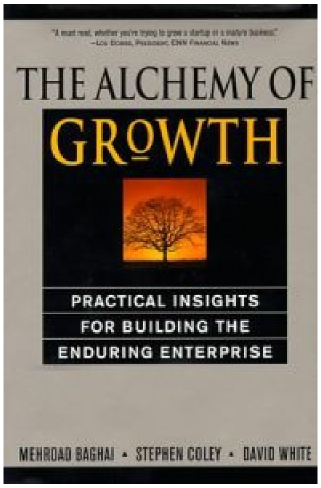

Book The Alchemy of Growth

Practical Insights for Building the Enduring Enterprise

Mehrdad Baghai, Stephen Coley and David White
Perseus Books, 2000
First Edition:1999

Recommendation

Growth in business today is like alchemy, as business leaders try to turn everyday metals into gold. Authors Mehrdad Baghai, Stephen Coley and David White, who are McKinsey consultants or alumni, explain that growth can transform an ordinary business into an exciting, vibrant environment where employees feel a sense of purpose. Then they present a step-by-step recipe for achieving growth. Along with their method, which is based on practical advice and real-life case studies, they include profiles of growing companies. Although the authors boil down a complex endeavor into a step-by-step formula, they make it clear that even a sustained effort to grow can take years to show results. If you seek a quick fix, this is not the book for you. However, if you are interested in a tested framework for growth, *BooksInShort* recommends this clear, methodical approach.

Take-Aways

- All businesses eventually mature and decline.
- A company can outlive its core businesses only by creating and maintaining a continuous pipeline of new businesses.
- Executives must manage three "Horizons of Growth" simultaneously.
- "Horizon 1" includes defending and extending your company's core businesses.
- "Horizon 2" focuses on building emerging businesses.
- "Horizon 3" creates viable options for your company's "businesses of tomorrow."
- Great companies build the resolve to grow and "earn the right" to keep growing.
- Building the resolve to grow can take years and requires total commitment from senior team members.
- Your company earns the right to grow when it achieves top operating performance.
- If you use the "Staircase to Growth" approach, your company can retain flexibility while securing growth options.

Summary

"Three Horizons of Growth"

First, the bad news: All businesses mature and eventually decline. For example, in 1988, Reynolds & Reynolds Company finished a decade of work with an average annual growth of 18%. As the decade ended, the company experienced "customer consolidation, a market shift to low-margin products and heightened competition." It had acquired a printer company at the precise moment that the industry grew most competitive. Reynolds & Reynolds's new CEO, David Holmes, recognized that its core businesses would not sustain growth. He boldly divested several units and integrated "multiple acquisitions." This fueled a rebound in stock price and profitability.

> "Just as alchemy sought to transform the everyday into the exalted, growth can transform employees' working lives."

Then, the good news, which Reynolds & Reynolds incarnates: A company can outlive its lines of business, which will contract and expand as necessary. As one revenue stream matures, you must have another ready to take its place and another after that. Developing a continuous pipeline of new businesses – that represent new profit sources – is the only way to sustain growth. The pipeline of continuous business creation operates in three distinct stages that require your active management –

the three "Horizons of Growth."

"Horizon 1"

Extend and defend your core businesses, the ones that lie at the heart of your organization. These are the businesses that customers and stock analysts identify with your corporate name and brand. The majority of profits and cash flow in successful companies comes from Horizon 1 enterprises. The cash that these operations generate and the skills they nurture provide the resources your firm needs for growth. You must operate a thriving Horizon 1 business in order to pave the way for subsequent initiatives. Your main challenge as the manager of a Horizon 1 business is to solidify your competitive positions and to uncover all the remaining potential in your core endeavors. Mature businesses can still realize incremental increases in profitability and growth. Various techniques for this include sales-force stimulation programs, "product extensions" and marketing changes. Ruthless "restructuring," "productivity enhancement" and cost-cutting measures also help maintain healthy performance.

"Horizon 2"

The second horizon of growth calls for building emerging businesses. These rising businesses should be fast-moving ventures that could transform the future of your company, albeit with considerable investment of time and money. Their substantial profits may still be as much as five years away, but they currently draw customers and generate revenue. Over time, Horizon 2 businesses can eventually become as successful as Horizon 1 businesses. Your firm's desire to increase market share and revenue is the only motivation that can provide the driving force for these new ventures. Your company needs several businesses in development or else its growth will slow and eventually stop.

"Horizon 3"

Your third horizon businesses are the seeds of tomorrow's ventures, nurtured with preliminary activities and investments. This can include "research projects, alliances, minority stakes or test-market pilots." It may be 10 years before they earn profits but, from the outset, they should demonstrate genuine potential to develop into viable concerns. They are embryonic, but not wild fancies. Deliberate initiatives can develop good ideas into Horizon 3 businesses. These options must be promising and worthy of management's support, though you should seed many Horizon 3 options, because the majority will not work out. Your company's goal is to balance funding these initiatives against the risk of using too much capital or other resources. Consider your many seeded enterprises with a cold eye to the future. Jettison those with little growth potential and nurture the others. Repeat this culling annually.

Managing the Three Horizons

Don't neglect the planning of future horizons or hesitate to initiate new concerns. Stewarding a pipeline of business creation is not the same as short-, medium- and long-term planning. Traditional planning deliberately defers some activities to medium and longer terms. Managing the three horizons requires you to develop enterprises in parallel, regardless of each individual undertaking's stage of maturity. You must manage the "sour medicine of operational improvements for core businesses" in alignment with the "sweet agenda of revitalization for new growth opportunities."

> "Only an exceptional organization manages to sustain growth when its core business matures."

