ELEPHANTS CAN DANCE

Growth Through Leadership and Governance

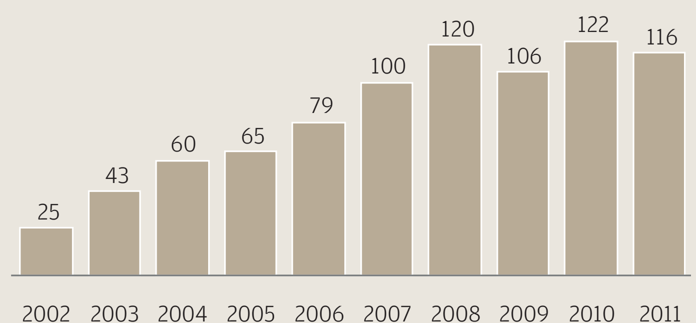
OC&C
Strategy Consultants

NOT ALL ELEPHANTS MUST DIE

CASE STUDY: FujiFilm vs Kodak

- Fifteen years ago, Kodak and FujiFilm were the dominant, global players in the photographic industry, being the leading suppliers of cameras and film respectively
- However from the late 1990s, it became increasingly apparent that Kodak's management team had failed to grasp the importance of digital photographic technology, and some fundamental errors prevented it from reinventing its position in the market
- This was not for a lack of technological skill (a Kodak engineer had invented the digital camera in 1975), but a rigid and arrogant leadership culture that failed to accept that their market was changing, and that the culture and governance of Kodak needed to change with it
- In contrast, during the same period, FujiFilm embraced the changes happening in the photographic market; diversifying through acquisition, and changing its business model to attack digital photography directly with a commitment to innovation and new technologies
- Today, whilst not as dominant as it once was, FujiFilm is a strong and viable competitor in the digital age and has embraced a new generation of photographic technology. In contrast, a recent Kodak shareholder meeting finished with an investor shouting at the Board: "You guys have no credibility. Zero"

Digital Camera Shipments 2002-11



Kodak Revenue 2002-11

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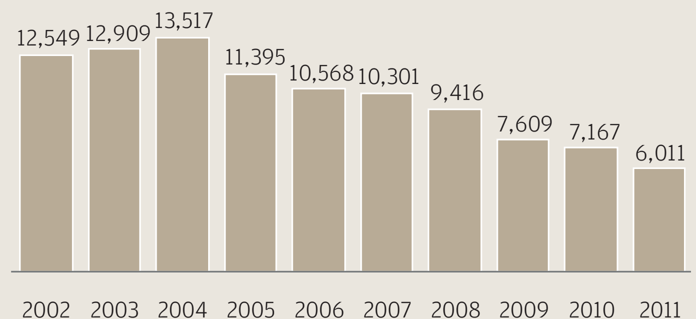


LEADING THE WAY

Many industry-leading corporations grow systematically slower than they should – underperforming their sector's growth and being outperformed by smaller, more nimble competitors

Scaling up companies too often results in slower top line growth. However, more than 25 years of OC&C experience has demonstrated that this is not an inevitable consequence of size; there are clear lessons to be drawn from management teams who have led their companies to sustained growth. We believe elephants can continue to dance.

Focusing on the leadership and governance structures of these successful companies highlights many examples where leadership decisions and governance processes have driven growth and allowed companies to flourish at all stages of development. CEOs need to lead to succeed.

THE FOUR STAGES: WINNING MODELS

STAGE #1: VISION

- Pushes forward innovation
- Invests for growth
- Leader stays close to operations

STAGE #2: EXPANSION

- Listens to the market
- Builds growth strategy plans
- Leaves high level of autonomy to BUs
- Considers new geographies

- Defines a reinvented company story
- Makes acquisitions and disposals
- Lets business units become more autonomous
- Able to recover fighting spirit, to develop a new ambition

STAGE #4: REINVENTION

- Gains market leadership through a "sales-led" approach
- Stronger control over BUs, including financial, HR, strategic and operational aspects

STAGE #3: DOMINATION

STRATEGY, LEADERSHIP, GOVERNANCE, SUCCESS

Having a clear strategy is necessary for growth, but never sufficient. Indeed, it is not uncommon for market giants, even with smart strategies, to eventually see their growth outpaced by the market and nimble smaller rivals.

