Book The Granularity of Growth

Making Choices That Drive Enduring Company Performance

Patrick Viguerie, Sven Smit and Mehrdad Baghai
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Recommendation

This is a useful, methodical book. Rather than offering general platitudes on growth and strategy, Patrick Viguerie, Sven Smit and Mehrdad Baghai offer data-driven ways to generate growth. However, neither the approach nor the book is easy. The approach requires leaders to undertake hard, detailed work with rigorous honesty as they examine their companies and markets more specifically (that's where the granular detail comes in) than most will want to. The authors are firm on the necessity of maintaining this intense level of awareness as markets change around you. The book requires a bit of patience, as the authors sometimes get overly invested in tiered structures, pacing readers through different categories of growth directions and structures that become a bit too abstract and technical. That aside, anyone looking for specific ways to address growth will find this helpful. *BooksInShort* recommends it to CEOs, strategists and students of business growth.

Take-Aways

- Big, growing companies have a better chance of surviving, but growth is difficult.
- To generate growth, focus on granularity: look at your business in a more "fine-grained" fashion, so your analyses contain more elements.
- A large company can use its scale – that is, its size – to facilitate granularity.
- Granularity disrupts generalizations and exposes growth pockets in mature markets.
- Three cylinders drive growth: portfolio momentum, M&A and market share.
- The market you compete in is more vital than your relative performance.
- Develop a growth map of strategic plans on three time horizons: soon (known markets), intermediate future (adjacent markets) and distant (new markets).
- Your "management processes" must unify four other main components: "growth direction, granular strategy, scale platforms" and a "granular blueprint."
- Track performance by granular clusters of employees, using specific, standardized and performance-based metrics.
- A granular path puts extra pressure on your leadership. It is hard and growth takes time.

Summary

The Core Challenges of Growth

Growth is tough for any company, but due to sheer scale, it is even harder for a large, mature company to keep growing at anything like the rates it demonstrated in its early years. The longer a company is in business, the likelier it is to be in a mature field where innovation evaporates. If you lead a large company, how can you make it grow?

> "A compelling growth strategy...is clear about which cylinders will drive growth in each time horizon."

First, define growth broadly – it is any increase in profits, no matter how you acquire them. Second, focus on granularity, which means looking at your business in a more "fine-grained" fashion, so that your analyses contain more elements. This focus will reveal more "pockets of opportunity." Most strategic thinking about growth, in either mature or young industries, is too broad to be useful. Mature industries have small areas that are growing and even young "growth" industries have stagnant areas.

> "If overestimating the benefit of sheer size is the first mistake many companies make, overestimating the synergy between different businesses is the second."

Revenue growth is essential for corporate survival. In a study of U.S. companies over the course of two business cycles, 1984-1994 and 1994-2002, the companies with both revenue growth and high stockholder value generation ("growth giants") were far more likely to survive than those with only one strong factor or the other, or those that were weak in both. Those with low growth despite high value creation were most likely to fail.

> "There are three ways to increase your portfolio momentum: Reallocate resources to pockets of high growth, shift your portfolio or grow your markets."

Growth giants outperformed their competitors even in supposedly low-growth mature industries. This underscores the importance of a granular approach, and proves that firms don't have to change industries or markets to grow. Instead, "look deeper" into markets where you compete and let your understanding of their specific possibilities drive your growth strategies.

> "To deliver both granularity and scale, a company must design its strategy and organization model to create an architecture for growth."

Granularity matters because it helps you compete and it disrupts generalizations. You can view markets on several levels of granularity. The global economy is at the highest, most general level. Then you can get more specific: industry, subindustry and category – down to the individual consumer. Look at the influence of a single trend, such as aging. It has little effect on the global economy (0.1 % annually). However, it has a varying impact in different regions (just 0.03% in Italy) and different industries (e.g., an aging population needs more health care and fewer toys). At the subindustry level or below, each trend's consequences contrast sharply and pack more of a punch.

