The Growth Cube for Scale-Based Competition

Do you compete against a company? Or against its scale? In today's ever-consolidating, ever-internationalizing, ever-scaling business environment, your competitors' greatest strengths may reside in their size just as much as in their people, products and strategies. Choosing the right kind of growth will play a significant role in the quest for long-term profitability.

EXECUTIVES IN EVERY INDUSTRY are thinking less about their competitive strategies and more about growth, volume and scale. In fact, productivity, quality, new products, services and speed are taking a backseat to growth. But not just any growth. Whether you seek to be a global market leader or a top-performing niche competitor, your critical (arguably your only) strategic challenge today is choosing the right kind of growth for your company's specific culture, position and industry.[1]

The A.T. Kearney Growth Cube provides a strategic framework to help companies work through that challenge. It's fully explained in Andrej Vizjak's upcoming book, *Competing Against Scale,* which sets forth the Growth Cube analysis for large and small companies across industries. In this article, we show how structuring your analysis using the Growth Cube can help you compete against scale. The article highlights the benefits of this approach through a case study of a once-struggling company that is now poised to elbow aside its competitors in the race to profitable growth.

The Case of Arcandor

Arcandor is a large German company with business units in travel, bricks-and-mortar retail and home shopping *(see sidebar: The Businesses of Arcandor on page 28)*. Formerly known as KarstadtQuelle, it was formed in 1999 through the merger of Karstadt, a chain of high-quality department and sporting-goods stores, and Quelle Schickedanz, a mail-order company.

The early 2000s were difficult years for the company as it faced mounting competition from fast-growing discounters and specialty stores. Profitability suffered profoundly in 2004, when the company took a $2.2 billion loss. However, May 2005 marked a fresh new direction when Thomas Middelhoff, former CEO of Bertelsmann, was named CEO. Under Middelhoff's leadership, the company divested nonstrategic assets to gain financial leeway and devised a plan for competing against scale.

Middelhoff and his team formulated a strategy to position the company for transformative growth, an approach that aligns to the A.T. Kearney Growth Cube *(see figure 1)*. The highest-profile move was a change in the company name to the more euphonious Arcandor in June 2007. But the name change was no mere whitewash. Rather, it reflected a new business-unit profile and philosophy on growth, symbolizing extensive behind-the-scenes work to restructure the company and maximize its advantages in the quest for profitable growth.

With Arcandor as a case illustration, the following outlines the six strategic components of the Growth Cube framework.

Position Your Scale Profile

The first face of the Growth Cube is positioning a scale profile. Is your company large ($10 billion or more in market capitalization) or small? Are you an industry leader or follower?

Leaders. Large industry leaders are well-positioned to compete in ever-consolidating markets, while small industry leaders generally exist in emerging industries; they must grow in size as their industry matures.

Followers. Large industry followers must speed up their growth, because in the long run only the top companies in an industry will survive, while small industry followers are in the vast majority. They are often profitable—but they lack economies of scale and acquisition

[1] *Our colleagues Graeme Deans and Mary Larson discuss the right kind of growth in their article, "Growth for the Sake of Growth Is…Overrated," on page 5.*

power, and thus must work to carve out, defend and, perhaps, expand their niche.

The first dimension was easy to measure, even during the 2004 crisis: Arcandor is large. The second was more difficult, because Arcandor operates in three industries: travel, retail and home shopping.

Overall, the first face of the Growth Cube analysis shows that Arcandor is a large industry leader in three industries likely to consolidate further in the quest for international scale.

Benchmark Your Growth Profile

Companies that survive long-term industry consolidation do so in part because they select the right growth profile. Conversely, companies that fall victim to acquisitions are often those that failed to self-finance their growth. The second face of the Growth Cube benchmarks a company's past direction by comparing revenue growth and profitability. There are four categories to consider:

