Zero growth

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What is a "cash cow?" It is a business area that has experienced strong growth over a period of ten to twenty years, or even more, by innovating regularly to develop its market, breaking into new countries and customer segments, concentrating its target market and securing a leadership position within it, and, in doing so, making a critical contribution to value creation for the group.

Such business areas are no longer growing, due their markets having matured and become concentrated. However, their management teams have retained their ambitious spirit and cannot accept this lack of growth. They try to revive the market by coming up with minor innovations or gain a few extra points of market share at the risk of accelerating the ongoing price war. They might also try to micro-segment the market by developing increasingly wide-ranging product lines that carry associated complexity costs or make bolt-on acquisitions of minor competitors despite negative returns to scale.

Instead of falling, the costs incurred by these business areas increase, without having a knock-on effect on revenues. Margins are eroded rather than maximized to generate high cash flows and support the development of other group businesses in markets with strong growth potential. Meanwhile, small competitors, which are simpler, low-cost or better adapted to certain client niches, are developing their proposition and stealing market share.

Managing a business that has reached maturity is, therefore, complex. Managers need to reduce the growth-related costs incurred by their business area and retain only the operational costs, even if this goes against the DNA of the staff working there. This is not just basic economic and managerial logic; it also represents a significant cultural and organizational challenge.

Reducing costs

In mature markets that are already highly concentrated, it makes much more sense to maximize cash flow generation and reinvest it in other, high-growth businesses than to try to gain a few more points of market share and/or revive a market that is structurally stagnant. *Marginal return on investment is closely linked to market growth and is inverse to the level of concentration of the market*.

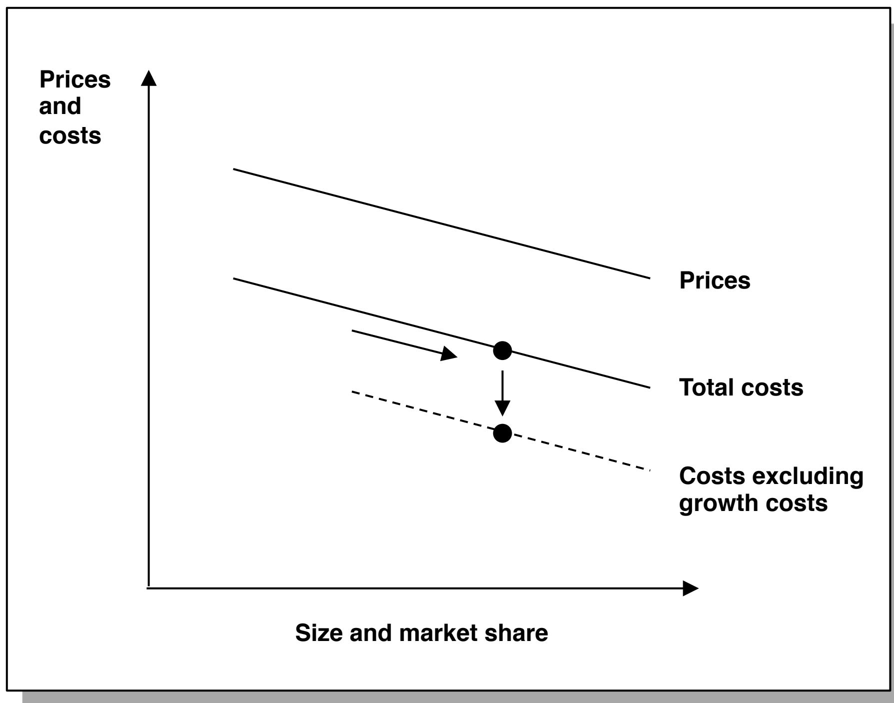
As a result, groups need to reduce, as much as possible, all costs and investments contributing to the growth of their cash cow and retain only highly optimized operational costs (see graph in appendix). These costs represent between 5% and 10% of total costs, depending on individual circumstances and the industry. This is, therefore, a critical issue.

How can it make sense for businesses that often account for one to two thirds of a group's total sales to continue to be run with the same budget, investments and operating procedures that were justified when the businesses were growing at an annual rate of 10%, now that their growth has slowed to 2% to 3% a year?

A large proportion of the key markets for major industries over the last twenty years are now experiencing a slowdown in growth in Europe, Japan and the US. These markets will not see a return to growth, or at least not growth that will benefit existing business activities. Once a group has established a clear leadership position for a certain business area, it needs to maintain its share of the market and fend off competition. However, it should not do more

- Graph -

In zero-growth business areas, companies need to reduce growth-related costs and focus as much as possible on operational costs



Growth costs: R&D, marketing, advertising and promotional spend, commercial costs, price cuts and reductions, CAPEX, management team development.

than this. Pursuing development beyond natural growth in these markets dilutes the company's resources.

