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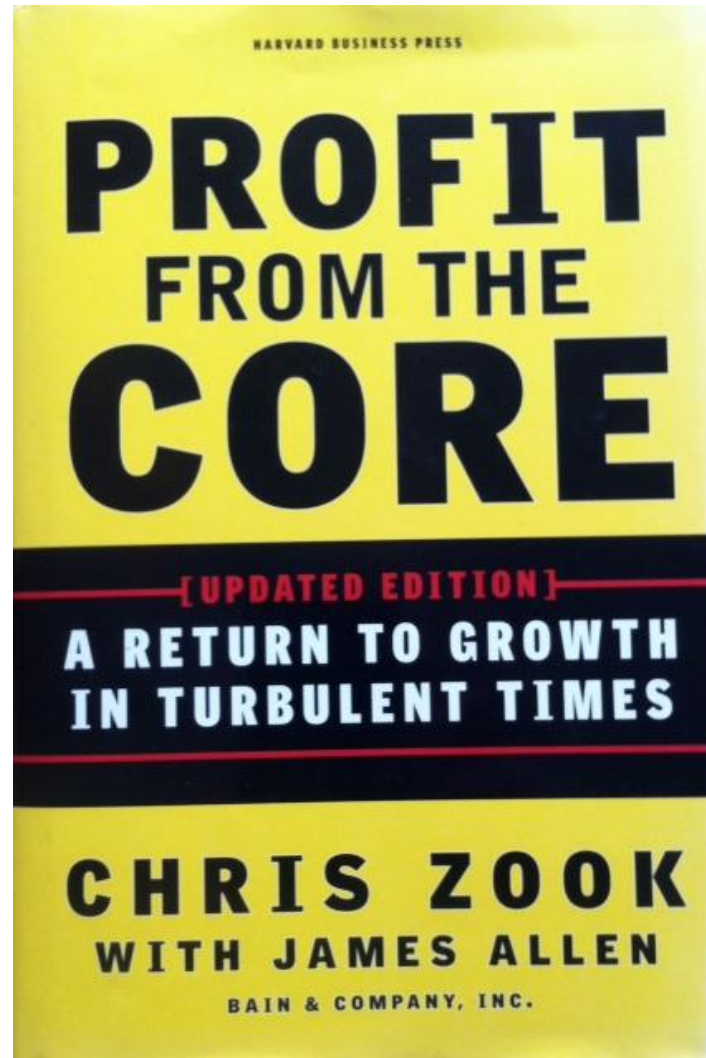
# More than a Book Review

Profit from the Core - A Return to Growth in Turbulent Times

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# Profit from the Core - A Return to Growth in Turbulent Times

by Chris Zook, with James Allen, Bain & Company, Harvard Business Press 2010



1. Leadership Economics – The Power of Focusing on the Core
2. Core, business boundaries and adjacencies
  - Case study No. 1: [Guinness Brewery \(Ireland\)](#)
3. The four bases of market power
  - Case Study No. 2: [Enterprise Rent-A-Car \(USA\)](#)
4. Adjacency expansion – Radiating from the Core
5. The Seven Pitfalls of Adjacency Expansion
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# Chapter 1

## Leadership Economics - The Power of Focusing on the Core

### Key Findings by Bain & Company, Inc.

- ▶ Most companies with sustainable value creation possess only one or two core businesses
- ▶ Spin-Offs normally create both focus and value and private equity funds achieve their greatest success by buying 'orphan' business from conglomerates
- ▶ Acquisitions made for the purpose of expanding 'scale' in a core business have a success rate that is (at least) 2x that of acquisitions which expand 'scope'
- ▶ Those companies which became smaller and still created value are those that focused on a strong core, often eventually turbo-charging their growth again

# Chapter 2

## The Notion of Core, Business Boundaries and Adjacencies

### Defining your Core Business

The unique range of products/services, customer segments and technologies which allow you to build the greatest competitive advantage

### Defining your Business Boundaries

Borderlines between your core business and areas of activities where you lose your main strength and competitive advantages