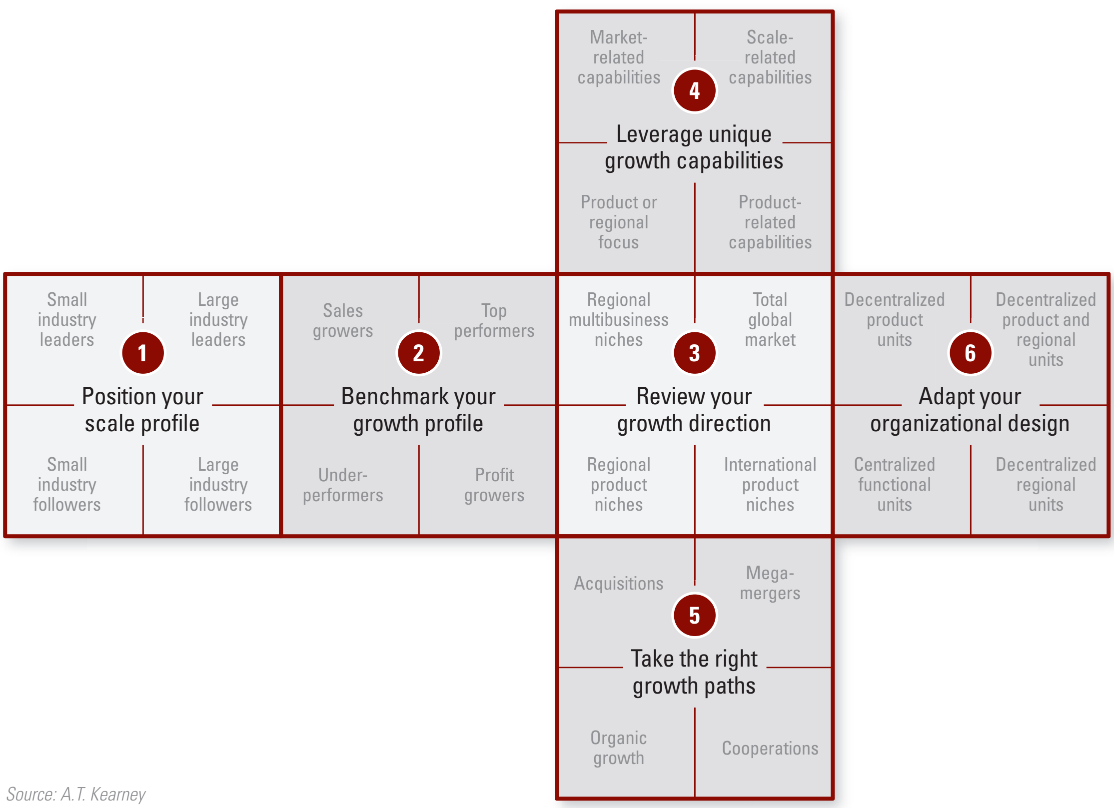
Top performers improve revenues and profitability at above-average levels. In any industry, they are well-positioned to compete against scale.

Profit growers succeed at profitability but lag in revenue growth. They have set the groundwork for profitable growth, but must figure out how to increase revenues more aggressively.

Sales growers improve revenues but lag leaders in profitability. Although increasing in scale, they must cut costs or risk becoming

FIGURE 1

The A.T. Kearney Growth Cube



Source: A.T. Kearney

targets for acquisition in later phases of industry consolidation.

Underperformers perform at below-average levels in both categories. They must change quickly—or prepare an exit strategy.

During its struggling years, Arcandor was an underperformer, faced with daunting twin challenges: The company had to sell more products to grow—while at the same time reducing costs to improve profitability. Arcandor also faced a burden of debt, which hampered its flexibility to pursue such growth paths.

Since May 2005, Middelhoff's team has steadily increased Arcandor's revenues and profitability. In 2006, the company posted a net profit of $442 million, or a little more than 2 percent of sales. Improved operating results, combined with steady but slow growth rates, make Arcandor a profit grower. Revenue growth—ideally, self-financed—is the path to success.

Review Your Growth Direction

In the third face of the Cube, a company reviews its growth direction. When do you add new product lines (diversification) and when do you add geographies (internationalization)? Growth follows a step-by-step process.

For example, a small company typically starts with a regional product niche. Diversification can lead to regional multibusiness niches, thus capitalizing on a regionally prominent brand or shared sales and distribu-

The Businesses of Arcandor

Arcandor is a financial holding company that operates in travel, bricks-and-mortar retail and home shopping. Its profile is based on three business units that act as separate companies within their own industries:

Thomas Cook. Almost 60 percent of Arcandor's revenues now come from its travel and tourism division, Thomas Cook, the second-leading provider of tourism services.[1] Arcandor owns a 52 percent majority stake in Thomas Cook, with the rest listed on the London Stock exchange. The company offers a global menu of destinations but serves primarily European and Canadian customers. Indeed, all major players in the industry have a regional focus, so Thomas Cook is clearly a regional leader in a market where future growth opportunities are likely to come through internationalization.

Karstadt. The retail unit operates five premium stores—including Berlin's KaDeWe, which is Continental Europe's biggest department store—and another 85 "top-of-the-city" department stores, along with 32 sporting-goods stores. Department stores are a regional business with no dominant global market leaders, as the top three department stores account for less than 15 percent of global market share. Karstadt is a regional leader in an industry where many regional leaders are starting to expand internationally.

