

Going for Growth

Engineering high performance
in the industrial products industry

An Accenture Research Study

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Introduction

Understanding Growth

You know what you're up against—soaring costs, a serious skills shortage, unpredictable exchange rates and unprecedented pricing pressures. How can you achieve global competitiveness and grow, particularly in rapidly emerging markets like China, where competition is so stiff?

Some companies in your industry are managing to sustain a high level of performance in this challenging environment. They are also achieving growth across multiple dimensions—new products, new markets and new services.

All of these companies display operational excellence, as well as a keen understanding of what we call their “competitive essence”—the ability to create and maintain a unique combination of business attributes that help them rise to challenges and outperform their peers. But what underpins that ability?

Accenture's extensive research has identified four pillars of high performance that help companies in your industry grow. They are:

Global Flexibility – a value chain nimble enough to seize growth opportunities wherever they may arise

Innovation and Pricing Power – nourished by the customer insight to enable continuous generation of new products and services

Productivity Plus – the operational excellence and balance sheet strength to undertake successful strategic acquisitions

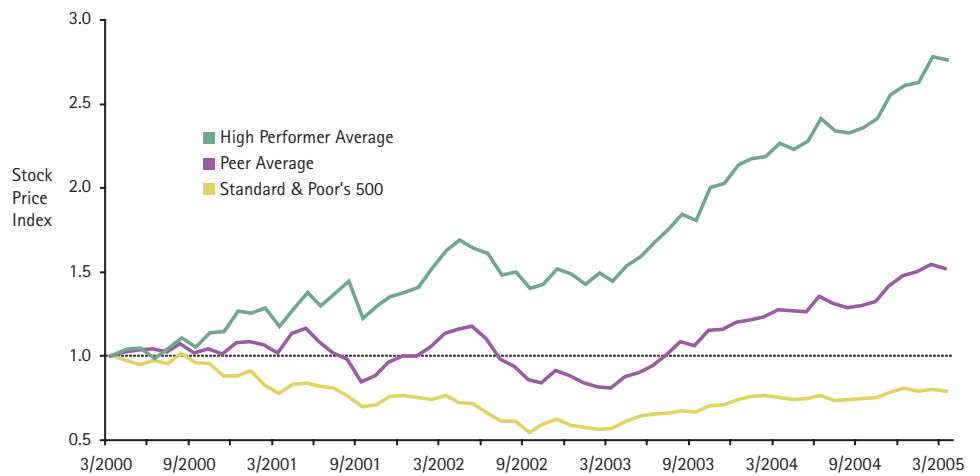
People Performance – a commitment to continuous learning and rigorous talent management

Each pillar is supported by a number of core capabilities. They range from low-cost country sourcing strategies that help keep supply chains supple, to value-based cultures that boost workforce productivity.

Distinctive capabilities constitute a key component of high performance in any industry. They are, by definition, difficult to replicate—difficult, but not impossible. Our research* shows that top companies in your industry use many of these capabilities to successfully differentiate themselves—a power that permits them to outperform their peers, consistently and over time. Here's how.

*See Research appendix

Total Return to Shareholders (TRS)¹
March 2000 - March 2005



Sources: Compustat, Accenture Analysis

¹Total shareholder return includes stock appreciation (with splits) plus dividends during the period 3/00 - 3/05. Data points are at end of month.

Pillar One

Global Flexibility

High-performance companies boast supply chains that are exceptionally responsive to global market opportunities—not only because they are flexible, but also because they are both integrated and extended.

Sales & marketing, product development, sourcing, manufacturing & distribution, parts & services—all components of the supply chain work in an integrated way, right through from suppliers to customers. The entire process is supported by common global processes and information systems—a single, global operating model.

Global flexibility leads to significant materials cost savings. American Standard has saved more than \$300 million in materials costs since the launch of its material management program, six years ago. The company leverages its collective buying power globally to consolidate the number of suppliers with which it does business and so improves purchasing efficiency.

American Standard has also moved rapidly into low-cost country sourcing, an important lubricant of global supply chain flexibility. The company plans to shift more than half of its European-bound production to low-cost Eastern Europe—and American Standard is not alone.

The proportion of Cooper Industries' materials spending that was accounted for by low-cost sourcing programs almost doubled between 2003 and 2004. China alone accounted for \$350 million in

the latter year and since Cooper plans to open a new product development and sourcing center soon in Shanghai, China's share can only increase.

