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Adjacent Growth Strategies

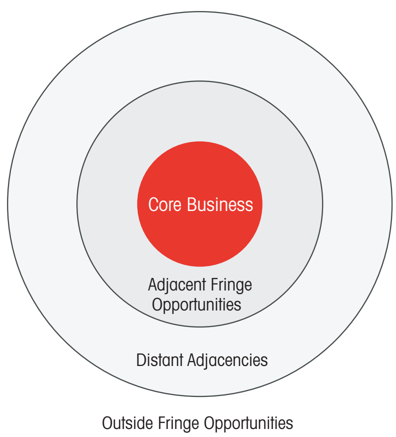
When looking for growth, sometimes the best opportunities are right next door.

For many a C-Suite executive today, organic growth in core business lines continues to become a difficult objective to achieve and sustain. And while this situation should offer little surprise to anyone familiar with the classic business cycle that charts a company from innovation to maturity and decline, it does seem to be happening faster than ever before. These days, even companies with core businesses less than a decade from inception are finding themselves in markets that are increasingly considered to be "developed" or even "mature".

The prospect of profitable growth is what fuels a company's stock price, and the results of such growth benefits employees at all levels, becoming a virtuous cycle. When profitable growth stops, on the other hand, that cycle reverses itself and the same forces that propelled the company's success can begin to drive it toward failure.

As it says in a quote by UPS founder Jim Casey in the lobby of the package delivery giant's Atlanta headquarters, "An expanding business is the only way to provide opportunities for our people". There are now close to 400,000 of those people, quite remarkable when you consider the ten-person bicycle messenger service Casey started more than 100 years ago.

In developed markets, all companies learn that it is no longer sufficient to limit growth strategies to geographic expansion or a stream of product enhancements. (Some, of course, learn of this fact faster than others.) To achieve the future growth objectives commonly demanded by today's stakeholders, companies must look for adjacent growth strategies.



Adjacency growth strategies are opportunities that exist outside or beyond a company's core business line, but are supported by the company's core competencies, and/or rely on synergies and/or efficiencies made possible by that core. Often times, these opportunities exist at the fringe of a company's core business, but not always. The opportunity for Starbucks® to start selling a line of teas was certainly one found on the fringe of the company's core business, but the decision to begin selling music on CD or via download could only have been found by looking well beyond any such fringe.

Of course, it must be recognized that the pursuit of growth in areas outside a company's core business reduces, or at the very least diffuses a company's focus on core growth and as such, is an inherently risky proposition. And that risk generally increases the further the strategy is from the company's core business. Unquestionably, the number of case studies describing adjacent growth strategies that became mega-successes is far outnumbered by those telling tales of failure.

We have long since entered a period in which profitable and sustainable growth is increasingly illusive for companies around the globe. So, regardless the risks, for many companies in which core growth simply cannot be expected to satisfy the mandates faced, adjacent growth strategies must be identified and judiciously considered… or else.

Some adjacent growth strategies win big. Others receive only "fabulous" parting gifts.

So, Starbucks ® appears to have a "hit" in the music retailing business, but it sure doesn't look like it was an obvious choice. It's not like other coffee shops have ever reported millions in sales as a result of selling a Ray Charles CD. Does this mean they could also sell independent films on DVD? Or, how about headphones? A second mortgage maybe? Concert tickets? Furniture? A women's clothing catalog? What about really cool tee-shirts? Or, even Starbucks brand anti-virus software?

Maybe Starbucks could sell absolutely anything… tires… oil change… why not? More than a few people would likely take their dry cleaning to Starbucks in a second if they'd take it. Travel reservations? You better believe it. Esoteric Native American jewelry? Could very well be.

Maybe Starbucks has become a little like Google ® to millions of people in the sense that they trust the company's quality and integrity. They go there everyday ready to happily fork over twelve bucks for little more than a couple of shots of espresso and some steamed milk, a chocolate bar roughly the size of a postage stamp, and a pack of gum in a really cool euro-tin container that probably goes for $1.95. They look at $200 coffee machines and $25 mugs with the Starbucks logo tastefully emblazoned on the side. Oh, and don't forget the basket of artsy board games that could be played once and then stored in the garage.

One company's adjacency is another company's core…

Without question, Starbucks is a company with opportunity galore. However, which opportunities are most likely to achieve or exceed expected results, is the real question at hand. Which markets are underserved in some way and which are already dominated by strong established competitors? Which markets appear to offer the best returns on invested capital? Is the management team able to view its new ideas objectively, or have they become too close to the proverbial forest? After all, you only need one opportunity to hit a home run, assuming of course, that it is the right opportunity. And conversely, only one opportunity is required for spectacular and devastating failure.

Both Wal-Mart ® and Kmart ® opened their first stores in 1962. Both pursued adjacent growth strategies. One became the world's largest retailer. The other filed for bankruptcy protection. Wal-Mart moved methodically into such adjacent ventures as Sam's Club ®, consumer electronics and expansion into Mexico. Kmart's history is strewn with adjacent strategies gone awry, as in Walden Books ®, Sports Authority ®, and even a chain of department stores in Czechoslovakia. Many observers believe that, by pursuing such ill-conceived adjacent growth strategies at the same time that its core business was being challenged by perhaps the world's toughest competitor, Kmart sapped its strength and became doomed to failure.