Primondo. This home-shopping business unit, best-known by its premier mail-order brand, Quelle, is a portfolio of companies that focus on clothing and apparel for higher-income and mature (age 60-plus) customer groups.[2] Although defined by its primary distribution channel, Primondo competes against bricks-and-mortar clothing retailers. Primondo is regionally focused, competing among the top two companies: Gap and Hennes & Mauritz (H&M). Nike has about 5 percent of global market share, and H&M about 3 percent. The competition is geographically dispersed. For example, H&M operates mostly in Europe, with an emerging presence in North America and just a few outlets in the Middle East, Hong Kong and China.

[1] *Arcandor's 2007 revenues were approximately $29.5 billion, of which $17.1 billion came from Thomas Cook, $6.6 billion from Karstadt, and $5.8 billion from Primondo.*

[2] *Quelle is part of the Neckermann brand; a majority of the brand has been sold to a financial investor, Sun Capital Partners.*

tion channels. Internationalization can lead to international product niches, capitalizing on a superior product by selling it in additional regions. By leveraging each strategy across the other, the company eventually gains international leadership in a total global market.

The challenges are to determine which direction makes the most sense for your industry and position, and to take each step more quickly than your competitors—because those that fall behind must try to regain that ground through riskier attempts at mega-mergers *(see sidebar: The Growth Cube for Companies Large and Small on page 30).*

Although a key competitor in each of its industries, Arcandor is clearly not yet an international leader. It focuses on regional industry segments, and its Growth Cube analysis showed that business units needed to grow both horizontally (toward new geographies) and vertically (toward diversification in multiple niches).

Arcandor's most internationalized business unit, for example, is Thomas Cook (travel and tourism), which has a strong presence in Europe and Canada. In 2007, Thomas Cook acquired MyTravel, a U.K.-based package holiday company, and in 2008 it snapped up luxury travel provider Elegant Resorts, also in the United Kingdom. It recently bought back former subsidiaries in India and Egypt and is investing significant sums for larger acquisitions in the near future. Thomas Cook's goal is to maximize scale to support full internationalization, including the Russian and Chinese markets.

Arcandor has also sought to diversify Thomas Cook's product mix. They recently expanded individual travel and package tour segments and added financial services.

Arcandor's Karstadt unit had its two retail formats (department and sporting-goods stores) only in Germany. An international expansion into Eastern Europe and regional capitals is now planned for its premium department stores. Arcandor also plans to form a pan-European premium group, joining with other renowned department stores to offer a larger assortment of leading global fashion brands.

> Whether **YOU SEEK TO BE A GLOBAL MARKET LEADER** or a niche competitor, your critical (arguably your only) **STRATEGIC CHALLENGE IS CHOOSING THE RIGHT KIND OF GROWTH.**

Primondo, especially through its premier mail-order brand, Quelle, was already expanding throughout the wider region. Primondo focuses on Eastern Europe and Russia, and it is currently the number one or two home-shopping company in nine markets there. The company is also active in other European markets such as Switzerland and Austria, and Middelhoff plans to continue expanding Primondo's international footprint. Primondo also operates successfully in three distinct sales formats: mail order, bricks-and-mortar retail and the Internet, which is growing at double-digit rates. In 2007, Arcandor added a fourth key sales format when it acquired the secondranked German TV shopping channel, HSE24. By diversifying its business niche and channel mix, Primondo has become a true home-shopping company and is planning to expand the TV shopping format to Eastern Europe.

Leverage Unique Growth Capabilities

So far, we've seen how the Growth Cube analysis can steer a company in the right direction for growth. What about the source of that growth? To find this out, we analyze unique capabilities that can be exploited for profitable growth, and again it's a step-by-step process:

- Begin with your regional or product focus, where you have few available product or market synergies
- Enlist product-related capabilities (strengths in R&D or production and logistics) to break out of a single region and expand the niche internationally
- Employ market-related capabilities (strengths in sales and marketing) to help grow your

The Growth Cube for Companies Large and Small

Andrej Vizjak's *Competing Against Scale* includes dozens of case studies of growth cube analysis for companies large and small. Here we take a look at three examples.

illycaffè. A small, family-owned company based in Trieste, Italy, illycaffè roasts and distributes top-brand coffees. In an industry where Kraft, Nestlé and Sara Lee together produce 45 percent of global volume, illy is a smaller industry follower—but a top performer with strong growth in revenue and profitability. The reason: its success at pursuing an international niche, with a portfolio of coffee-related products targeting the upscale market. The company's capabilities include innovation (it invented decaffeination and instant coffee, and it is now working on a two-stage espresso-making process) and marketing strength in enhancing its already powerful brand. It has recently pursued acquisitions and partnerships with companies that produce coffee makers and complementary products such as teas, chocolates and confectionaries. To overcome its scale limitations, illy uses centralized functional units—an organizational structure that helps make illy a role model for how to turn a commodity business into art.