However, we have also observed companies who have succeeded in reinventing themselves and sustaining tremendous growth rates. Often this is due to a combination of appropriate governance and an adapted leadership approach.

We believe both the leadership style and the choice of governance model are crucial for a company's top line performance. Critically, leaders need the ability to spot when and what governance changes must take place to ensure the company stays ahead of the market.

This OC&C Insight collects together some of our perspectives about the distinctions between appropriate and inappropriate governance and leadership models, specifically in relation to the maturity of the company. Some of these lessons will appear obvious; others are surprising and demand more radical change. However there are four consistent themes that recur throughout:

- Company maturity follows a development cycle of four distinct stages, irrespective of industry, geography or era
- At each stage, Boards must review whether a shift of leadership or governance model is necessary to succeed in the next stage of evolution
- The fourth stage is where many companies tend to stumble as they fail to reinvent themselves; often radical reinvention is required to enter a new development cycle
- CEO and Board hesitation to implement changes to the governance structure for the next stage of maturity frequently causes the value of a business to suffer

STAGE #1: VISION

In its infancy, a company is usually driven by an entrepreneurial and insurgent spirit, focussed on a strong vision. Revenue growth is innovation-led rather than marketing or sales-led.

At this stage the company is often steered by its founder, with an informal governance model that focuses on innovation, invests for growth and is able to directly manage the detailed day to day operations of the company.

The key challenge during the Vision stage is to stay close to customers to gain deep knowledge of customer needs and wants, and enable the company to define how best to serve unmet buyer needs. Typically, excessive focus on delivering short term profits or a lack of successful innovation results in failure to move to the next stage.

In order to ensure successful transition from Vision to Expansion phase, companies must remain aware of their progression through these maturity stages and review and evaluate governance structures accordingly, to place the needs of the customer first.

TO MOVE BEYOND THE VISION STAGE, MANAGEMENT MUST RETAIN THE ENTREPRENEURIAL SPIRIT BUT ADAPT TO SERVE A BROADER SET OF CUSTOMERS

	STAGE #1: VISION
Winning Attributes	• Innovation • Entrepreneurship • Insurgent passion
Failure Modes	• Lack of customer understanding • Weak innovation • Too much short term profit focus
Classic Examples	• Amazon (1990s) • Facebook (2000s) • Google (1990s) • Airbus (1980s) • Xero (2000s)

CASE STUDY: Amazon

- Amazon has successfully transitioned from Vision to Expand to the Dominate phase since it was founded in 1994, becoming the world's largest e-retailer.
- Amazon was able to sustain growth over this period thanks to its flexible approach which placed the needs of the customer first:
  - They focused on customer experience and needs, offering excellent customer service. They were unafraid to experiment to find out what customers want – such as free shipping for orders over a certain value
  - Amazon is lean – its growth has not led to expensive, expansive governance structures. Amazon states on its website 'We work hard to spend wisely and maintain our lean culture. We understand the importance of continually reinforcing a cost-conscious culture'
  - Furthermore, CEO Jeff Bezos remains involved in key strategic and operational decisions for the business
- These factors allowed Amazon to rapidly expand into new categories and geographies, and become a dominant online player

STAGE #2: EXPANSION

During the Expansion phase, companies seek stronger market positions and loyal customer bases. They shift focus, from defining their business purpose, to geographic growth or portfolio expansion. Success during this stage often requires the company to develop a more segmented approach to the addressable customer base and become more systematic in the application of marketing and other activities.