It is therefore essential for companies to conduct a stark analysis of their surplus growth-related costs and then to eliminate these for the business area in question.

Redeploying resources

These growth-related costs and investments do not necessarily need to be eliminated at group level. Rather, these budgets need to be redeployed where they can make a productive contribution and bring about growth. For example, they could be put towards R&D, marketing spend, advertising and promotional budgets, commercial costs, CAPEX, price cuts and special offers, management team development, and so on. All development-related costs and investments should be directed towards high-growth business areas.

All other things remaining equal, these costs should represent a significantly smaller proportion of revenues for zero-growth business areas, and yet the opposite is true for the majority of large groups today. These companies are underinvesting in growth businesses *because they are overinvesting in zero-growth business areas.*

Reorganizing the group

It is difficult for large groups to optimize costs incurred by their cash cows without radically changing their internal organization. For example, R&D is often housed within a company's original business area or located in its home country, or made up of teams from the original business area or from the group's home country. It is only natural that these people, due to their history and closeness with these markets, continue to "innovate" primarily for France, Germany, the US and so on, despite the fact that returns on investment are falling, while devoting marginal attention to innovations for Turkey, Indonesia, China and other such countries, which they treat as mere extensions to those developed for the group's historic business areas.

Companies need dedicated R&D departments and teams for high-growth business areas and markets. In cases where there is value in concentrating and co-ordinating these functions, they should be managed at group level and physically located for the most part in high-growth business areas and markets. If there is value in keeping R&D staff in mature markets, groups need to ensure that these teams incorporate members from high-growth business areas and markets.

In all cases, these functions need to stay close to high-growth areas – whether by way of their position within the organization, their physical location or the composition of their workforce – and give priority to these businesses.

Differentiating management objectives

A cash cow must be managed in terms of profitability, net cash flows (maximizing cash flows generated by the business's operations, and keeping investments and working capital to a minimum) and a minimum market share, which needs to be retained. A high-growth business, on the other hand, is managed with a view to growth, profitability and market share gains. Establishing one-size-fits-all objectives and performance criteria across the group is a sure-fire way for a company to destroy its growth and profitability.

Each business contributes in a different way to the group's financial dynamic and its value creation. Cash cows are sources of internal funding for other, high-growth businesses and serve as a base from which to raise the debt and additional capital required for their growth.

Companies need to value the workforces of their zero-growth business areas, because they carry out an essential task for the group in generating the cash flows needed to finance its wider growth. These staff members should be able to earn just as much and have the same promotion opportunities as staff working in one of the group's high-growth business areas. The only difference is that these benefits are based on sets of objectives that are structurally different from one another.

Rotating teams of staff

A management team that has spent ten years running the same business area stands up for its unit. It no longer stands up for its group. Managers often find it difficult to understand that their business area has a different contribution to make to the value of the group at each stage of its life cycle.

It makes sense for a company to rotate its teams of staff on a regular basis, transferring them to different business areas, departments and regions. If a company does not do so, it must at least replace the management team of a business unit once the unit has matured and needs to be run differently, despite the fact that the managers have done a good job and made a success of the business. Such a move may, therefore, come as quite a shock for the managers concerned, unless the company approaches this by offering important promotions.

Relocating management teams

More often than not, the management teams of large groups come from the business areas and markets that constitute the group's historic success and struggle to cut their ties with these. However, in order to build a future for the group, these managers need to be physically or at least culturally close to the new markets, customers and workforces in which the group is investing. How can a large company logically justify basing the entirety of its management team in Europe, surrounded by its established cash cows, when more than half of its revenues, customers, workforce, and investments (as well as, increasingly, shareholders), and all of its potential growth are in Asia?

In order to create value, a company's costs, investments and management need to follow (and anticipate) its growth.

Each business area within a group needs to be run differently depending to its stage in its life cycle. Zero-growth business areas need to either generate significant, regular cash flows or be sold. Companies need to look at these units realistically, taking into account their worth for the group as a whole, and motivate their workforces appropriately.

A number of steps can be taken to achieve this. However, what groups ultimately need to do is maximize cash flows. Any investment by a company in one of its cash cows results in corresponding underinvestment in other, high-growth business areas and therefore limits the overall growth of the group. In zero-growth business areas, companies need to reduce their costs.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich and Shanghai. The firm assists CEOs and senior executives of European, North American and Asian corporations in formulating and implementing growth strategies. Estin & Co also helps private equity firms to analyze and improve the value of their investments.