# Micro vs. macro strategies

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Micro strategies make it possible to concentrate an activity. Macro strategies make it possible to concentrate an entire industry. The two are complementary and must be rolled out on different time horizons. Without the former, there is no profitability. Without the latter, there is no long-term growth.

**Dynamic segmentation**

"Micro strategies" aim at establishing strong positions which generate recurring cash flows: concentration of resources on well defined segments; market share gains and implementation of scale effects; accretive growth thanks to the development of competitive advantages; market concentration and establishment of a clear leadership in the chosen segments. Hence, they make it possible to grow without dilution.

However, they have limitations. In mature markets, it is difficult to concentrate markets indefinitely. Therefore, new sources of growth must regularly be found.

Moreover, the segmentations on which those strategies rest are not everlasting. They change rapidly as a result of changes in demand, technologies, or business models. They also disappear as a result of the strategies led by competitors: to grow, those competitors expand beyond their traditional segments and consolidate horizontally or vertically activities which used to be distinct; in the process, they transform them.

Hence, businesses which used to be national become global (consumer goods, food ingredients...), producers integrate in distribution or vice versa (fashion, luxury...), offerings are extended in terms of products and services or price range (railway components, industrial equipment...), entire sections of a value chain disappear under the impact of new technologies (music, publishing, online TV...), and businesses which used to be distinct merge completely and transform industries as a result (smartphones, eyewear...).

In the automotive industry, leaders which were specialized in selling components directly to manufacturers were gradually relegated to tier 2 positions or disappeared in favor of module integrators. By acquiring specialized competitors and adding value, these module integrators have changed the segmentation of the industry. For example, Mahle, a German OEM which was historically specialized in pistons for engines, gradually extended its business perimeter by acquiring other manufacturers of specialized components until it offered complete systems: engine, filtration and thermal management systems. With that strategy, it grew by more than 10% per year, and it increased its revenue from €4.3 billion in 2006 to €12.7 billion in 2016.

What is the point of establishing strong positions in some segments if the definitions of those segments change rapidly and if the playing field is multiplied by ten within five years?

**Value vs. competitiveness**

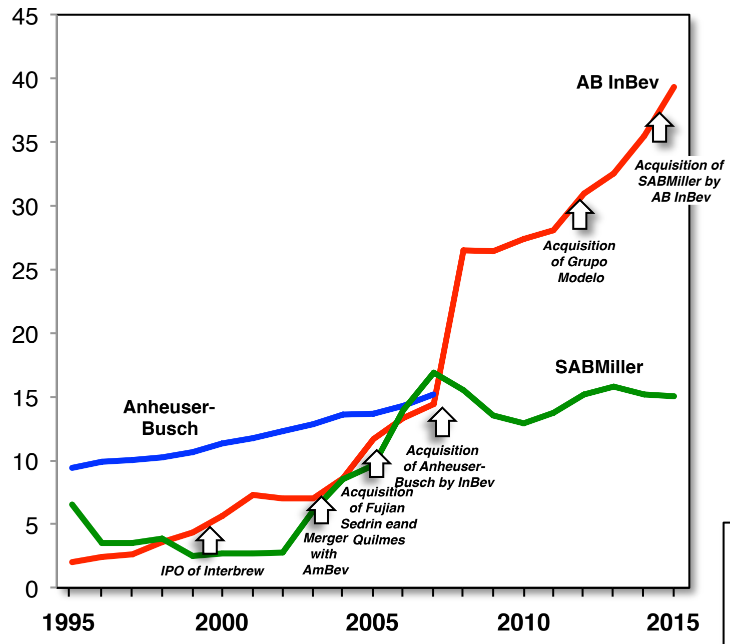
"Macro strategies" take over from classic "micro strategies" with a more long-term perspective from two different perspectives:

- They anticipate what the segmentation and the competitive structure of the industry may be in five to ten years and how the relevant playing field may evolve.

**- Table 1 -**

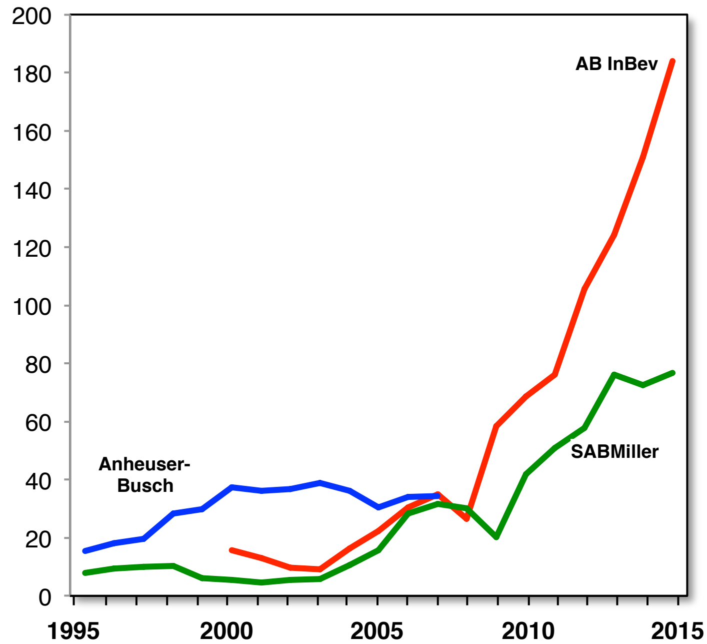
**InBev concentrated the global beer market by acquiring major American and international competitors**

