Strategy and speed

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In today's markets, the success of a business strategy depends more than ever on the speed and the ambition at which it is carried out, rather than simply on identifying the right direction for the strategy.

Ex post analyses of company or project failures generally show that the chosen strategy was directionally correct but that it was not carried out quickly enough. This often leads to the conclusion "we pursued the right strategy but we failed." This is a mistake.

The secret to a successful strategy does not just lie in identifying the right direction, but is also increasingly about deciding on how far-reaching the strategy should be and how quickly it should be carried out. Investing 100 in China over 5 years is not the same as investing 50 over 10 years. Ultimately, market positions, competitiveness, dynamics and profitability will end up being very different in the two situations.

Choosing a strategy therefore means choosing a speed. This process should not be dependent on implementation issues, nor should it be based on how fast (or slowly) a company's staff can execute the strategy. Instead, it should be the decision of the CEO and executive committee.

The value to speed

Value creation for a company and its shareholders depends on its competetiveness and growth.

Competitiveness means having strong, sustainable market positions, which allow a company to fend off competitors by putting up barriers in terms of price, cost and brand.

Growth allows companies to boost their competitive edge, generate additional resources, and increase profits and cash flows.

Differences in the speed at which companies develop are the reason for differences in competitiveness in sectors where leadership and size drive value.

As an example, imagine two companies that have a size of 100 and a margin of 15. The companies are joint leaders in a market that is growing by 10% a year and experiencing scale effects of around 15%[1] (see Figure 1).

Company A is growing by 30% a year. The company's increase in size allows it to lower prices, helping it to gain market share. After 5 years, its size will be 375 and its absolute margin 55 (i.e. 15% of turnover).

Company B is growing by 10% a year (the same rate as the market). After 5 years, the company's size will be 160. Company B is also forced to lower prices in order to follow the market leader. Its margin will therefore be negative (-5).

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[1] Decrease in unit costs each time the company doubles in size

- Figure 1 -
Value to growth

Current situation → Situation in 5 years

	Company A and Company B		Company A	Company B
Revenues	100	Revenues	375	160
		Annual growth	30%	10%
Expenses	85	Expenses	320	165
EBIT [1]	15	EBIT [1]	55	-5
As a % of revenues	15%	As a % of revenues	15%	-4%
			+60	

(1) Operating profit

- Figure 2 -
Relative speed versus absolute speed

Current situation → Situation in 5 years

	Company A and Company B	Market growing by 2.5% a year: Company A	Market growing by 2.5% a year: Company B	Market growing by 10% a year: Company A	Market growing by 10% a year: Company B
Annual growth		7,5%	2,5%	30%	10%
EBIT [1]	15	20	10	55	-5
As a % of revenues	15%	15%	9%	15%	-4%
		+10		+60	

(1) Operating profit

Ultimately, the difference in development speed between the two companies will allow Company A to be competitive and create value, while causing Company B to lose its competitive edge and destroy value. The strategies of both companies are directionally correct, but Company B's inaccurate assessment (or inaccurate implementation) of the development speed will result in the wrong strategy.

Relative speed versus absolute speed

As a market's growth rate increases, this observation becomes even more crucial.

The greater the market's growth rate, the more speed is a key concern for companies seeking development.

Think back to the example of Companies A and B (see Figure 2). If the market is growing by 2.5% a year, and A's performance is three times greater than the market's and B's, the difference in operating profit between A and B after 5 years will be 10.

If the market is growing by 10%, the difference will be 60.

In this context, the question is not whether rapidity is important in pursuing growth, but rather what speed is necessary to be competitive and create value?

Companies commonly make two mistakes:

- *Absolute speed versus relative speed*. "Our company is performing well because it is growing by more than 10% a year." If the company's competitors are growing at a rate of 30% a year, this will not be not fast enough.
- *Targeted speed versus internal capabilities*. "Our operational capacity limits our speed." If your race car cannot do more than 50 mph, you have three options: you can get a new car, pull out of the race or join another team. You do not decide to try and win the race with your current car. You are sure to lose.

The speed at which a company can develop must therefore always be defined in relative terms, taking into consideration economics, competitive levers of the industry in question, and the rate at which the market and competitors are growing.

The company should define its operational plan based on this strategic requirement, rather than the other way round.

If the company's ambitions are greater than its perceived operational capacity, the company must either abandon its plans or change its approach (e.g. by making acquisitions, striking partnerships, changing its business model or making its structure more focused, etc.).

This is what happened in China's budget hotel sector (see Figure 3). In 2007, the market was experiencing rapid growth. The American hotel company Super 8 (owned by the Wyndham Group) decided to accelerate its growth by increasing the number of new hotels it opened each year from 3 or 4 to over 10 (i.e. an annual growth rate of more than 15% for the chain).

