



Engineers of growth

By Thomas H. Walsh

Some of the best performers in this huge and fragmented industry are found in the industrial/electrical sector. These companies, suppliers of many of the parts and components crucial to the industry as a whole, have mastered one of the three key building blocks of high performance: distinctive, difficult-to-replicate capabilities.

Five years ago, the industrial products industry was mired in a severe recession. No longer. Faster global economic growth and resurgent manufacturing activity are driving demand for durable and capital goods worldwide—good news for an industry whose business it is to provide the guts of the world’s manufacturing facilities.

The rosier economic picture notwithstanding, growth will remain a challenge for industrial products makers, which are still grappling with overcapacity. Like many other industries, theirs is feeling the pinch of soaring commodity and energy prices. Coupled with exchange rate uncertainties and the rising cost of benefits like health care and pensions, these pressures are steadily squeezing profit margins.

Pricing pressures that result from globalization loom especially large for industrial products makers. And although rapid infrastructure growth in emerging markets like China and India presents huge opportunities, it also raises new supply chain challenges about how best to balance cost, quality and customer service in unfamiliar environments.

The industrial products industry is large and fragmented. It is made up of four major segments—industrial/electrical, heavy equipment, consumer durables and construction—each of which has multiple subsegments. Consumer durables, for example, includes hand tools, major home appliances like refrigerators and office furnishings; heavy equipment producers manufacture agricultural, construction and mining equipment; and the construction segment encompasses not only building materials but also the engineering and construction companies that build houses and other buildings, as well as infrastructure like bridges and roads.

Identifying the high performers from among this sprawl is a daunting proposition, so Accenture decided to focus on one particular segment. We picked industrial/electrical because, in many respects, the rest of the industry depends on it. From the makers of the flow meters that monitor and measure the movement of fluids and gases to the suppliers of electric motors and the manufacturers of commercial air-conditioning and heating systems, industrial/electrical companies supply many of the parts and components that are crucial to the industry’s other segments.

Six companies in the segment emerged from our research as high-performance businesses. They are distinguished by their success in rising to the market’s challenges and consistently outperforming their peer group, defined for the purposes of our research as 34 companies (see “About the research,” page 11). What’s more, the gap between these high performers and the rest continues to widen. Our research methodology is described more fully elsewhere, but two key insights arising from it merit immediate comment.

First, when we looked at the share price performance of the industrial products industry’s conglomerates over three, five and seven years, it was clear they tend to underperform their smaller, more specialized competitors. Right now, we can only speculate about the reasons for the relatively poor performance of these

About the research

We started out by identifying the 100 or so top public companies in the industrial/electrical segment of industrial products makers. We then proceeded to screen these segments, picking only those with more than \$2 billion in annual revenues, more than half of which had to derive from the key product subsegments: power generation; automation; heating, ventilation and air-conditioning; general industrial products, which includes such items as flow meters, bearings and belts; and general electrical equipment, a subsegment that ranges from small motors to switches.