**Revenue**
(Bn€)




| | Yearly revenue growth 00-07 | 07-15 |
|---|---|---|
| Interbrew/ InBev/AB InBev | 14% | 13% |
| SABMiller | 30% | -1% |
| Anheuser-Busch | 4% | - |

**Market capitalization**
(Bn€)




*The TSR for initial shareholders (from the IPO in 2000) of Interbrew (which became successively InBev and AB InBev) was 14% per year*

Sources: Bloomberg, Estin & Co analyses and estimates

- They aim at optimizing value—therefore growth—and not only competitiveness, because in a rapidly changing environment, value is a strategic weapon as powerful as competitiveness to survive and concentrate the industry.

In numerous businesses, the relevant playing field can indeed be multiplied by ten in five years even as the market growth in all of the activities does not exceed 3% per year. In those situations, growth, investment and acquisition issues change in nature.

In this case, companies which eventually concentrate an entire sector are not necessarily the first in terms of revenue, nor those which have strong competitive positions in a few segments of the sector. *It is those which grow the quickest and which develop the strongest capitalizations*.

In 2002, Mittal had revenue and EBITDA five times below Arcelor, but it was growing at 30% per year. In 2006, its revenue and its EBITDA were still 60% lower than those of the European leader. However, its valuation multiple was 3 times higher and its value 1.9 times higher because of its growth, and this enable Mittal to acquire Arcelor.

In a similar manner, Interbrew, the Belgian brewer, concentrated the beer market over the past 20 years by catching up and buying out its major competitors (cf. table 1). In 1995, it was still a small local player mainly positioned on the European market with two major brands, Stella Artois and Jupiler (Piedboeuf). It was four times smaller than Anheuser-Busch, the world leader which dominated the largest market, North America.

For 15 years, it made regular acquisitions of increasing size and it grew at over 20% per year while Anheuser-Busch grew at only 4% a year given maturity of the U.S. market. In 2008, it bought Anheuseur-Busch with the financial resources provided by its capitalization and it continued its growth through acquisitions at the same pace. In 2016, it acquired SABMiller, the worldwide number two, which had grown at 30% per year between 2000 and 2007 by developing itself in emerging countries but had failed to continue this growth beyond.

Ultimately, the small Belgian actor (now AB InBev) concentrated the global worldwide beer market by conducting a systematic strategy of acquisitions, development of synergies, and extension of its geographic perimeter against the major historical leaders of the industry. This result could not have been anticipated in any way 20 years earlier.

**Relevant playing field**

For a company, the regular redefinition of its relevant playing field for the next five to ten years—both in terms of ambition and structure—is critical. If the playing field is too small, then it will saturate it too fast without sufficient growth opportunities. It would also have left aside activities, geographies, and acquisition targets which would have been critical for a long-term consolidation of the industry. If playing field is too large, its investments are likely to be dilutive (competitive positions not strong enough and/or no synergies with existing positions).

Assa Abloy, the global leader in door opening solutions, continually redefined its playing field between 2000 and 2016, which went from 7 billion to 50 billion euros over the period (in 2016 values). Originally positioned on mechanical locks in Europe, it expanded its geographical scope to North America, Latin America and emerging Asia. It is also developed in new businesses in door closers and beyond: mechanical locks, electromechanical locks, electronic identification, sliding doors, security doors (see table 2)… Hence, it increased its revenue more than 5.5 times (from 1.4 billion to nearly 8 billion euros) and its EBITDA more than 7 times between 2000 and 2016.

How far should the limits of the playing field be extended to support continued growth while avoiding a dilution of resources?

Three perspectives are necessary:

- The first is to bound ambitions by determining the growth rate which is financially sustainable by the company in the medium term (see table 3) and to ensure that this growth rate does not deteriorate over time.