During this phase, companies tend to adopt a structure similar to a group of entrepreneurs with individual business units (e.g. geographies or product lines) headed up by strong leaders enjoying significant autonomy. Typically the head office will contribute to the definition and approval of the strategies of the individual units, and allocate human and financial resources between the units. The central structure is usually relatively small, but has strong Strategic, Financial and HR functions.

The key challenge through the Expansion phase is successfully identifying the differences between customer segments. In particular, companies need to understand the difference between the needs of early-adopters and those of the mainstream market. The mainstream market customers may have less flexibility to adapt to new products and services, and hence need a more complete, easy-to-use proposition than the one that worked for earlier customers.

In order to ensure successful transition from the Expansion to Domination phase, leaders must begin to address structures, processes, and drive efficiency.

TO MOVE BEYOND THE EXPANSION PHASE, THE CULTURE MUST EVOLVE FROM ONE FOCUSED ON WINNING NEW CUSTOMER PENETRATION TO ALSO MANAGING FOR GREATER EFFICIENCY

	STAGE #2: EXPANSION
Winning Attributes	• Segmentation • Marketing processes
Failure Modes	• Not listening to customers
Classic Examples	• Zara (1990s) • Apple (2000s) • Easyjet (2000s) • Starbucks (1990s) • Autotrader (1990s)

CASE STUDY: Zara

- Zara is one of 8 brands operated by Inditex. Founded in 1975, it is now present in 1,600 stores globally and is still expanding rapidly
- Zara's success is founded on its ability to produce a wide range of fashion forward clothing in short timescales (typically 12,000 different items per year), alongside its ability to tailor its offering to exactly what customers want
- Zara is able to do this because of three factors:
  - **Strong, Integrated Governance**
    Zara keeps much of the operations and production of clothing in house (even outside its home market Spain) allowing it to collect detailed data to help make rapid business decisions
  - **Dispersing Decision Making**
    Zara allows store managers to make purchasing decisions based on what they see selling well in their own stores
  - **Lean Governance**
    Throughout its growth Zara has committed to reviewing corporate practices to continually improve processes and keep management costs low

STAGE #3: DOMINATION

Companies in the Domination phase have experienced successful expansion and will often have a number of successful business lines. Their focus switches toward market leadership through a "sales-led" approach. The battle is to grab incremental market share.

At this stage, sustained revenue growth can still be driven by team spirit prevailing over increasingly rigid governance structures, with business units retaining some autonomy. However, as efficiency tends to become more valuable than innovation, and execution more important than insight, most companies tend to move to centralised governance models, rigid systems and established structures. The business becomes governed by a culture of metrics, through which performance can be managed.

It is common at this stage for the focus to switch towards the better management of operating costs and a rationalisation of internal functions, in order to create value through margin expansion.

In every dominant business, there is a stage of maturity where gaining further market share becomes increasingly difficult. Dominant companies tend to have centralised governance models, systems and structures that, whilst well intentioned, ultimately stifle the rate of revenue growth.

The leadership and Board can confuse customer loyalty and customer commitment. Many businesses focus on measuring retention rates and repeat purchasing as evidence of customer loyalty. However, all too often these same customers will willingly and rapidly switch to alternatives when those become available to them, demonstrating little true commitment.

At this point a business must make the difficult and hazardous transition into a phase of Reinvention.

	STAGE #3: DOMINATION
Winning Attributes	• Structure / channels • Sales efficiency • Grab market share
Failure Modes	• Confusion between customer loyalty and customer commitment • Complacency • Control stifling local leadership
Classic Examples	• AB InBev (2000s) • LVMH / L'Oreal (1990s) • Premier Inn (2000s) • ISS / G4S / Onet (1990s) • Bouygues (1990s) • Sony (1990s)

DOMINATION CAN BRING RESTRICTIVE GOVERNANCE STRUCTURES, THE TRANSITION TO REINVENTION OFTEN NECESSITATES A COMPLETE SHIFT IN THE MANAGEMENT STYLE TO REGAIN A FIGHTING SPIRIT