In a market with value to network density (strong relationship between local market share and good occupancy rate), Chinese leaders grew their network much faster than Super 8 : Home Inns, the leader, opened around 300 new hotels a year. Viewed from the US perspective, Super 8 achieved strong growth (15%). However, viewed from the Chinese perspective, this rate of growth was insufficient, and this resulted in considerable operating losses (due to its low occupancy rate compared to the market leaders). Meanwhile, Home Inns achieved high margins.

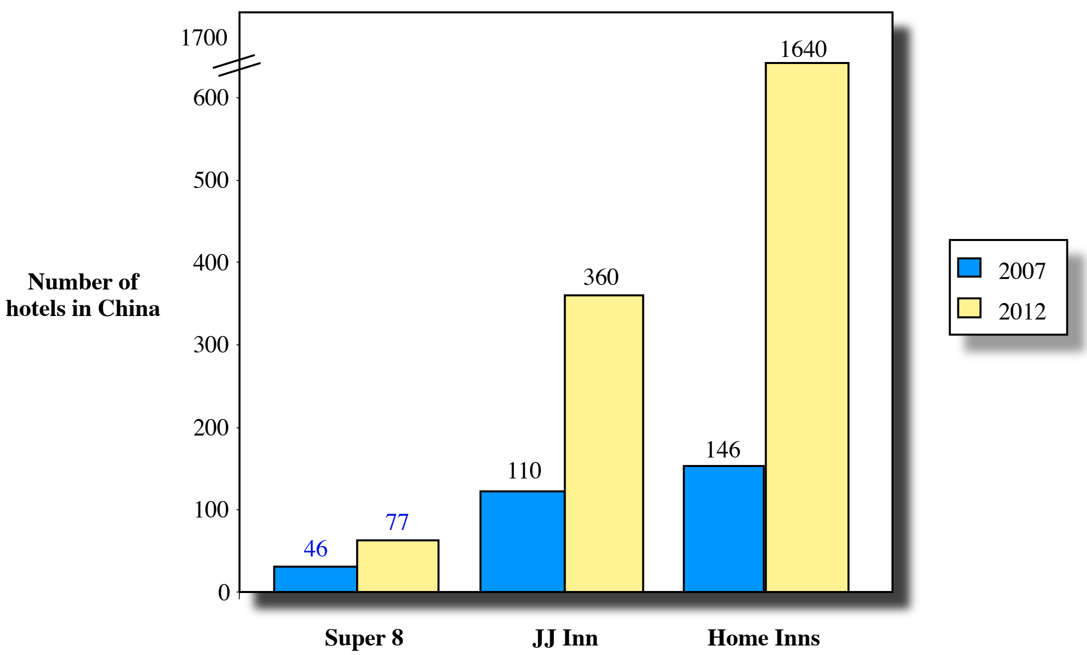
What should a company do to reach its optimal development speed?

The speed and breadth of a company's development is a choice made by its management rather than a constraint imposed on the company.

In order to decide on an optimal development speed and implement it successfully, the company needs to activate the following five strategic levers.

- Figure 3 -

Despite growing by 15% p.a., Super 8 experienced much weaker growth than the market leaders, resulting in a loss of competitiveness in recent years



	Super 8	JJ Inn	Home Inns
Number of new hotels	8	50	300
Annual growth (2007-2012)	16%	27%	62%

Source: Companies, Estin & Co analysis

1. Focus on priorities

A company with a limited number of growth axes is able to develop more quickly than a company with a larger number of plans. This is because:

- The top management will devote more time and attention to these axes and will be able to contribute more efficiently;
- The company's management will be incentivized to reach success on each axis as they will each have strong implications for the company as a whole;
- Management will act more decisively, will be able to prioritize and will not scatter their attention and lose focus;
- Cross-functional approaches will be possible and will contribute to developing innovative work models, given the small number of projects.

The company should therefore focus on those projects that are the main drivers of its growth.

2. Allocate resources according to priorities

When embarking on a strategic growth plan, a company needs to be prepared to make substantial investments in order to ensure this plan has a significant impact.

