfolio of partnerships. Above all, it is about seducing your customers.

But smart growth is also about organisation. It is about making sure that you have the intelligence, the controls, the organisation and the processes required to mint money from visions.

Together with your board members you may want to revisit each of the 10 soul-searching questions listed in this article, and do a poll. Ask yourselves how satisfactory an answer you have for each of these questions, on a scale from one to five. Unless you score five on each, you should no longer wonder why smart growth is wise.

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