Altana. Altana, the German chemical company that divested its pharmaceutical business in late 2006, excels along all dimensions of the Growth Cube. A small industry follower, Altana has outperformed competitors in sales growth and profitability to act as a top performer with respect to its growth profile. It has developed international product niches by leveraging its unique product-related capabilities through selective acquisitions and organic growth. Organizationally, Altana maintains decentralized product units. To continue its success, Altana should capture synergies across divisions to serve customers better and develop new products.

Deutsche Telekom. Deutsche Telekom (DT) has grown over the past 13 years into a global leader in both the fixed-network and mobile segments of the telecommunications industry. DT has been a profit grower since 2002, with good profitability and a falling debt burden but overall revenue growth of only 3.4 percent per year. With fixed-network operations in 10 countries outside of Germany, and T-Mobile as one of the top three global mobile companies, DT is well-suited to pursue a total global market leadership position. Its product- and market-related capabilities include technical expertise, product marketing skill and the T-Mobile brand. Its growth direction should include further acquisitions in complementary geographies. DT is organized in decentralized product and regional operating units, which in the future must be carefully managed to maintain a customer focus and orchestrate its international footprint. In this competitive, consolidating industry, the company must also improve its growth profile and secure a healthy financial position to leverage its potential acquisition power.

niches in a particular region and transfer successes from one niche to another

- Leverage scale-related capabilities, including acquisition power, if you are a large company in mature, consolidated industries

The analysis showed that each Arcandor unit had unique product capabilities. Thomas Cook had a solid, distinct reputation in Europe and Canada. Karstadt had a reputation for high-quality assortments with established brands, and Primondo had Privileg, the leading white-goods brand in Germany; also, its expertise in adapting its assortments to local needs and tastes would come in handy during geographic expansion.

The market-related capabilities for Arcandor were also unique. Thomas Cook had an international presence and multichannel distribution, Karstadt had prominent, downtown store locations, and Primondo had expertise in multichannel retailing.

The Growth Cube analysis showed one final unique growth capability for Arcandor: the potential to work across business units. The two business units Karstadt (especially its premium stores) and Primondo could leverage capabilities in internationalization and business enhancement, while Thomas Cook should exploit its unique knowledge about customers.

Take the Right Growth Paths

With greater clarity on the direction and source of growth, it is time to determine the best *method* of growth: internal or external.

Organic (internal) growth requires little investment and has few barriers to implementation. But in times of rapid industry consolidation, organic growth is simply not fast enough, and companies must grow externally to compete with scale.

Acquisitions (external) are generally most successful when a large company acquires a smaller one, thus reducing barriers to implementation.

Cooperations or alliances between partners with equal rights require less investment but are tough to implement due to their complicated governance.

Mega-mergers between two large companies involve both large investments and complicated implementations.

The best path—or combination of paths—may depend on the region in which you operate (for example, organic growth is far more popular than acquisitions in Asia) and the level of concentration in your industry. It also depends on your company's situation. Indeed, in 2005, Arcandor had to take an even more drastic step in its growth path—divesting noncore activities and markets to gain the financial freedom needed to pursue new growth opportunities. However, now that it has achieved new organic growth, Arcandor is complementing this with acquisitions and cooperations to strengthen each business unit *(see figure 2 on page 32)*.

Arcandor's first acquisition after recovering its financial footing was purchasing the other 50 percent of Thomas Cook from Lufthansa in 2006. MyTravel was next; it was merged into Thomas Cook to form the new Thomas Cook Group, which is now acquiring new companies to boost its range as a tour operator. Arcandor's other major acquisition, as mentioned earlier, was the HSE24 TV shopping channel.

Adapt Your Organizational Design

To get the most from its capabilities, a company must have the right organizational design in place. Do you centralize or decentralize—and if the latter, by product, region or both? Growth creates complexity, and how you choose to manage that complexity helps determine how profitable that growth will be.