CASE STUDY: AB InBev

- AB InBev is an example of a company that was able to buck the trend and grow profits following a large merger, with a clear structure
- In 2008 InBev (itself a result of several mergers) bought Anheuser-Busch to form AB InBev
- This acquisition led to an increase in the EBITDA of Anheuser from 23% in 2007 to 38% for AB InBev in 2010
- The impressive growth post merger can, at least in part, be explained by the company's management style and company culture, with clear structure and channels
- The company is centred around 10 nonnegotiable beliefs which focus on people and culture, and are followed by management down to front line staff; there is a strong focus on efficiency and performance
- This strong leadership structure allows management to flow strategic ideas and changes quickly down the chain of employees, resulting in a flexible yet globally dominant company

STAGE #4: REINVENTION

The challenge for a company in the Reinvention phase is to regain a fighting spirit, either by reinvigorating a visionary focus within the firm (such as expanding into new adjacent services and products) or by developing a new ambition.

Succeeding in this phase is a real challenge. Companies find that their restrictive governance structures stifle innovation, but are hard to replace, and they can even experience an inability to understand their own capabilities and assets in order to identify appropriate opportunities. Heavy governance structures may be dismantled in the name of cost effectiveness, rather than being reinvented to boost innovation.

Frequently this phase is accompanied by the more pervasive problem of a depleted leadership and management team, who become incapable of driving change and reigniting growth. If there is no change of leadership or governance, companies tend to slide towards long-term decline, unable to Reinvent the business through a new vision or capture appropriate market adjacencies.

Leading Reinvention requires the delicate balance of managing "core" historic businesses whilst identifying, testing and developing a visionary approach. Often budgeting and strategy decisions continue to focus on squeezing out improvements in margin, rather than capturing new revenue growth. Occasionally the logical disposal of "cash cows" to fund new acquisitions is dropped in favour of the certainty of those legacy business returns.

Frequently companies who fail to navigate this phase end-up being acquired cheaply by competitors – or succumbing to disintegration and financial restructuring as their enterprise value erodes.

Success comes from a leader being able to drive the company towards a renewed and inspiring goal, supported by a governance structure that makes such a change possible. Winning businesses re-enter a Vision phase to complement and ultimately replace their existing business lines.

	STAGE #4: REINVENTION
Winning Attributes	• Adjacencies • Expansions • Portfolio change
Failure Modes	• Fiefdoms / siloes • Rigid structures • Lack of "capabilities" understanding
Classic Examples	• IBM (1990s) • Thomson Reuters (1990s) • Microsoft (2000s) • Amadeus (2000s) • Veolia (2000s) • Fuji / Kodak (2000s) • PPR (1990s)

CASE STUDY: IBM vs HP

- IBM and HP are both companies that have dominated areas of the technology market; they have also, at some time, experienced declining market positions
- Both companies' problems were caused, at least in part, by weak management and poor governance structures, which were a legacy from their growth and expansion phases
  - In the late 1980s IBM had many different divisions, spread globally and operated independently and who had little accountability to the centre
  - Furthermore there was an air of competition between these divisions and group management was largely weak and inactive – the company had lost its focus on customers
  - More recently, HP saw its dominant position eroded as the core business came under attack from competitors. The company had lost its entrepreneurial spirit and was struggling to keep up with the market
- At IBM a new CEO, Louis Gerstner, was brought in to revive the company by turning around the management culture, to refocus on working together to provide customer solutions, and by putting in place more efficient and cohesive reporting structures
- Both Gerstner and HP CEO, Leo Apotheker, realised that the challenges faced by their companies required radical actions. But whilst Gerstner was able to convince IBM's Board to divest their PC division to Lenovo, Apotheker was unable to persuade the HP board to divest their printer business and focus on software and services

SUCCESS COMES FROM A LEADER BEING ABLE TO DRIVE THE COMPANY TOWARDS A RENEWED AND INSPIRING GOAL, SUPPORTED BY A GOVERNANCE STRUCTURE THAT MAKES SUCH A CHANGE POSSIBLE

ARE YOU DOING WHAT YOU SHOULD TO MOVE TO THE NEXT STAGE OF GROWTH?