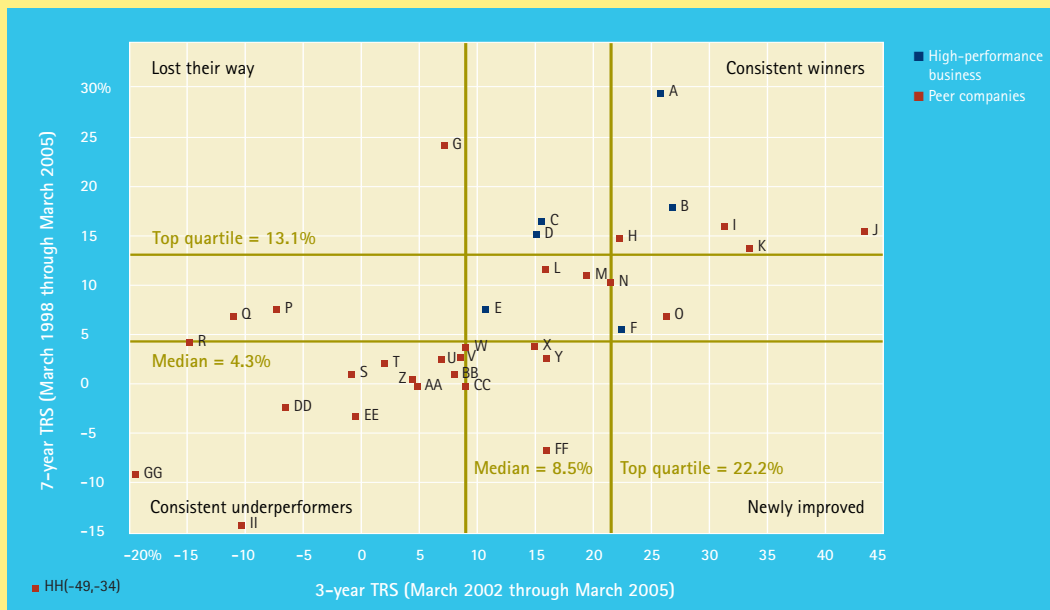
That left 34 companies, which we then evaluated according to Accenture's standard high-performance business criteria—three-, five- and seven-year compound annual growth rate of total return to shareholders—through March 2005.

Six companies consistently delivered above-average returns to shareholders over all these time periods. What's more, based on the three-year average, they achieved both growth and margins above the industry median.

When we looked at average TRS for these six companies over the five years between March 2000 and March 2005 and compared it with the peer group average for the same period, we found a steadily widening gap.

High-performing industrial products companies consistently deliver above-median returns to shareholders

7-year TRS (CAGR) versus 3-year TRS (CAGR)



SOURCE: COMPUSTAT; ACCENTURE ANALYSIS

behemoths. However, Accenture research has suggested that scale is seldom, if ever, the primary determinant of high performance (see “Is bigger always better?” *Outlook*, October 2004). Much more important is one of the three key building blocks of high performance: distinctive, difficult-to-replicate capabilities (see “Marks of distinction,” *Outlook*, June 2005).

It appears, moreover, that a company cannot excel at just one capability and be a high performer—a likely explanation for our second key insight: Although they were markedly more productive than their peers in terms of revenue per employee, Japanese industrial products vendors did not demonstrate all the other characteristics of high performance in this industry. Again, we can only speculate as to why these phenomenal producers failed to make the grade, but the fact that several came very close tends to support the hypothesis that high performance hinges on mastery of *all* the core capabilities—not just operational excellence—that we have identified as key to success in this industry (and which are discussed below).

The six high-performance businesses we identified have achieved superior results through a balance of operational excellence and growth, both organic and via acquisition, across multiple dimensions, from new products to new markets. We have identified four “pillars” that support this achievement and that consist, in turn, of multiple capabilities.

Global flexibility

High-performance businesses capitalize on regional cost differences and swiftly take advantage of growth opportunities in emerging markets. They do so with integrated, flexible and extended supply chains

that run all the way from the customer contact in sales and marketing right through to dealers and distributors; this superior supply chain capability is supported by common global processes and information systems.

For example, six years ago, New Jersey-based American Standard, which makes air-conditioning systems and services, bathroom and kitchen fixtures and fittings, and vehicle control systems, launched a material management program, in conjunction with a Six Sigma quality improvement initiative. The company leverages its collective buying power globally to improve purchasing efficiency and consolidate the number of suppliers with which it does business. It’s estimated that American Standard has saved more than \$300 million in materials costs since the program’s inception.

American Standard has also begun moving production and sourcing to low-cost countries, with a goal of shifting more than half of its European-bound production to Eastern Europe. Its fellow high performers are equally aggressive in their pursuit of low-cost-country sourcing.