### Definition of Business Adjacencies

Growth opportunities which allow you to extend the boundaries of the core business drawing on existing customer relationships, technologies or skills to build competitive advantage in a new adjacent arena

# Case Study No. 1

## Guinness Brewery (Ireland) – Returning to the Core



- ▶ Founded in 1759 by Arthur Guinness purchasing a small disused brewery at the outskirts of Dublin
- ▶ In 1886, first brewery to be listed at the LSE – London Stock Exchange and in the early part of the 20<sup>th</sup> century, Guinness was the largest brewery of the world
- ▶ After World War II, launched a major diversification program by adding more than 250 operations/businesses
- ▶ In the early 1980s, corporate crisis forced a massive and dramatic divesture program to sell more than 150 business in less than 18 months
- ▶ Cash flow generated was reinvested into automated brewing processes, new products, rebuilding of Guinness brand and international expansion
- ▶ Over the next 8 years, share price increased by 10.000 (!) times

Research Update on recent performance of Guinness – see Chapter 7

# Chapter 3

## The Four Bases of Market Power in Core Business

- ▶ **Customer Loyalty** – Building a high and structurally stable level of loyalty in an well-defined customer segment: Most important factor
- ▶ **Channel Dominance** – Building leadership in a new or existing distribution channel, sometimes from a position of followership
- ▶ **Product Development or Service Differentiation** – Building superior products or service ‘solutions’ to meet the needs of your customers
- ▶ **Capital Availability** – Superior access to capital funds or lower cost of capital allow to ‘out-invest’ competitors

## Case Study No. 2

### Enterprise Rent-A-Car (USA) – The Power of Distribution Channel



- ▶ Established in 1957 in St. Louis, Missouri, by Jack C. Taylor
- ▶ Still family-owned, currently belongs to 20 largest non-listed US corporations
- ▶ Unique business model based on suburban/neighborhood locations, low cost business systems, customer orientation
- ▶ B2B model: customers are repair shops and insurance companies, today, 70% market share in the insurance replacement market segment
- ▶ Move into competition (Hertz, Avis) in 1995: Opening of first rental location at Denver airport
- ▶ Acquisitions of Alamo Rent A Car and National Car Rental in the 90s to move into the airport rental car segment

Research Update on recent performance of Enterprise Rent-A-Car – see Chapter 7



# Chapter 4

## Adjacency Expansion – Radiating from the Core

The **profitable core** is centered on the strongest positions in terms of

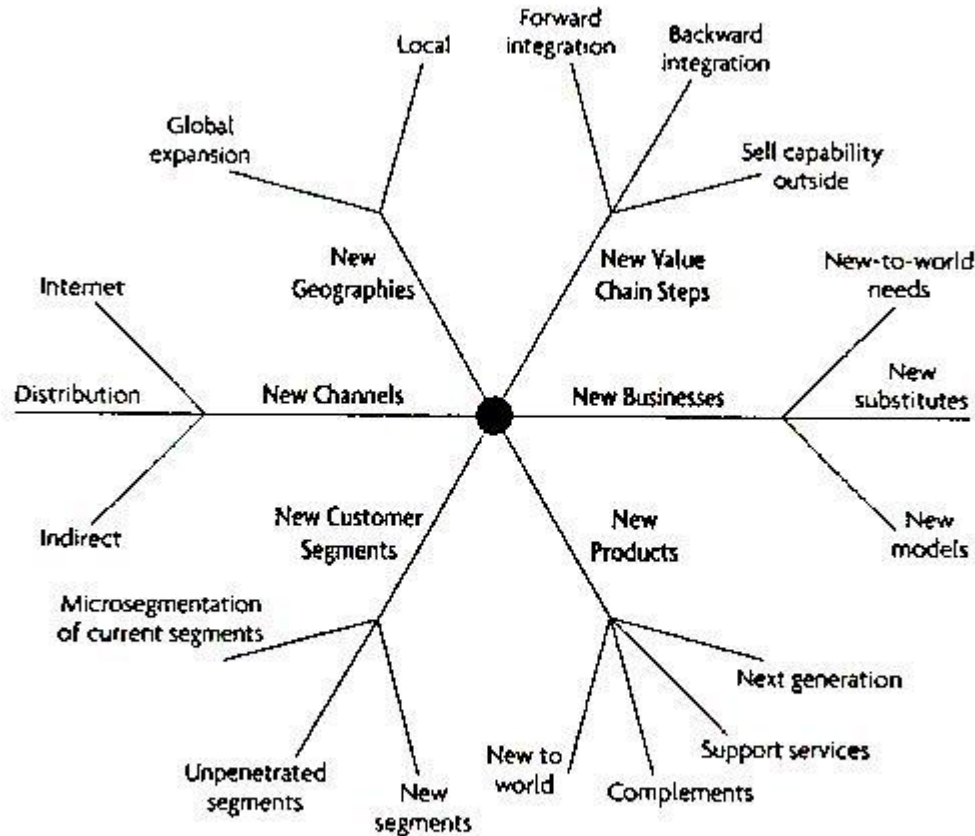
- ▶ Loyal customers
- ▶ Competitive advantages
- ▶ Unique skills and capabilities
- ▶ Ability to earn profits,