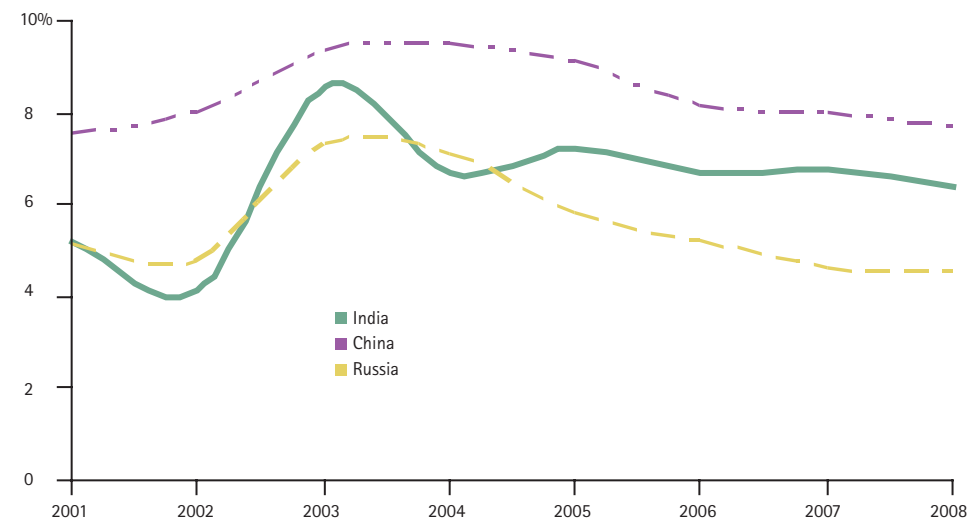
High-performance companies are global companies. They sell almost as much abroad as they do domestically. And they pursue market share aggressively and on a global basis. China represents an especially significant source of opportunity.

ITT Industries acquired Shanghai Hengtong Purified Water Development Co. last year and is eyeing additional purchases of local firms as a way of expanding in China, where it already has 10 manufacturing plants and employs almost 10,000 people. The company expects its revenue from China to reach about \$500 million in 2005, driven mainly by sales of pumps and wastewater treatment equipment.

Thanks to the suppleness of their supply chains, high-performance companies can flex their global operations to take optimal advantage of regional cost differences. And because they are able to swiftly capitalize on growth opportunities in emerging markets like China, their revenues from these regions are growing steadily.

Emerging Markets

Gross Domestic Product (GDP) Real Growth



Source: Economist Intelligence Unit – Viewswire, 2005

Pillar Two

Innovation and Pricing Power

High-performance companies can command premium pricing. That's because they have an exceptionally good understanding of their customers' needs—an insight derived by means of rigorous marketing analytics that involve really listening to the voice of the customer.

Danaher actually calls the cornerstone of its famous Danaher Business System the "Voice of the Customer." ITT's Value-Based Product Development Initiative ensures that it's making what its customers really want by having its engineers, as well as its sales representatives, sit down and listen to them.

Customer insight underpins effective product portfolio management for these companies. It also powers the proprietary innovation that is a hallmark of their high performance. A keen understanding of their costs is another—and they use the combination of the two to great advantage. After all, you can charge more for smart products and customers who sign up for sophisticated service offerings are more likely to stick with you. What's more, the insights derived from listening to the customer can help you cut not only sales and marketing costs, but also the costs of production.

Without an integrated and extended supply chain, of course, these advantages wouldn't amount to much. Cooper Connection, the Customer Relationship Management initiative launched by Cooper Industries in 2001, was designed to improve distributor relationships in the electrical products segment, where Cooper derives 85 percent of its revenues. It does so by tying the company's independent distributor base directly into its sales efforts—

a clear example of supply chain extension. The initiative consists of two parts.

Cooper creates cross-selling initiatives by leveraging the customer base common to all five of its electrical products businesses. Its distributors are rewarded for adding to or expanding the Cooper product lines they carry. At the same time, the sales force effectiveness program aims to stimulate user demand and improve product pull-through for distributors by targeting potential customer groups and building ongoing relationships with them.

The Cooper Connection has driven synergies right across the company's sales channels, not only contributing significantly to supply chain efficiencies but also, by integrating customer insight and interaction, building pricing power.

A continuous process of innovation drives that power. All high-performance companies spend significantly on Research & Development. And in an industry where product differentiation can be elusive, they often excel at service offerings. Take Finland's Kone.

The elevator and escalator manufacturer offers its customers maintenance contracts with a performance guarantee. The service obviously comes at a premium price, but it reduces elevator downtime, cuts out unnecessary maintenance visits and ensures that maintenance takes place before a fault occurs. What's more, the data gathered through its monitoring systems gives Kone important insights into its customers' changing needs so it can continuously update and improve its offering.

