Canback

THE GROWTH TESSERACT: FINDING YOUR COMPANY'S GROWTH OPPORTUNITIES

By Staffan Canback

I often work on growth strategies for global clients. I'm struck by how they usually lack a framework for organizing their thoughts on growth. This leads to befuddled thinking and an inability to identify, quantify, and capture growth opportunities.

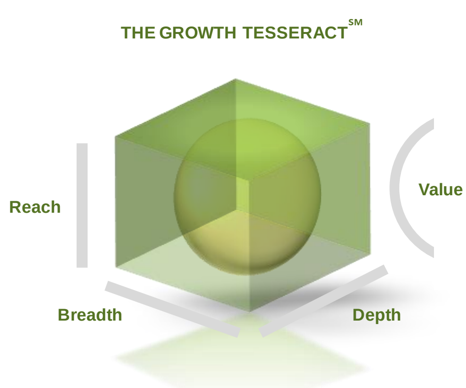
Shareholder value has three components: profitability, growth, and risk. For profitability, there is the dupont identity. For risk, there is the discount rate. For growth, there is...nothing.

I developed the Growth Tesseract framework to rectify this. It is an outgrowth of my doctoral studies. The framework is mutually exclusive and completely exhaustive—that is, it covers all possible growth opportunities and there is no overlap between the four dimensions.

Introduction

A tesseract is a cube in four dimensions.[i] It is a fitting metaphor because there are four ways for a company to grow. Not three, not eight: four and four only.

Further, the dimensions are orthogonal.



A company can:

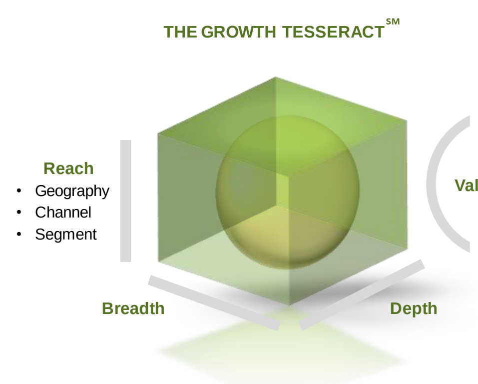
1. Expand its reach
2. Develop its breadth
3. Increase its depth
4. Maximize the value it delivers

Any growth initiative you can think of fits in one of these four dimensions. If it fits in more than one, the initiative can be unbundled into the individual dimensions.

In the following, each dimension is discussed, ending with a few ways to apply the framework.

1. Reach

Expanding reach is an important lever for growth. There are several methods through which this can be accomplished.



The three most important ways of increasing reach are:

- *Geographic reach.* It can be achieved by entering new countries or new regions of an already-served country. It is one of the most important levers for growth, especially if scale economies are important.

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Playing in only a few markets becomes more and more difficult as globalization spreads, so expanding reach is a necessity for many.

- *Channel reach.* This comes from seeking out new distribution channels, and by extension new outlets. For example, a company may be strong in modern trade, but not in traditional trade or e-commerce.

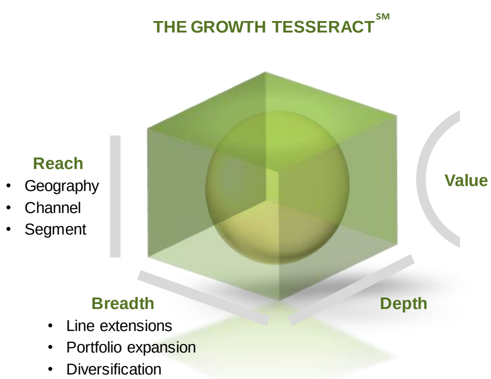
  Expanding into new channels in existing markets is often a quick way to increase sales, but channel conflicts may impede progress.

- *Segment reach*. Growth into new segments (primarily consumer or occasion) is often the quickest way to grow. An example is a company strong in school lunch snacks that expands into the after-school meal occasion.

2. Breadth

Companies that fail to expand their product or service offerings tend to disappear. There are exceptions, but most companies that are successful over decades expand their breadth dramatically.

Breadth can be used to play up or down the price ladder, or to enter new product or service markets.



The three most important levers to grow breadth are:

- *Line extensions*. This means adding variants to an existing product. An example is Fanta Grape as an extension to the original orange Fanta. Line extensions can be tricky because they sometimes clutter the brand, but done correctly, they are a major lever for growth.

- *Portfolio expansion*. 1) Companies can play up or down the price ladder. For example, Canada Goose introduced Black Label to premiumize from an already high price point, while Nordstrom introduced Nordstrom Rack to play in the value segment.

  2) Companies can introduce related, but entirely new, products. An example is Nike, which started as a sneaker company but expanded into sports apparel and is now a street fashion company.

- *Diversification*. Sometimes diversification is an excellent way to grow. Diversification is much maligned but there are circumstances when it makes sense, such as when cash flow is strong but the current business is slowly fading.