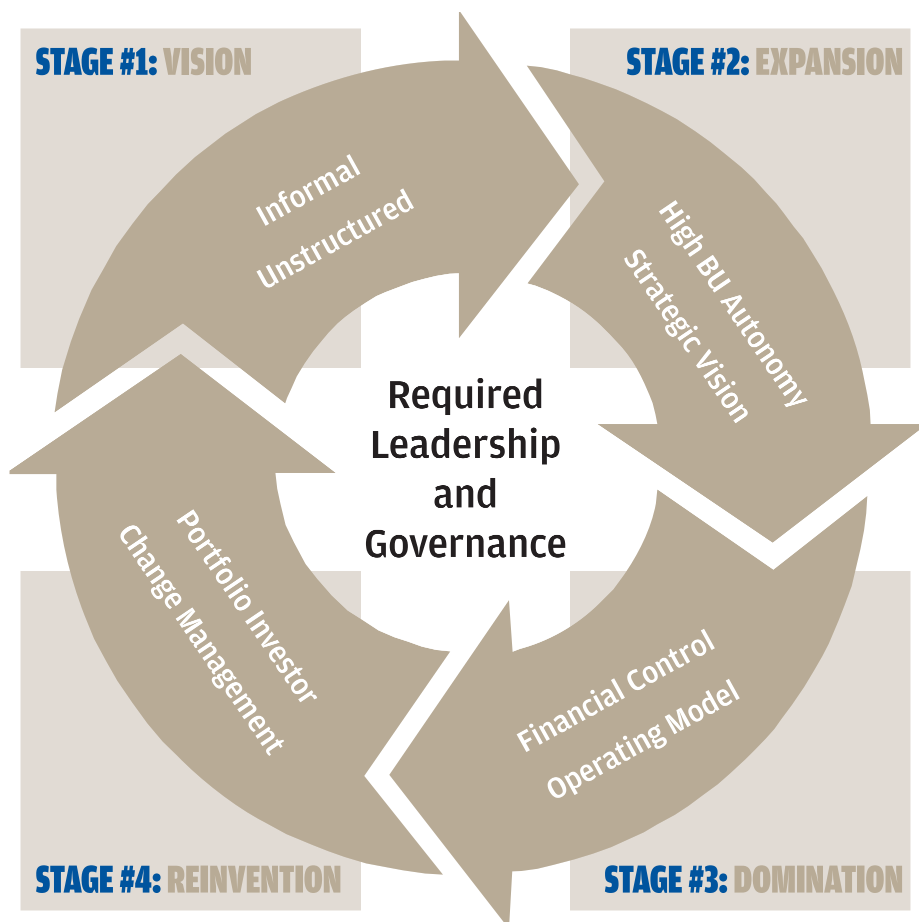
Successfully moving through the maturity cycle and continuing to grow with (or ahead of) the market is a difficult task, but by no means impossible. By adapting leadership and governance structures at each stage of maturity, a company can remain focussed on the key issues that will ensure growth at each phase.

The real challenge for any company is ensuring that the governance structures in place are appropriate for the current stage, yet also flexible enough to allow the company to move to the next phase of growth. Recognising when and what governance structure changes are needed is difficult; often these changes will need to take place when the company is thriving and current governance structures appear to be driving success. However, a company needs to remain focused on the needs of its next stage of development, often before it has reached it. Poor timing and poor implementation of governance changes by the CEO and Board are frequently the main cause of slowing growth and can ultimately result in the decline of a company.

Implementing the right governance structures at the right time is not just advisable but critical for long-term growth. As our case studies have demonstrated continual growth is possible, but is always underpinned by the right leadership and governance.

Are you doing what you should to move to the next stage of growth?

IT IS POSSIBLE TO MAKE AN ELEPHANT DANCE BUT IT IS BY NO MEANS AN EASY FEAT



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