High Performance Growth Model





Pillar Three

Productivity Plus

High-performance companies are lean—a lot leaner than their peer group. Leanness, indeed, is part of their DNA. It impacts not only their manufacturing processes, but their business as a whole. The Danaher Business System (DBS), probably the best known of the lean production processes at which these companies excel, “is our culture,” according to the company’s core values statement.

The productivity mavens among high-performance companies are exceptionally good at making the most of available resources. Daikin Industries, for instance, which boasts the highest productivity of any Japanese company in the industry—and they all excel at that particular metric—optimizes the capacity of all its existing facilities.

In the summer of 2004, for example, the Osaka-based company kept its main facility operating at full capacity, despite forecasts of declining demand—but suspended a plant-building plan in India because demand was falling short of expectations. Daikin also terminated the non-mainstream product lines of a company it recently acquired in India—a clear instance of keeping its product portfolio slim in order to maintain the leanness of its organization.

Most high-performance companies also outsource non-core, largely back-office services in order to lower fixed costs. Many have well-defined, Six Sigma-type initiatives in place. In perpetual pursuit of value-chain efficiency, most have made procurement a strategic capability. And they all take each of these efforts much further than their competitors.

High-performance companies are more likely to have strong organic growth capabilities

than their peers. They don’t just grow with their markets—they actually make them. And that capability is underpinned by exceptional financial flexibility—the superior financial and capital markets strength to undertake serial strategic acquisitions, usually small and medium-sized, that will complement their organic growth strengths.

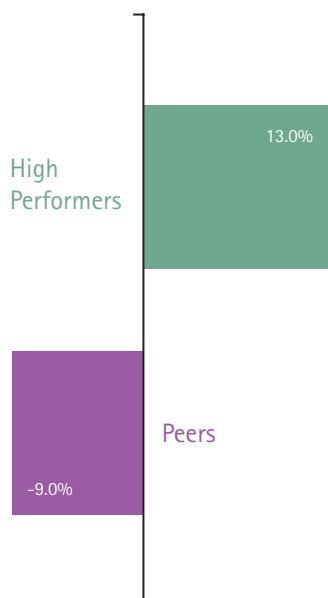
Sandvik, for example, has a well-established history of buying competitors at very good prices at the bottom of the cycle—a capability made possible by the strength of its balance sheet. Acquisitions, indeed, have been responsible for nearly half of the Swedish group’s sales growth since 1994—although any acquisition must enhance earnings per share within two years.

Of course, a poorly integrated acquisition can wreak havoc with the strongest balance sheet and destroy shareholder value. High-

performance companies, however, are much better than their peers at post-merger integration. When Danaher acquires a company, a special Danaher Business Systems team is sent to evaluate its operations, identify opportunities and create an implementation plan. Only if the company is deemed likely to assimilate DBS will the acquisition go ahead.

Take Danaher’s 2002 integration of Gilbarco, which is in the business of gasoline underground storage systems. Even before the acquisition closed, Danaher had begun to implement its Danaher Business System at Gilbarco. By the time the acquisition closed in February of that year, Gilbarco executives had been trained in the basics of DBS and within 60 days of the close, all Gilbarco employees had undergone DBS training.

Three-Year Net Cash Flow Compound Annual Growth Rate (CAGR) 2000 - 2004



Discussion and Implications

Combined with strong balance sheets, restrained CAPEX spending and good working capital management, high-performance companies generated strong free cash flow for greater financial flexibility to:

- Fund R&D and New Product Development
- Increase Capital Investments
- Increase Marketing and Sales Initiatives
- Fund Acquisitions
- Buy Back Shares/Pay Down Debt
- Increase Dividend Payouts

Sources: Compustat and Accenture Analysis

Pillar 4

People Performance

High-performance companies have risen to the human capital challenge confronting your industry by ensuring that they recruit the right people—and keep them. In light of Manufacturing Institute research that shows a majority of American manufacturers experiencing a serious shortage of qualified employees—with major consequences for business performance—that's no small advantage.

Human Resources is a core capability for high-performance companies. Their business strategies are reinforced by a strictly managed measurement and rewards system. Continuous learning is a philosophical priority for them. And they are committed to the constant re-skilling of their workforces.

Daikin motivates its employees to improve their expertise by means of a *Meister* certificate, awarded to skilled workers with more than 10 years' experience in their specialist area and demonstrably superior capability in training younger workers. The company also invests in IT technology to facilitate that training.