How and Where to Grow

Growth is an engine driven by three "cylinders":

1. **"Portfolio momentum"** – This "organic revenue growth" is generated according to how well your existing portfolio of investments performs, that is, through choices made earlier. Among the companies studied from 1999 to 2006, "the average large company grew at 10.1%" annually. Portfolio momentum generated 6.6% of that sustained growth.
2. **"Mergers and acquisitions"** – Numerous studies challenge the profitability of mergers, but from 1999 to 2006, M&A generated 3.1% of the studied companies' growth.
3. **"Market share"** – This measures how much of a given market a company controls. During the study period, market share generated only 0.4% of overall growth. The ratio differs a bit by region, since large U.S. companies tend to lose market share over time and European companies tend to gain a bit. Location is essential for growth. Where you compete is "almost four times more important" than beating your competitors.

> "Scale and granularity are not opposed: Scale enables granularity, and granularity doesn't necessarily inhibit scale."

You don't have to fire on all cylinders to do well, but articulating numerical goals in each of these areas creates greater precision and provides specific benchmarks for measuring performance. In the top quarter of companies studied, "firing" on each cylinder meant 8.5% annual growth in portfolio momentum, 4.5% annual growth in the M&A cylinder and 2.3% growth in market share. Combining the idea of cylinders with granularity gives you a powerful analytical tool. Examine performance in each cylinder (how well it is firing) according to such granular breakdowns as geographical distribution, industry or subindustry, growth and so on. Use the information to correct poor performance and to identify new opportunities for expansion in each cylinder.

> "Strikingly, a company that grew more slowly than GDP for the first economic cycle was five times more likely to disappear as a going concern before the end of the next cycle than a company that expanded more rapidly."

Portfolio momentum is hard to maintain and increasing it is harder still. In one study, companies that hit "strong tailwinds" lost momentum and their overall growth slowed. Only a few increased momentum by shifting their portfolios and diversifying. Some 95% of the positive changes came from the "market growth of the initial portfolio." To shape your momentum, reallocate the resources in your portfolio to shift investments to growth areas.

> "All growth strategies involve choices about moving – or where, when and how to evolve the portfolio mix over time."

M&A activity can add momentum, though measuring its impact takes time. Eventually, more than half of all M&As produce positive outcomes, though many result in higher operating costs. The right kind and size of M&A for your firm depends on your context and purpose. Larger deals work well for market consolidation or for shedding failing assets, while smaller deals work well when you're building a platform, especially if the deals support a unified growth strategy. Successful companies are proactive and active in their M&A choices: They move quickly, divest early and trade on an ongoing basis. They monitor internal growth and let new businesses act as independent units. Most firms divest failing assets because they don't want to admit they've made mistakes or face the emotional challenges of firing workers.

> "Saying that M&A can be successful and that acquisitive companies are frequently rewarded doesn't tell us how companies use it to grow."

Gaining shares of new markets also generates momentum, but success requires moving one step at a time, testing small moves before risking larger investments. Moving a large company into new growth markets takes time. Realigning your portfolio could take as long as five years. Share gain has less impact on overall growth than the other cylinders have. However, it provides a larger percentage of short-term gains, and it matters psychologically, since companies in a market measure their performance against each other and companies tend to grow or shrink across their market segments. Market share also needs attention if everyone in your industry is competing to carve up the existing pie in a limited-growth environment.

Planning for Growth

As you develop your long-range growth plans, envision them as fitting a "growth map" that covers three possible realms:

1. **"Extend and defend core businesses"** – This requires specific action from each cylinder. For portfolio momentum, realign your assets to fuel the units that are most ready to grow. Acquire new businesses to fill gaps in your portfolio, and divest those that are stagnant. To gain market share, focus on raising performance.
2. **"Build emerging businesses"** – Shift momentum to markets where you don't now compete. Make acquisitions that solidify your current power and diversify your portfolio. Gain market share by invigorating your business "proposition" or "delivery model."
3. **"Create viable options"** – This look at new opportunities is more speculative, so avoid wild risks. Instead, move with small, measured steps "into white space." Build new units. Acquire companies with the knowledge that you'll operate a range of businesses in shifting terrain. To gain market share, reshape your business model.