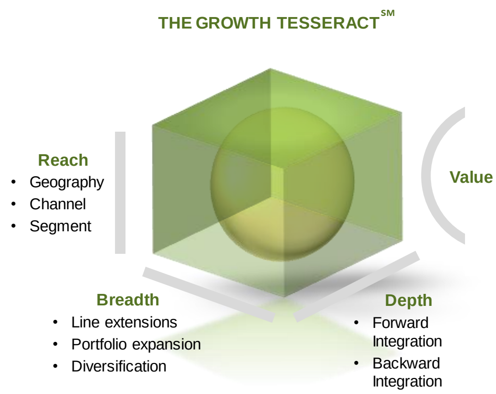
  Nokia's diversification into cellular phones from rubber boots and forestry in the ‘80s is an example.

3. Depth

Growing revenue is easy. Your company sells me a pen for one-trillion-and-one dollars, and my company immediately sells it back for one-trillion dollars. You now have the largest company in the world (and I the second largest).

But we should not be maximizing revenue: value added is what counts. In this case, your value added is one dollar—hardly a record-breaking sum.

Value added equals revenue less external purchases, or equivalently, the sum of labor and capital costs. A company can grow by increasing value added even if revenue does not necessarily grow. Instead, (vertical) depth increases.



There are two ways to increase (vertical) depth:

- *Integrate forwards* by, for example, buying a distributor or building one's own retail outlets.

- *Integrate backwards* by, for example, buying a supplier that makes widgets for your product.

It has been shown that increasing depth is generally a bad idea. Executives sometimes erroneously think that they absorb more margin, but fail to see that they also increase assets.

There are, however, notable exceptions. Here are two examples:

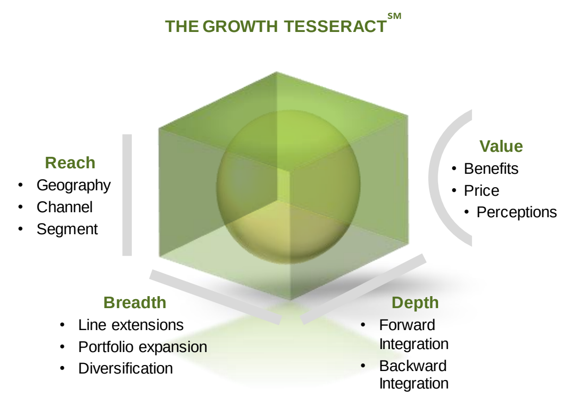
- Brewers increasingly integrate forward into distribution.[ii] This pays off in many markets because the increased control over deliveries and visibility into outlets generates profit opportunities beyond a third-party distribution arrangement.

- A ball-bearing manufacturer owned a steel mill. The reason was that ownership increased delivery precision and when steel markets were tight, the price of steel suitable for ball-bearings sky rocketed without an internal source.

In general, decreasing depth is the better way to go, but in certain highly specific situations, increasing depth makes sense. It is therefore included in the framework.

4. Value

Finally, a company can grow without increasing reach, breadth, or depth. Instead, it can work to improve its value proposition.



To a customer, value equals perceived benefit less perceived price. A company can optimize these three levers to generate growth.

- *Benefits*. A product's or service's benefit is the bundle of tangible (functional) and intangible (emotional) attributes that goes along with it.

  A simple example is sea salt. The functional attribute is NaCl, which the body needs. The emotional attribute is salt from the sea, which sounds more appealing to some than salt from a mine. In addition, there may be a convenient-to-pour package attribute, or an iodine attribute.

- *Price*. This is what the customer pays. A company must continuously monitor its prices against the competition, against substitutes, and against the grey market (if it exists).

  Fundamental analytical tools to assess your price position are: a) elasticity models and b) attribute component price analyses.

- *Perceptions*. Both benefits and price can be influenced by perceptions. That is, customers perceive a benefit or price differently than reality. Shaping customers' perceptions occurs through marketing.

  An example is Microsoft's and Adobe's move from selling software products to selling software for rent: suddenly the upfront price declines, but the life cycle price increases dramatically.

Applications

Understanding the Growth Tesseract framework is easy—that is the point of it. But what are the applications? Here are three examples:

- *As a diagnostic tool*. A company may wonder why it has not been able to grow as quickly as budgets dictated.

  To understand why, each past growth initiative is assigned to one or more of the dimensions and divided into two groups: successes and failures. From this emerges a pattern of the company's strengths and weaknesses.

- *To set future strategy*. We are often commissioned to develop what we call "Sources of Growth" strategies. In these efforts, we uncover opportunities that have been overlooked and that go above and beyond existing plans.

  By having this rigorous and rigid framework, we can be sure to cover all opportunities. The goal is to identify 20% growth in affluent countries and 40% growth in emerging countries.

- *To evaluate acquisitions*. What aspects of a potential acquisition leads to growth? In our M&A due diligence work we have found the framework useful to create realistic demand forecasts for the as-is and to-be scenarios. This in turn feeds into the financial models.

The Growth Tesseract brings science to growth initiatives. It is an invaluable tool for management teams because it structures the internal discussions, and because it ensures completeness in strategies.

In a future article, I will discuss the organizational hurdles to making growth happen.

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I want to thank Mario van Geldern for articulating the need for a growth framework.

[i] The cube-sphere shown is not a proper tesseract. But it illustrates 4 dimensions well.

[ii] Not possible in the United States and a few other countries.