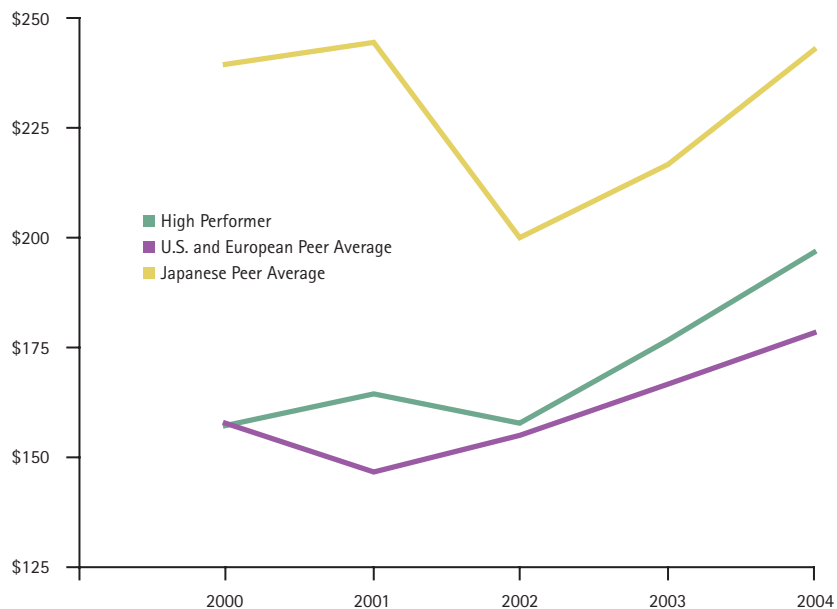
High-performance companies align their leadership and talent development with exceptionally strong core values. Value-based systems help them serve their customers and manage their businesses better, largely because they are understood—and lived on a daily basis—by every member of the workforce.

Like all such systems, ITT Industries' and the core values that underpin it are unique to the company. ITT focuses on portfolio management, consistent results, growth, leadership and operational excellence. Others may emphasize different goals—or express similar goals differently.

The Danaher Business System is based on the Japanese philosophy of *kaizen*, or continuous improvement. It forms the basis for all training at the company, from the shop floor to senior management. Executives are expected to complete Executive Leadership training, which typically takes two years and includes seven distinct modules. And once trained, all employees are engaged in the *kaizen* "events" and policy deployment initiatives that underpin Danaher's outstanding productivity.

Whatever they are called, the purpose of these systems is always the same. They are designed to nurture an appropriately skilled and highly motivated workforce, committed to the company's core values. The upshot: people dedicated to helping grow the company through good times and bad.

Revenues \$100K/Employee
(2000 - 2004)



Sources: Compustat, Accenture Analysis

Note: Foreign companies' currency was converted to USD using Ten Dots Tool

Conclusion

Achieving Growth

Growth is about making markets, not just being in them. High performance obviously requires operational excellence. It also demands mastery of many if not most of the distinctive capabilities that hold up the four pillars of high performance.

It's a challenge. Some high performers plainly do better in some pillars and capabilities than others. And even these companies have scope for improvement and growth. But it's all well worth the effort. As Accenture research has clearly shown:

- A single, global operating model, comprising a simple, integrated and extended supply chain and supported by bold programs of growth and low-cost country sourcing will give you **Global Flexibility**.
- Customer insight systematically applied to the management of your product portfolio powers a process of constant product and service innovation that will boost your **Innovation and Pricing Power**.

- Operational excellence, coupled with business process outsourcing and other measures to increase the efficiency of your value chain, will strengthen your balance sheet, giving you the financial discipline to undertake strategic acquisitions and acquire **Productivity Plus**.
- Strong core values, clearly communicated to your workforce through a commitment to continuous learning and re-skilling, will lead to better **People Performance**.

And all four of these pillars, effectively integrated, will strengthen those attributes, unique to your individual business, that constitute your competitive essence—the force that drives high performance in your industry, as in so many others.