The investments fall into three categories:

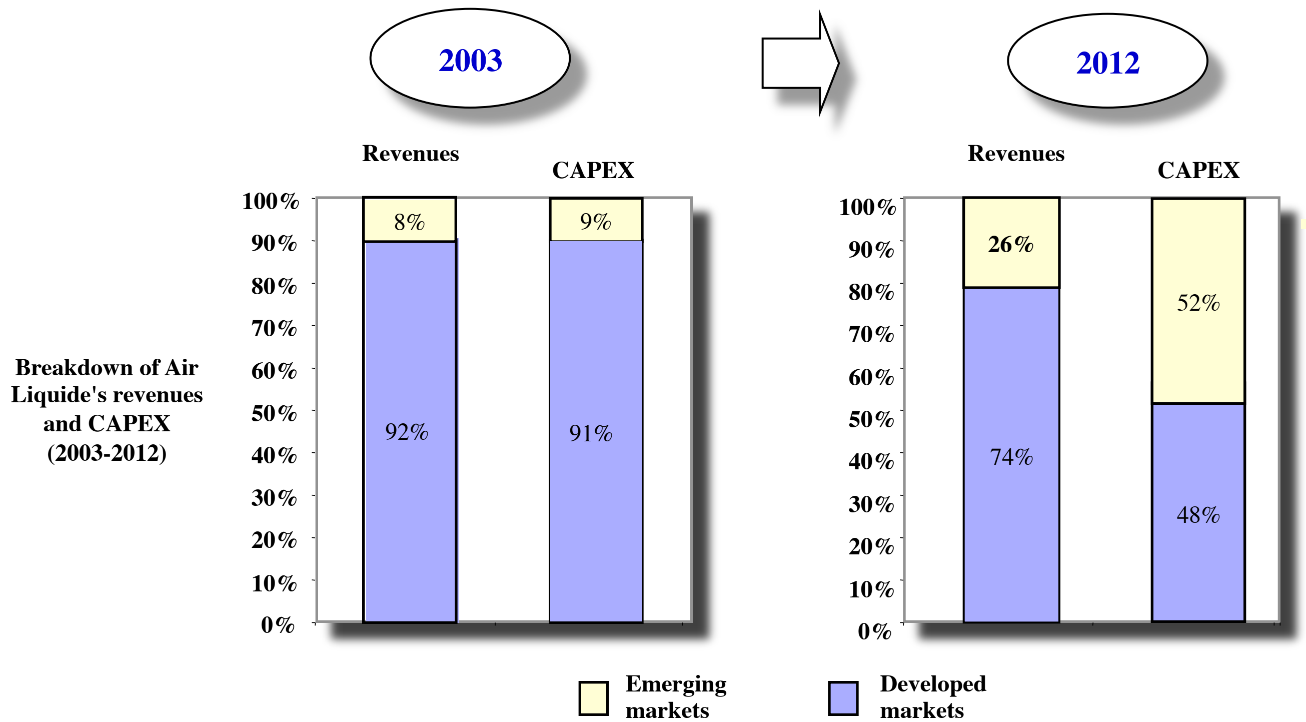
- *Human resources*: the company must anticipate the need to reinforce its staff in order to support its growth. This involves thinking carefully about the numbers of employees needed and the level of expertise needed. The company should define the required employee profile and experience with a 3 to 5 years outlook in mind, rather than in reference to its current situation. Otherwise, there is a risk for the company to go through a stop and go loop, with growth problems caused by lacking the adequate resources to meet targets;
- *Operational expenses*: in addition to investing in human resources, growth requires for companies to invest more than competitors. For example, companies that want to accelerate their growth in the consumer goods sector need to invest in advertising and marketing. It therefore makes sense to invest more than the traditional 5% of revenues at a given moment in time and to anticipate the required investment a year in advance. Margins will be affected accordingly. The same rationale applies to innovation and product development resources;
- *Capital expenditures*: a growth priority can only be defined as such if the amount of capital expenditure in this area is significantly greater than the current share of revenues or operating profits that the area yields. For example, Air Liquide's strategy is to invest in emerging markets (see Figure 4). The company allocates more than 50% of its investments to these markets, which account for 20% of the company's overall revenues.

3. Adapt its business model to its growth ambitions

A consequence of rapid growth is that companies have to adjust their business models to their expansion plans.