FIGURE 2

Arcandor's growth path for its business units

	Divestments	Mergers and acquisitions	Alliances
Thomas Cook *(tourism)*	**2006** – Aldiana – Creativ Hotel Buenaventura – Inversora de Hoteles Vacacionales – Thomas Cook Canada – Thomas Cook UK & Ireland **2005** – Thomas Cook (India)	**2008** – Elegant Resorts – Hotels4U.com – Thomas Cook Egypt – Thomas Cook (India) **2007** – MyTravel **2006** – Thomas Cook AG (remaining 50% of shares)	
Karstadt *(retail)*	**2006** – Fitness 24 **2005** – Golf House – 74 small Karstadt department stores – Runners Point – SinnLeffers – Starbucks joint venture – Wehmeyer		**2007** – Gravis – Hugendubel and Weltbild – Singapore Airlines **2006/2007** – Goldman Sachs (High Street joint venture)
Primondo *(home shopping)*	**2008** – neckermann.de (51%) **2007** – Quelle France – Quelle Spain **2006** – Fritz Berger – Quelle Belgium – Quelle Netherlands – Thirty and more mail-order company **2005** – Home Shopping Europe (HSE)	**2007** – HSE24	**2007** – MyBy (with Axel Springer) **2006** – Electronic Partners – MediMax – Redcats (through La Redoute brand)
Arcandor	**2007** – Itellium Systems & Services (74.9%) **2005** – KarstadtQuelle logistics division – DSF sports channel – Sport1 website		**2007** – Electronic Data Systems – Li & Fung Group **2004** – Atos Origin

Source: A.T. Kearney

For Arcandor, a decentralized organization made sense, as there were few potential operational synergies among its travel, retail and home-shopping units. And by listing the Thomas Cook Group as an FTSE-100 company on the London Stock Exchange, Arcandor laid the cornerstone for its transformation from an integrated group into a financial holding company.

In this role, Arcandor is a major, but less than 100 percent, shareholder in many of its business units, such as Thomas Cook (52 percent). The company has an internal strategic requirement to have Karstadt and Primondo ready for the capital markets within the next one to two years, with a similar organizational structure.

By acting as a shareholder, and intervening only when performance targets are not met, Arcandor can free its business units to operate as separate companies with their own entrepreneurial cultures. Because a financial holding company need not be limited to any geography or industry, as Arcandor acquires new companies, it can make case-by-case decisions as to the level of integration or collaboration needed with other companies in the portfolio.

Match the Strategy with Execution

It is too soon to judge the long-term success of the transformation of the retail company KarstadtQuelle into the financial holding company Arcandor, but progress has been made within just three years. It achieved one of the biggest turnarounds in Germany. Certainly the

FIGURE 3

Key strategies for future growth

ARCANDOR
COMMITTED TO CREATING VALUE

Tourism — Thomas Cook	*Retail* — KARSTADT	*Home shopping* — PRIMONDO
Expand internationally • Form cooperative partnerships to enter new markets **Digitize** • Leverage multichannel strategies • Expand e-commerce business **Improve business model** • Enhance asset portfolio	**Elevate profile** • Upgrade certain department stores to "premium group stores" • Trade up on portfolio of private-label and outside brands **Expand internationally** • Open premium stores in Moscow, St. Petersburg, Istanbul and Dubai **Implement new structure for managing categories and assortment** • Optimize assortment and visual merchandising **Enhance service and customer orientation** • Provide "extra touch" for premium levels of service	**Specialize** • Focus on smaller, specialized catalogs directed at distinct customer groups **Expand internationally** • Expand growth in Central and Eastern European markets • Tailor assortment to changing customer demands **Digitize** • Expand e-commerce and home-shopping channels

Source: A.T. Kearney

company has taken many bold—and promising—moves. Its key acquisitions have positioned Arcandor for growth. However, these strategic moves must now be matched by superior execution. Figure 3 summarizes the key courses that each business unit will implement in its pursuit of growth.

Arcandor's business units are preparing to compete against scale by developing international product niches and positioning for future growth. In today's increasingly global business environment, market-related capabilities are growing in importance, and Arcandor's involvement in different retail formats provides a unique opportunity to exploit those capabilities. But one thing is clear: Arcandor's days of divestments are over. Its focus will now shift even further to organic growth and select acquisitions as it continues strengthening its business units and its market share.

Consulting Authors

Andrej Vizjak is a partner and managing director of A.T. Kearney's Eastern European operations. Based in the Munich office, he can be reached at andrej.vizjak@atkearney.com.

Mirko Warschun is a partner in the firm's consumer industries and retail practice. Based in the Munich office, he can be reached at mirko.warschun@atkearney.com.

Thomas Salditt is a consultant in the firm's consumer industries and retail practice. Based in the Munich office, he can be reached at thomas.salditt@atkearney.com.

Carsten Seeliger is a vice president of Arcandor AG and can be contacted at carsten.seeliger@arcandor.com.