Chris Zook first came to prominence with the best selling business book *Profit from the Core*. Zook runs the worldwide strategy practice for $1 billion global consulting firm Bain & Co. About six years ago, he realised that sixty per cent of the firm’s work came from helping companies look for, or evaluating, the next source of profitable growth.

The result was a multi-year worldwide Bain & Co. study covering over 8000 companies which looked at how companies grow and why some companies that seemed to be primed for growth with all the right pieces in place, still failed to deliver. The results were surprising. Just 13 per cent of the companies studied achieved sustained profitable growth. This revelation led to *Profit from the Core*.

Now Zook has followed up with a second book, *Beyond the Core*. This is a direct response to the one question he continually encountered wherever he talked about his ideas on corporate growth, namely: What is it that allows some companies to push the boundaries of their core business out into new areas with a high rate of success, often year after year?

In London recently, Zook talked with Des Dearlove.

How would you define the main premise of your first book, *Profit from the Core*?

The main idea was that a large number of companies that seem to have all the pieces in place for sustained profitable growth, somewhere along the way lose sight of their core, mis-define their core, or prematurely abandon their core in search of new growth.

But, *Profit from the Core* actually had several main strands: First, we wanted to compile some basic data on the odds of managing sustained profitable growth. We were writing at a time when companies had extremely aggressive growth targets, both in terms of revenue and earnings. However, we defined our threshold growth at the relatively modest level of 5.5 per cent in real terms for both revenues and profits, and earning back the cost of capital on average over five years. Most businesses aspire to do that. They certainly did at that time. Even then, we found that only 13 per cent of companies worldwide achieved this average level of performance over a ten year period.

Then we looked at the companies which had achieved this and asked what was unique or distinguishing about them? We looked at the companies from a lot of different dimensions and discovered a number of interesting things that proved to be jumping off points for our later work.

There was not a disproportionate number of technology companies, despite the fact that the
book was written at the end of 2000. Eighty per cent of the companies were in basic industries. The distinguishing factor was that they had a leadership position or very strong core. The companies tended to be market leaders or have a strong niche position in one core business or two at the very most. They were companies like Tesco or UPS. Conglomerates or multi-industry companies were disproportionately under-represented.

Over 80 per cent of companies that achieved good growth levels over ten years grew in a pattern that resembled the emanating rings of a tree. They grew in their core business, possibly gaining a slight amount of market share, but they also pushed out the boundaries of their core businesses to somewhat new areas.

The third thing that came out of the book was a framework that we now use throughout Bain & Co. When we go into a company and work with the client on growth we usually begin by focusing on four questions. These are prescriptive and very diagnostic in terms of understanding growth situations. The four questions may sound trivial, but I think they form the building blocks of growth strategy. They are:

What exactly is your core? How close are you to full potential for profitable growth within your core?

What are the most attractive adjacent moves that surround your core business – that both reinforce it and draw upon your strengths – which ones should you pursue, in what order, and can the core support that kind of growth? And finally, in certain industries it is very important to ask whether the core is in the process of being redefined or fundamentally changed in terms of the rules of the game?

How does a company define its core?

Defining your core involves a combination of judgment and pure analytics. The starting premise is to ask where I am, should be or will be vis-a-vis my competitors, and am I earning returns equal to or superior to my competitors? Also, in which customer segments do I have uniquely loyal customers, that value me more highly than they value my competitors?

Start with the answer to those two questions. Then drill down a layer and ask what exactly is it that allows me to earn differential returns and have more loyal customers. It might be a unique product, a unique insight about customer behaviour, or even an entire business system as in the case of Dell Computer. It could be two or three competencies combined in a unique way in a business.

Could you give an example? Take Intel. What would its core be?