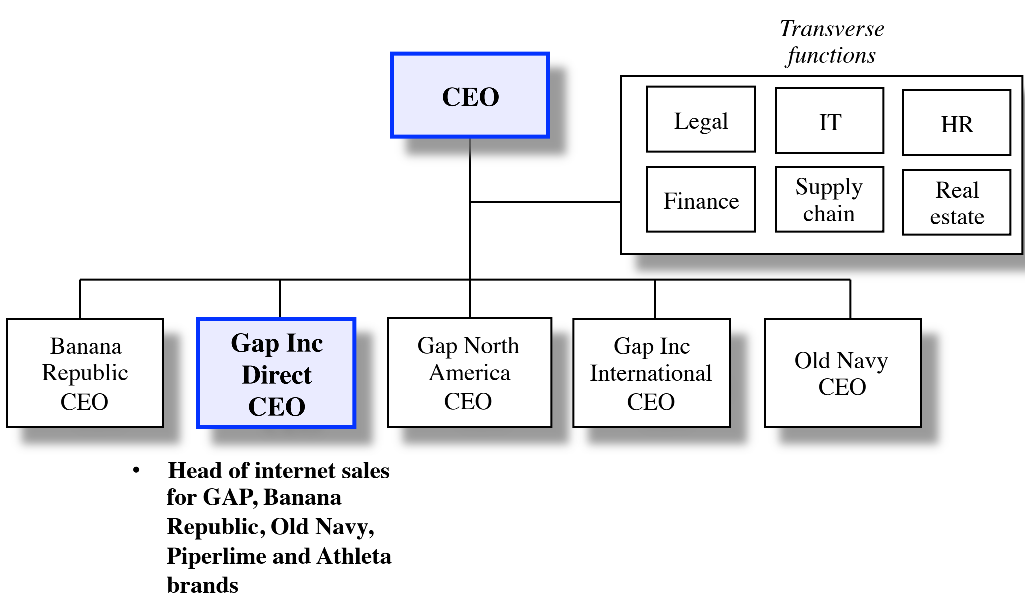
Apple's strategy has always been to develop groundbreaking, extremely differentiated innovations, roll them out quickly around the world and then improve them. Competitors viewed the first-generation iPhone as weak in terms of voice (quality of the reception) and photography. But that was not the point. What made the product stand out were the additional features and applications, beyond the phone and camera.

- Figure 4 -
Air Liquide has sharply increased its share of investment in emerging markets in recent years



Source: company, Estin & Co analyses

- Figure 5 -
GAP has created a dedicated e-commerce business reporting directly to the group CEO



Source: Estin & Co analyses

Similarly, companies aiming to grow in emerging markets should have a business model that allows them to respond to the needs of consumers in these countries. Super 8 sought to offer superior quality to Home Inns (e.g. standardized rooms with windows, individual air conditioning…). However, the price premium was insufficient to justify the difference in costs, and rolling out their concept was more difficult. Home Inns could invest rapidly in all types of different buildings (e.g. former offices, decommissioned factories, etc.) and renovate them at a low cost, while Super 8 had to exclusively rely on greenfield projects which took much longer to complete.

Getting the balance right between developing a quality product and launching it quickly is critical. If the product is launched too early, there is a risk of the concept being destroyed. If it is launched too late, the company risks not being able to stand out from its competitors.

4. Monitor priorities at Management level

A company's CEO or managing director should oversee the company key growth areas. The success or failure of these growth ambitions will determine the success or failure of the company overall. If it is decided that a growth plan does not fall within the realm of the CEO or managing director, then the stake is not high enough. The area is therefore not of strategic or critical importance for the company.

Retailers often see e-commerce as being of critical importance. It should therefore be led and supervised by senior executives. This is what Gap decided to do in 2008 (see figure 5). Today, e-commerce is growing at a rate of over 25% a year. It is driving nearly 40% of Gap's growth and has helped the company to experience an 8% annual growth rate over the last few years, compared with a growth rate of just 5% for stores.

5. Simplify the organizational structure

Rapid growth can only be reached by a simple organization.

Companies often try to optimize all possible variables simultaneously (geographies, activities, price ranges, business models, brands…), in order to secure an overall coherence of these parameters. This results in "internal" optimization negotiations that reduce speed and increase costs. Experience shows this is both lengthy and costly; the theory does not pass the practice test.

Simplifying the organization requires to define the one or two key variables that will structure the organization. The nature of the business and the priorities determine what this variable should be.

- *Nature of the business*. Is there value to centralize decisions and investments? If so, a global organization should be implemented. Is there value to proximity between activities? If so, an integrated organization enabling to generate synergies should be implemented. In general, it is optimal to select one dimension (geographies, activities, business models…) and simplify the organization around this very dimension. This enables to build coherence and thus improve speed. If the industry is not compatible, then two dimensions should be selected. In this situation, special care should be given to the implementation of an upstream process to define priorities, centralize resources and make critical decisions, and of a downstream process to conduct daily business with strong reporting and process control.
- *Growth priorities*. The organization should enable to drive growth and not slow it down. Start-ups generally experience stronger growth than mature companies as they are solely focused on one priority. This should not be the case. What are the fields where the organization should be structured in a similar way (while capitalizing on marginal synergies between non-critical functions)?

Conclusion

Speed and breadth are essential elements of any strategy and are often mistakenly neglected to the benefit of direction. Both require focusing on key priorities, making substantial investments, and adapting the organizational structure and business models to the ambitions.

The keys to growth are focus and simplicity. This applies to allocation of resources, as well as to organizations.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zürich 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 evaluate their investments.