## - Table 2

**Assa Abloy multiplied its playing field by 7 over the past 20 years**
**(from 7 to 50 billion euros in 2016 values)**

| | Sweden and Finland | Europe | North America | Asia | Africa | South America |
|---|---|---|---|---|---|---|
| Mechanical lock | Historical perimeter | • Vachette<br>• Fichet<br>• Mul-T-Lock<br>1990-2000 | • Essex<br>• Curries<br>• Graham<br>1990-2000 | • Secureware<br>• Abloy security<br>• Lockwood<br>1990-2000 | | |
| Electro-mechanical lock | | • Effeff<br>1999 | • NE Lock and Hardware | | | |
| Electronic identification | | | • HID corp.<br>2000 | • ACG | | |
| Door opening solutions | • Launch of Hi-O<br>• Besam<br>• Crawford<br>2002 2011 | • Ditec Group<br>• Doorman Services<br>2005-2009 | • Maiman<br>• 4Front Docking<br>• Amarr<br>2009-2013 | • Irevo<br>• Pan Pan<br>• King Door C.<br>2005-2010 | • Union Locks<br>2002 | • Yale La Fonte<br>2000 |
| Security solutions | | • IAI Industrial Systems<br>2015 | • Fargo Electronics | | • Security World<br>2005 | |
| Digital keys | • Launch of Mobile Key<br>• Launch of Seos<br>2010-2012 | | | | | |

**- Playing field development**
**(in 2016 values) -**

| |
|---|
| 1990 = 7 Bn€ |
| 2000 = 15 Bn€ |
| 2010 = 50 Bn€ |

Sources: Assa Abloy; Estin & Co analyses and estimates

- The second is to determine the activities adjacent to the current businesses where the company can achieve revenue and cost synergies and establish leadership positions.
- The third is to take into account not only the evolutions of competitors' market shares by segment, but their overall growth and their value creation dynamics. The one which grows the fastest (yet remains profitable) develops the capacity to take over competitors.

**Sustainable growth**

In evolving businesses where the playing fields change, a company should always try to grow as fast as permitted by its sustainable growth rate (see table 3). If it does not, it under-optimizes its value and becomes vulnerable in case the sector concentrates.

If the financially sustainable growth rate barely makes it possible to consolidate positions in existing businesses, there is no development or attractive diversification beyond these businesses.

If the sustainable growth rate makes it possible to develop competitive positions well beyond the current businesses, be it organically or through acquisitions, investments should be made, by identifying the closest or most attractive activities compared to the current businesses.

The magnitude and the speed at which synergies (either on the cost or revenue side) are implemented are critical. Those synergies are what can make up for any goodwill paid at acquisition and what can enable to maintain the same level of profitability, hence the same the sustainable growth rate.

**Magnitude and speed**

"Micro strategies" and "macro strategies" cannot be placed along a continuum. The switch from the former to the latter is a disruption.

Macro strategies necessitate adding together *three growth rates* of the company with the corresponding investments: the one of the underlying markets; the one on top to extend the playing field; and the one needed to win market shares in existing and new businesses. This explains that companies are growing at 15% a year over long period in underlying markets which are growing at 3% by regularly extending their playing field and by acquisitions. These strategies are not easily compatible with a traditional management of the company.

Macro strategies are part of a dynamic vision of the industry. Each successful major acquisition changes the value of the company, its growth potential and its playing field. Hence, they have a "snowball effect". Ambition, the ability to manage movement and regular changes, to integrate new organizations, teams and skills, and to go fast while at the same time controlling risks and results are key.

In the short and medium term, it is indeed the most competitive ones which concentrate their market in a given segment. But in the long term, in an industry whose segmentation and size change, it is the fastest and the most ambitious ones which create value and eventually concentrate an entire industrial sector with its multiple segments.

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*Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists CEOs and senior executives of European, North American and Asian corporations in the formulation and implementation of growth strategies, as well as managers of private equity funds in the analysis and valuation of their investments.*

## - Table 3 -
## Sustainable growth

| | n | n+1 | n+1 with leverage | |
|---|---|---|---|---|
| **Revenue** | **100** | **116** | **167,2** | |
| **EBIT** | **10%** | **10%** | **10%** | |
| **Capital employed** | **50** | **58** | **83,6** | ***With a revenue / capital employed ratio of 2x*** |
| **ROCE** | **20%** | **20%** | **20%** | |
| **Debt / equity** | **0,25** | **0,25** | **0,80** | |
| **Equity** | **40** | **46,4** | **46,4** | ***With a dividend distribution rate of 20% of the net result*** |
| **Net result** | **8** | **9,3** | **13,3** | |
| **ROE** | **20%** | **20%** | **29%** | |
| **Sustainable growth (p.a., over 5 years)** | $\boxed{16\%}$ | **16%** | $\boxed{23\%}$ | |
| | ***Size and value multiplied by 2 in five years*** | | ***Size multiplied by 3 and value multiplied by 4 in five years*** | |

*The sustainable growth rate is the growth rate which the company can financially sustain in the long term given its profitability, with a level of debt at its maximum (within acceptable risk limits) [(1)], a dividend distribution rate as required by shareholders, and an acceptable capitalistic structure [(2)].*

*It is specific to each company.*

*For instance, a company with an average ROCE of 20% (before tax), a leverage of 25% (debt / equity ratio) and a dividend distribution rate at 20% of the net result can grow at 16% p.a. over 10 years without requiring external capital (see above).*

*With a reasonable increase in financial leverage, it can grow at over 20% p.a.*

(1) Hence very different whether the activity is cyclical or not
(2) Will the shareholders accept dilution or not?

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