whereas surrounding the business core are the most promising **'business adjacencies'** for expansion defined by

- ▶ Skills and capabilities of the core can be leveraged
- ▶ Core customer can be protected by defensive action

# Profit from the core - A Return to Growth in Turbulent Times

Graphic on Page 77



**3-1** Adjacencies Radiate from the Core

# Defining and mapping business adjacencies

The three corporate strategies of adjacency expansion

- ▶ **Direct** (active move) – new geography, new distribution channel, new products
- ▶ **'Option' type** (active or defensive move) – a hedge against future uncertainties
- ▶ **Sequential move** by gradually expanding the boundaries of core business

# Five Types of Business Adjacencies

## ▶ Customer and product adjacencies

- Using the existing core to attract new customer segments by similar products

## ▶ Share-of-the-wallet adjacencies

- Capturing more of the purchasing power of your core customers

## ▶ Skills/capability adjacencies

- Based on deep organizational and technological expertise to be offered to both existing and new customers

## ▶ Network adjacencies

- Adding new networks of product access, distribution and know-how

## ▶ New-to-the-world adjacencies

- Created by major external turbulences, major shifts in customer behavior, major changes in technology

# The Seven Common Pitfalls of Adjacency Expansion

## Pitfall #1: Expanding towards an Entrenched Position

Lesson from military history (Liddell Hart): Frontal assault on an entrenched position of enemy loses in virtually 100% of cases, even with superior force

## Pitfall #2: Over-estimating the Profit Pool

Frequently as part of an acquisition, firstly future profit streams are significantly overestimated and secondly, operational risks are seriously underestimated putting additional strain on present and future profitability

## Pitfall #3: False Bundling and Overstretching

A clear danger sign: 'We want to be the one-stop shop for the needs of all of our customers'

## Case Study Nr. 3

### WH Smith Bookseller (UK) – The Danger of Overstretching



- ▶ Founded in 1792 as a single store near London selling newspapers and books, with initial regional focus (London and surroundings)
- ▶ Core customer base: train travelers in need of reading material but also other goods for long trips like card games, foot warmers and even rugs
- ▶ In early 1990s, expansion into broader retail product lines by adding toys, typewriters, music, gifts and do-it-yourself tools
- ▶ After losing GBP 195 m. in 1996, the company decided a new strategy; return to basics; e.g. selling majority stake in Virgin Megastore chain and purchasing 230 UK newspaper stands from rival chain John Menzies
- ▶ Today, distribution network of more than 1.000 stores mainly in/close to train stations or airports
- ▶ Today, an annual turnover of more than GBP 3.5 bn. and positive profit performance in recent years

Research update on recent performance of WH Smith – see chapter 7

# The Seven Common Pitfalls of Adjacency Expansion

## Pitfall #4: Invaders from Unexpected Fronts

The discovery of new, un- or underserved market territory often brings additional competitors from unexpected directions

Caution: 'The early bird does not always catch the worm' and sometimes it is more prudent to allow another firm to fight the early battles while you preserve your powder and move in as a strong follower....

