Growing High or Fading Fast

Why Businesses Have to Grow to Stay in Operation

An entrepreneur will see the value created for his/her business when it grows. It is the gravitational pull that attracts and retains the best people. No business has been able to survive let alone stay in the black over time when it fails to grow.

In today's global economy, the average life span of a business is approximately 12 years, down from more than 25 years for businesses in existence in the 1950s. The ultimate life span of even established global business is only about 40 years – ending in either bankruptcy or acquisition.

The main reason a business closes or falls into tough times, reducing its value, is that their competitors surpass them in sales and branding. The business failed to adapt and redefine its core product/service. For example, IBM redefined its core offering by moving along the value chain into new service segments, starting with the most basic integration and repair services for its own hardware. They eventually reached up into value-added consulting services.

ADJACENCY EXPANSION

Adjacency (Business Definition): New territory such as new growth initiatives that push out the boundaries of their core business.

The best adjacency expansion strategies have a repeatable characteristic like the Nike formula from running to basketball to golf segments. On the other hand, Reebok referred to itself as a sports and performance company, not a fashion and fitness company. They purchased the Boston Whaler boat company, and added such brands as Ralph Lauren and Polo Footwear. In 1990, the two companies had uncannily identical sales – Nike: $2.3 billion; Reebok: $2.2 billion. Today, Nike's revenues are over $12 billion and Reebok's hover around the $4 billion mark.

As measured by a discounted cash flow at their cost of capital, the value of the core businesses accounted for only about 50% of their market value. The rest of the value lies in future growth opportunities. About 25% of the remaining core businesses' valuation and stock price comes from profit projections of known adjacencies with the remaining 25% of valuation coming from future adjacencies not yet seen in the marketplace.

Just 25% of investments in growth initiatives, most of them true adjacency expansions, created value and added to growth. The average success rate for new products is about 30%; for start-ups, below 10%; for joint ventures about 20%; and for related acquisitions, about 30%. In another study of this same subject, only 27% of adjacency moves could be considered successful; 25% were clear failures, with the balance having neutral or ambiguous returns.

TYPES OF ADJACENCY EXPANSION

There are six ways the boundaries of a business can expand:

Product Adjacencies
Selling a new project or services to core customers is the most commonly pursued.

Geographic Adjacencies
Businesses consistently underestimate the complexity, especially if done overseas.

Value Chain Adjacencies
Combining different channels of distribution with one business, such as manufacturing, wholesaling and retailing, can be fraught with problems.

Channel Adjacencies
Combining direct sales (Internet) with indirect sales to dealers can help with expansion.

Customer Adjacencies
Entering a new customer segment, such as discount brokerage service and investment advisory services, can move a business to the next level.

New Business Adjacencies
The classic example is when American Airlines created the Sabre reservation system.

ASSESSING THE ADJACENCIES

The value of the adjacencies to the core business can be measured by the following characteristics:

Customers
Are they the same as or different from those currently served?

Competitors
Are they the same as or different from those currently encountered?

Cost Structure
Is the cost structure (infrastructure) the same or different?

Channels of Distribution
Are these the same or different?

Singular Capability
If there is a singular capability that gives the core business its uniqueness – brand, asset, technology, then is this relevant in the new opportunity?

FINDING THE BEST DECISION

More than 80% of the most successful businesses achieved a large portion of their profitable growth by moving into adjacencies surrounding their original core business. Furthermore, we calculate that if your objective is profitable growth, it is at least three times better to have a very strong position in a lower growth industry than a weak position in a hot industry.

One of the most difficult judgments for a CEO of a business with a strong core competency or a niche position is to determine whether the core business is performing at full potential – perhaps denying all but a handful of adjacency bets. The biggest problem is deciding on the right growth ideas, and turning them into viable economic propositions.

In spite of the importance of growth through adjacency expansion, many of the best adjacency decisions are the decisions to say no. Adjacency moves are almost never the solution for a weak core business in a stable market. However, adjacency moves are a critical option for businesses with strong competitive positions whose marketing is deteriorating.