Research Appendix

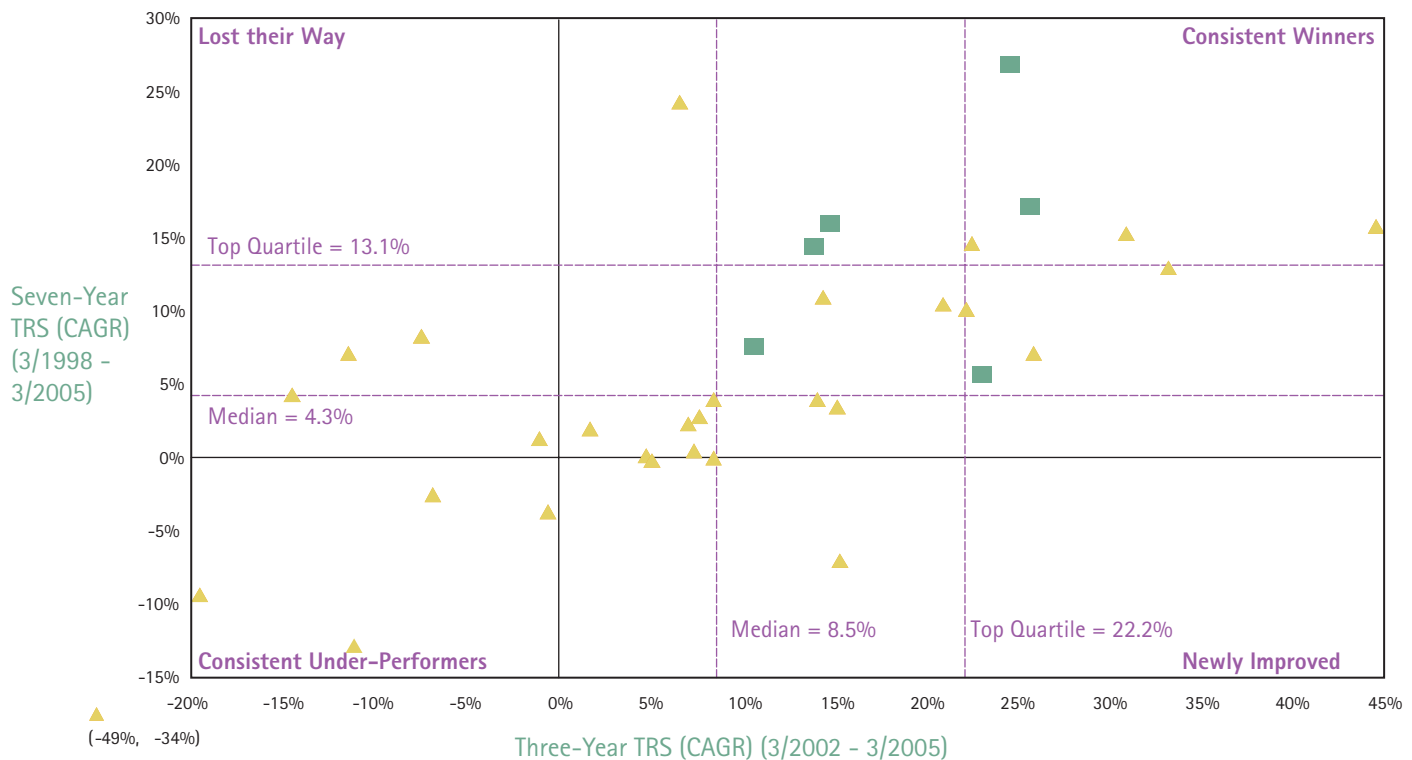
When we set out to identify what constitutes high performance in the industrial products industry, we decided to focus on the industrial-electrical segment—largely because, in many respects, the rest of the industry depends on it.

half of which derived from the key product sub-segments (power generation, automation, HVAC, general industrial and general electrical).

We began by picking the 100 or so top public companies in the segment and proceeded to screen them. We chose only those with annual revenues exceeding \$2 billion, more than

Total Return to Shareholders

Seven-Year TRS (CAGR) vs. Three-Year TRS (CAGR) (through March 2005)



Sources: Compustat, Accenture Analysis

Total shareholder return includes stock appreciation (with splits) plus dividends. Data points are at end of month.

■ High Performers
▲ Peer Companies

Accenture defines high performance on the basis of stock market performance and return to shareholders over three, five and seven years. We measured the Compound Annual Growth Rate (CAGR) of Total Return to Shareholders (TRS) over these three time periods, through March 2005, for the 34 companies that emerged from our screening process.

Six of these companies consistently delivered above

average returns to shareholders over all three periods. Based on the three-year average, they also achieved both growth and returns in excess of capital costs above the industry median. And when we looked at average TRS for these six companies over five years and compared it with the peer group average over the same period, we found that the gap was steadily widening.

Spread vs. Growth Three-Year Average



Sources: Compustat, Accenture Analysis

Note: Operating expenses and invested capital are adjusted for off balance sheet operating leases, pension obligations and medical benefit obligations.

About Accenture

Accenture is a global management consulting, technology services and outsourcing company. Committed to delivering innovation, Accenture collaborates with its clients to help them become high-performance businesses and governments. With deep industry and business process expertise, broad global resources and a proven track record, Accenture can mobilize the right people, skills and technologies to help clients improve their performance. With more than 123,000 people in 48 countries, the company generated net revenues of US\$15.55 billion for the fiscal year ended Aug. 31, 2005. Its home page is www.accenture.com.

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