Industry giant IBM ®, on the other hand, seeing clearly that its core business would not be able to produce the future growth it needed, chose to migrate from a product company to a service based organization with the creation of IBM Global Services. The strategy, categorically, saved the company and now represents forty percent of the organization's annual revenues.

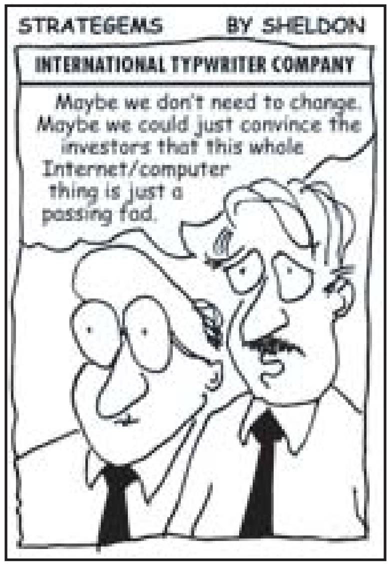
Nike ®, as an organization, has successfully expanded well beyond its running shoes core business, into adjacencies that include shoes, clothing and sporting equipment for virtually every sport known to man. While Enron's more than 35 adjacent initiatives most certainly played a role in its spectacular demise.

Many CEOs today report that the decisions related to adjacent growth strategies have been among the most difficult decisions of their careers.

Some believe that the optimal path to successful adjacent growth involves a series of small steps beyond the core; others have followed a path of bolder diversification. Neither can be thought of as "the right" way, and both offer more risk than the strategies related to core growth. Core growth strategies that fail to produce expected results are one thing. But, when a company's adjacent growth strategy fails, the result is not only measured by financial losses, but the company's credibility with the investor community very often suffers greatly as well, making future adjacent growth decisions that much more difficult.

Although difficult to quantify with absolute accuracy, many business analysts report that only twenty-five percent of investments in adjacent growth initiatives have created value and contributed to growth. And, although a .250 batting average might be more than sufficient in the world of Major League Baseball, such odds of success are far less than comforting for most, if not all, in the investor community.

Even Proctor & Gamble ®, an industry giant with more than a century of experience in adjacent growth strategies for consumer products, reports that only ten to fifteen percent of its new products that are tested or introduced to the market are still actively being sold on the shelf just two years later. Do the math and that puts the company's new product failure rate at between 85 and 90 percent.



P&G's answer to this alarming statistic is to conduct extensive pre-market testing and invest massively in those products that prove to satisfy the company's established rigorous criteria for success.

That's fine for a company with pockets as deep as the Mariana Trench, but offers little guidance for mid-sized companies whose coffers might be better compared to the depth of a backyard pool.

Proof or Consequences…

There are, however, cost-effective methodologies and best practices that middle market or even emerging organizations can employ to mitigate the risks associated with adjacent growth strategies. John Mooers, President of Mooers Strategy Group, a strategic consulting firm located in Southern California warns that "too often mid-sized companies facing growth challenges in their core business line are too eager to jump to the next lily pad in an effort to mollify their investors and shareholders. It's just never a good idea."

Mooers Strategy Group offers its clients a specialized practice group comprised of experts focused on issues related to adjacency growth. Referred to as STAG, it is an acronym that stands for Special Team on Adjacent Growth. The STAG philosophy is based on the firm's proven 360-degree analysis techniques and emphasizes the importance of using only those individuals intimately familiar with a client's industry and marketplace when validating any given adjacent growth opportunity.

According to Mooers, "The risks of attempting to move beyond a company's core to achieve growth are simply too great in this day and age. For some, there are simply too many apparent choices and for others, seemingly precious few."

Clearly, there are several different types of adjacent growth strategies that companies can consider.

• Product adjacencies are those that offer a new product or service to a company's core customers. IBM's Global Services, offered to the company's hardware customers, is an example of such a strategy.

• Geographic adjacencies move a company into new geographic markets and are often found to have held underappreciated risks.

• Value chain adjacencies are those that move up or down a company's value chain, as in pharmaceutical giant Merck's acquisition of mail-order drug distributor, Medco.

• Channel adjacencies look to take advantage of new channels of distribution, as is the case when a company decides to begin offering its products at Wal-Mart, for example.

• Customer adjacencies look to modify a company's core products or services for a new customer segment, as can be seen in the Toys-R-Us ® move to open its Kids-R-Us ®, or Babies-R-Us ® franchises.

• New business adjacencies, which are considered by many to be the toughest breed of all, occur when a company attempts to build an entirely new business based on one of its strong capabilities. The classic example might be the American Airlines ® spin-off of its Sabre reservation system, which subsequently became Travelocity ®, and is today worth more than the airline itself.

Each category of potential strategy for adjacent growth offers its own unique set of considerations and concerns. Each requires different skill sets, organizational cultures, core competencies, attitudes about risk, and financial resources.

Mooers explains that: "The proof of a growth strategy's potential viability cannot be dependably ascertained by looking in any one place, or by those unfamiliar with the marketplace involved. Perhaps no degree of analysis and insight can claim to guarantee a successful result, but all companies should understand the critical nature of getting as close to certainty as possible."

For more information, contact John Mooers by calling 949-645-8828.