Neglecting any of the three horizons weakens your prospects for long-term growth. To nurture a successful business-creation pipeline, extend and defend your current Horizon 1 profit generators, while building Horizon 2 businesses in the medium-term and following up on long-term Horizon 3 options. Your leaders should manage all three horizons. With three horizons humming, more executives will be involved. Their "growth mind-set" will inspire everyone in your organization. This spirit of looking forward makes all your Horizon endeavors more valuable.

"Overcoming Inertia"

Management failings – more than harsh economic realities – will probably limit growth, but both are at play. The question is not whether growth is possible, but whether your company can embrace all the challenges growth involves. Successful growth companies "earn the right to grow" by dint of their employees' efforts and their managers' commitment. Leaders must break the shackles of ingrained beliefs and think more expansively about the future and its new business opportunities. You will need one to four years of sustained hard work to properly lay the foundation for growth. Commit your company time, energy and resources to that pursuit.

"Earning the Right to Grow"

A growth program's success requires complete managerial attention. Before beginning a three-horizon growth program, resolve all major core-business issues. Your company must also invest and show that it can remain profitable while generating sufficient revenue to pursue growth. You risk demoralizing your company if economic setbacks force you to curtail or terminate "growth initiatives." Your organization should take three specific actions to establish its readiness to grow:

1. **Achieve "superior operating performance"** – Strong strategic positioning and knowledgeable execution allows management to lead growth initiatives.
2. **"Strategic Divestment"** – Decide whether to turn around or sell underperforming or "strategically distracting" sideline businesses. Growth-sustaining companies tend to choose divestment rather than spending time, money and energy turning around a business that is not central to the company's future or brand. When you divest wisely, investors and other stakeholders recognize that you are serious about growth.
3. **"Build investor confidence"** – You must convince investors that using cash and management time pursuing growth initiatives is sound policy. Investors want proof that better returns await than if the cash were paid out in higher dividends or stock repurchases. Communicate with investors clearly, consistently and regularly. Keep them apprised of your growth initiatives; be honest about successes and setbacks.

"Resolving to Grow"

You must “transform your entire culture” to sow the seeds of profitable growth. No matter what your culture, you must have a “passion for growth” that fuels your determination and instills that backbone in everyone in your organization. Most companies need years to transform and the unwavering support of management. Often, the catalyst for this new, shared resolve comes with a leadership change or the threat of one. The following methods can build the commitment to grow:

1. **“Get the commitment of the senior team”** – Rallying a leadership team for growth can take up to two years of debate, personal development and possible “personnel change.” To determine if growth is right for your firm and what commitments senior management must make, “undertake an intense analytical process.”
2. **“Raise the bar”** – Create exciting new targets as rallying points for growth. Even if the targets seem unrealistic, bold expectations inspire employees, management, investors and other stakeholders. Ask management for their “growth ideas” and pursue their suggestions. This also inspires the senior team.
3. **“Remove organizational barriers”** – Internal barriers can make many large companies hesitant to embrace growth initiatives. Barriers might include the perception that an employee has to avoid making mistakes in order to advance, self-limiting “fixed beliefs” or incentive systems that reward achievements based on budget rather than merit. Decide if you need to revamp your “planning processes, targets, goals and incentives.”

“Staircase to Growth”

Executives who are trying to develop Horizon 3 options face major problems, notably market uncertainty, and gaps in skills, assets and relationships. To lead growth successfully, take a series of measured steps rather than bold leaps. Each step must make money, bring your firm closer to its ultimate goals and set the stage for future opportunities. Individually, the steps are not dramatic. But as part of a larger staircase toward continued growth, their results matter.

> “Successful companies can and must outlive their individual businesses.”

Building a staircase to growth will provoke a lot of internal analysis. Ask how big each step should be? How do you know when to persist with a staircase and when to give up? No formula can replace managerial judgment, but an analysis of growth staircases shows that almost all successful staircases encompass four phases, which are linked to the three horizons of growth:

Phase One: “Seeding Growth Options”

To develop a new line of business, first secure growth opportunities your company can use to start staircases. An idea for a business is inadequate. A new venture doesn’t become a real option until you take a concrete step – research and development, a pilot program or a “small acquisition” – to establish your initial business position. The search for the right phase-one possibilities requires creativity, patience and persistence.

Phase Two: “Testing the Business Model”

Push your staircase into the next phase – moving from Horizon 2 to Horizon 3 – by testing your business models. Develop a market-based understanding of what might work, identify which capabilities are critical, learn how to develop the best options and estimate the likely commercial potential. Phase two focuses on direction and establishes how you will get to the top of the staircase. Normally, it takes two to four years to move a business from phase one to phase three.

Phase Three: “Replicating the Business Model”

If your Horizon 2 business model is commercially viable, you are ready to enter phase three, when growth accelerates – which requires large investments – and revenue streams increase. As these changes manifest, investors and stockholders will come to understand that your organization provides advantages beyond “just option value.” This phase calls for gaining and holding “positional advantage” in the eyes of investors. If you can establish a “strong market position” before your competitors, you gain the advantage. Brave public moves like “major acquisitions and heavy investments” mark your commitment to phase three.

Phase Four: “Managing for Profitability”

This stage recognizes that all Horizon 1 businesses reach maturity. Rolling out and extending the business model takes a back seat to managing for profitability. The core business shifts its focus to finding value through “incremental extension, cost reduction and renewal.” The staircase approach encompasses a series of small steps, not giant leaps. This permits companies to do a better job of managing the risks involved with growth. Incremental steps allow your firm to build “strong capabilities and to secure strategic options,” while remaining as fluid as possible.

About the Authors

Mehrdad Baghai, managing director of Alchemy Growth Partners in Sydney, co-authored *Granularity of Growth* and *As One*. **David White** and **Stephen Coley** are directors with McKinsey, and Coley authored *Le Chapeau a disparu*.