## Pitfall #5: Failing to consider all adjacencies

A comprehensive review of potential adjacencies is necessary, not just on those in close vicinity of your current business model

## Pitfall #6: Missing a new segment

Failing to pursue a newly emerging customer segment near your core

# The Seven Common Pitfalls of Adjacency Expansion

(continued)

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## Pitfall #7: Pursuing high-end adjacencies in a single-minded manner

Adjacency Expansion activities tend to gravitate around the 'high-end': more sophisticated products with higher margins for the more affluent customer.

This frequently leaves an open flank for new breeds of low-cost competitors which will erode your total customer base and will derange your economies of scale.



# Summary and conclusion

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Excerpt from the book:

‘The most successful sustained growth companies always follow the **pattern of expanding in a regular and organized way into a series of adjacencies around one or two strong cores**. The pattern resembles the growth rings of a tree, emanating out from the center, expanding and reinforcing the core.

‘The most successful companies have the **largest number of new adjacencies** raining down upon them every day. Success multiplies opportunities. ...

## Chapter 7

### Update Research on Guinness, Enterprise Rent-A-Car and WH Smith

#### Guinness / Diageo plc 2013 – Website [www.diageo.com](http://www.diageo.com)

- ▶ Merger 1997 with Grand Metropolitan to create Diageo plc headquartered in London, England
- ▶ Due to controversy over the merger, Guinness was maintained as a separate entity within Diageo plc.
- ▶ Company statement: ‘Diageo is a multinational alcoholic beverage company...It is the world largest producer of spirits and a major producer of beer and wine.’
- ▶ Main brands: Smirnoff (vodka), Johnnie Walker (whisky), Bailey’s (liqueur), Guinness (beer)
- ▶ Diageo Financials 2012: Net sales GBP 10.8 bn. (+ 8%), Operating Profit GBP 3.2 bn. (+22%)
- ▶ Member of FTSE 100 index, Market cap at GBP 48.9 bn. (as of May 2013)

## Chapter 7

### Update Research on Guinness, Enterprise Rent-A-Car and WH Smith

#### Enterprise Rent-A-Car 2013 – Website [www.enterpriseholdings.com](http://www.enterpriseholdings.com)

- ▶ Presently, the largest car rental service provider in the world measured by either revenues (US\$ 15.4 bn. in FY 2012) or employees (74,000 FTEs) or size of the fleet (1.3 m. cars and trucks)
- ▶ No public annual report is available, no public financials are available
- ▶ The only investment-grade car rental company in North America (according to S&P's, Moody's)
- ▶ Company statements: 'Our philosophy is that business is a marathon, not a 100-yard dash' 'Our owners, the Taylor family, have put a significant portion of the companies' cumulative earnings right back into our privately held business.'

## Chapter 7

### Update Research on Guinness, Enterprise Rent-A-Car and WH Smith

WH Smith plc 2013 – Website [www.whsmithplc.co.uk](http://www.whsmithplc.co.uk)

- ▶ FY 2012 (ended 31 August 2012) showed group profit before tax up by 10% to GBP 102 m.
- ▶ Good performance from Travel to GBP 63 m. (+ 11%), resilient performance from High Street to GBP 54 m. (+4%)
- ▶ Strong free cash flow of GBP 91 m.
- ▶ Successful share buy-back programme
- ▶ Further good progress in Travel's growing international channels with 101 units now open

Many thanks for your attention!



# Workshop for six groups

Basically: USA, Northern Europe, Western Europe, Southern Europe, Central Europe, South Africa

Topics to be discussed per working group

- a) Define your current core business and associated business boundaries
- b) Identify and assess sources of market power of your organization
- c) Identify three past and present initiatives for adjacency expansion
- d) How successful has adjacency expansion been in your case? Please rate according to scale 1 (very low) to 10 (Excellent)! Which of the seven pitfalls have you encountered?