Intel’s core would begin with the IA-32 processor architecture. Above all I would say it begins with the microprocessor and IA-32 architecture and the embellishments of that. Add to that low-cost manufacturing capabilities with very low error and failure rates, something that is extremely hard for competitors to mimic. Plus, you would add into the core the Intel brand and what it stands for. So, at the centre of the business and the reason they have so much market share is the microprocessor architecture, low-cost manufacturing with the lowest error rates and the highest quality, and then the brand.

What do you believe constitutes good growth?

We have a strict definition of good growth. It’s market share growth or adjacency growth around a strong core, which earns more than its cost of capital and therefore creates value. We are very sceptical of growth that is pure diversification unless the company has a unique skill that allows it to buy a business and uniquely add value to it. Equally, we are sceptical of revenue growth without profit growth, and also of the sustainability of profit growth without any accompanying revenue growth. Companies frequently make precipitous moves...
because of the enormous pressure imposed by the equity markets and market analysts to do something in the name of growth.

From your research, which growth path is most often advocated by executives from companies with solid growth? Plus this term you use – adjacency – what exactly does it mean?

When you ask executives from companies which have sustained good growth the number one way was to take the strongest core business and to move into new areas around the core but that leverage the core. So we define that form of growth as adjacencies. Our research identified six types. These all have three things in common: they are fundamentally strategic in nature as opposed to tactical; they entail a higher level of risk than the average growth move because they are pushing out into the unknown; and they are typically a decision that the executives at the most senior level, CEO or president, get involved in.

You can think of the six most simple types as atoms that can be assembled into molecules. So for example, Nike’s growth strategy isn’t any one of these but rather a combination of several.

The six types are: geographic adjacencies – Vodafone purchasing Mannesmann to go into Germany for example; product or service adjacency – a totally new product, or service but leveraging your current customer service base or leveraging other assets you have; going into a new channel; new customer segments; more rarely done, and more rarely successful, are significant moves up or down the value chain, so forward integration, a manufacturer going into retail, or backward integrating into supply; and finally a company that feels they have a core capability, so to speak, that can be transferred to a totally different arena and the fields of business around it – this is also rare.

So those are what we call adjacencies. We did a lot of analysis with the data of moves closer and further from the core. Eventually we developed a measure for the number of steps away from the core. So adjacent moves could be up to five steps away depending on how far they departed from what was considered central to the core. We discovered that for growth moves more than one and a half to two steps away from the core the odds of success declined dramatically. Amazingly, the average adjacent move had a failure rate of 75 per cent.

What is a good example of a company that moved too far from its core?

In 1998, Mattel purchased the Learning Company Inc. based on the premise that both companies sold to children, and that the plastic toys Mattel sold were vulnerable to being replaced by digital products and software. So Mattel figured it needed to make this move to survive. But it paid three billion dollars, enormous in proportion to the size of the Learning Company. Plus, the Learning Company was on the East Coast of the USA when Mattel was on the West Coast. And if you read the press clippings about Mattel at that time it sounded as if the two businesses were more related than it ultimately turned out. In fact it was different customers, different channels, different products, different infrastructure, different competitors, and different brands. It didn’t leverage anything of Mattel’s. It was fundamentally four or five steps away from the core. Mattel ultimately sold the Learning Company in 2000.

If you had a message for practicing managers, not necessarily senior managers, but middle managers as well, what would the message be?

It would be a very hopeful message. The best growth ideas do not usually come from exotic mental gymnastics, investment bankers, gurus, the pressure to find the next hot market or invent the next technology.

In at least 85 per cent of the companies we profiled the best growth initiatives came from drilling down in more detail into the customer base in one of several ways: Taking a customer and mapping out all their life cycle purchases in detail; understanding the customers in so much detail that they can develop new customer segments; sending teams of engineers onto the site and mapping out the customer economics in detail in order to find new product ideas and ways of improving productivity.

So I think the hopeful message for managers is that they may, more than they think, hold the keys to growth. It may come through something as relatively straightforward as drilling down into the customer base, as opposed to something as disorienting and fundamentally risky as searching for the next big idea.