"To Move or Not To Move"

As you move from planning to acting, recognize that the question isn't whether to move. To grow, you must move. The question is how to move and in what direction. Among the growth giants in one study, 70% expanded existing businesses, while the other 30% diversified. If your company has little momentum, expanding beyond your current portfolio will bring the most benefit. If your company has momentum, you will get good results from M&A, but you'll earn the best outcome from moving within your "existing portfolio," so you don't travel away from a beneficial tailwind. Many companies suspend acquisitions instinctively when the economy stalls, moving to a conservative position to defend what they can. Ideally, you want to do the opposite: "Firing the M&A cylinder is the most value-creating step you can take during a downturn."

> "So the question is not so much "Should we enter new markets?" as "Do we have distinctive insights and capabilities that we can bring to bear on our chosen markets?"

As you think about where to move, cultivate an "expansive mindset." Define your business broadly, so you don't have more than 5% of the market. While the farther a business is from yours, the more "complicated and challenging" the acquisition is likely to be, still "advantage trumps adjacency." Good opportunities will repay you for grappling with their complexities.

> "Integration is where many if not most acquisitions fall apart."

Scale and granularity used to be opposed. For example, think of mass production on the early assembly lines. Every Ford car was the same. However, information technology changed things. Now, scale can and should enable granularity in companies that combine proper strategic growth with appropriate organizational patterns. This "growth architecture" will vary from company to company. To define your best approach, review your current direction and status as objectively as possible. Is your company aligned with the economy? Do your investments take advantage of your strengths? How do you rate in the following five components of a well-designed organization?

1. **"Growth direction"** – This is the plan for how your firm can grow in "multiple cylinders across time horizons." If you are weak in all five components, start with this one. If you have this one, but not the other four, seek leaders who can develop granular strategies.
2. **"Granular strategy"** – This identifies the sequential steps you'll take to develop new possibilities, "capture granular growth opportunities and build real advantages." If you only have a granular strategy and a granular blueprint, to keep you going long term, you need to add leaders with vision who can help you find new markets quickly.
3. **"Scale platform"** – This describes how big organizations make the most of their size. If you have both growth direction and scale platforms, you are off to a great start.
4. **"Granular blueprint"** – This sets out how a firm "matches the texture of the market." Here, you're seeking that "sweet spot" where you get the maximum benefit from granularity at the least cost. This will differ by industry and cylinder, and it will evolve as IT enables your business to track more details.
5. **"Management processes"** – This uses "strategic planning, resource allocation and performance management to link the other elements." A business that is good primarily at planning should focus on its processes. Less commonly, a business with good design and processes but limited planning needs strategy to adapt to a changing market.

> "When mapping out a growth direction...define your market sufficiently broadly that your market share is no more than five percent."

Don't design from the top down for lower-level decisions. Instead, focus on crucial choices about "where to compete and what to buy." Then shape your organization to respond to the market. Guide your growth with a "cluster-based growth model." To do so, divide your organization into clusters of as few as 50 people in knowledge work or as many as 300 in other areas. Establish a scorecard that tracks specific, measurable, standard performance goals at each level, and determine how to monitor them throughout the company.

> "There is no such thing as a growth industry; most so-called growth industries have mature segments, and most mature industries have granular growth pockets."

Working on a large scale has traditional advantages, such as lowering production costs. It also has less familiar ones, such as the possibility of raising efficiency across the board. Both will change over time, but keep harnessing all possible advantages of scale. To maximize those benefits, use systematic, system-wide reporting structures that guide specific, high-quality data from all units and about all levels of granularity. To get the most benefits of scale from M&A, turn to the guidance of a CEO with a coherent strategy and a longer timeline (unlike short-term consultants). The goal is to integrate acquired companies fully into your business in a structured fashion.

"Economic downturns create great opportunities for portfolio moves, yet few companies seize them."

Implementing a granular approach to growth is challenging. Focusing on very specific aspects of your organization will reveal a lot of underperforming and failing areas. This will generate increasing pressure on you as a leader, but real new growth takes time – it can take five years or more. Implementing this strategy means doing more work while generating the excitement to mobilize your entire organization for a sustained effort.

About the Authors

Patrick Viguerie and **Sven Smit** are directors at McKinsey & Company. **Mehrdad Baghai** is co-author of *The Alchemy of Growth* and managing director of Alchemy Growth Partners.