For example, at Cooper Industries, which makes electrical products, tools and hardware, such programs accounted for 35 percent of the \$1.9 billion the company spent on materials in 2004, up from 19 percent in 2003. (For more on Cooper Industries, see the case study on page 14. For more on low-cost-country sourcing, see “The secrets of successful low-cost-country sourcing,” *Outlook*, June 2005.)

Pricing power

Understanding customer needs is a critical requirement for success in any industry, but the industrial

products makers have been relatively slow to recognize it. High performers are plainly exceptions.

They've employed rigorous marketing analytics to boost their product portfolio management, and thanks to their success in exploiting customer insight to boost innovation, they can provide the sophisticated service offerings and smart products their customers demand.

Finland's KONE Corporation, which makes elevators and escalators, has responded to customer requests for maintenance contracts that have a performance guarantee—a value-added service for which the company can charge a premium price (see case study, page 15). ITT Industry's Value-Based Product Development Initiative, a Six Sigma continuous improvement effort, ensures customer-driven product development at the defense electronics, fluid technology and electronic components company. The initiative brings customers together with both marketing reps and the company's engineers so that instead of developing "me-too" or "gee-whiz" products, ITT actually makes what its customers want.

Productivity plus

As one would expect, operational excellence is a hallmark of high performance in this industry. Six Sigma-type initiatives are symptomatic of well-defined cost-cutting programs designed to improve operational efficiency; outsourcing noncore professional services to lower fixed costs has also become a strategic option.

In addition, industrial products high performers have elevated the status of strategic procurement within their corporate cultures so that their role in boosting value-chain efficiency is enhanced. And they all exhibit

strong discipline when it comes to the financial and capital markets.

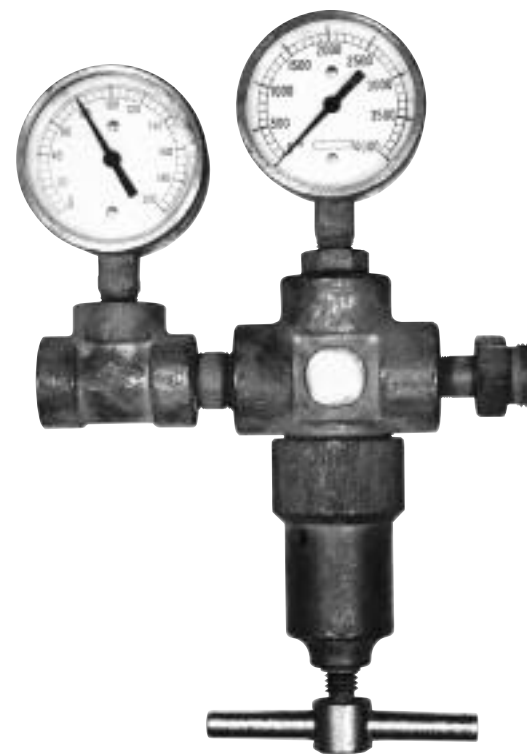
By combining balance sheet strength and good working capital management, these high performers have given themselves the financial flexibility to undertake all manner of capital markets activities, including strategic acquisitions. Sweden's Sandvik—which makes drills and cutting tools, stainless steel wire and welding products, and mining equipment—has a famously robust approach to identifying possible acquisitions: Any acquisition target must have the strong potential to enhance Sandvik's earnings per share within two years.

What's more, high performers excel at post-merger integration. Even before its 2002 acquisition of Gilbarco was complete, Washington, D.C.-based Danaher Corporation (see page 20), which designs, manufactures and markets consumer and industrial products in process and environmental controls as well as in tools and components, was introducing Gilbarco executives to its successful Danaher Business System. Within 60 days of the deal's close, the continuous improvement events that form the system's core were well under way.

People performance

High-performance businesses assiduously cultivate a continuous learning environment and are committed to the constant retraining of their workforces. High performers align their leadership and talent development with company values and business strategies that are reinforced by a rigorously managed measurement and rewards system.

Danaher's leadership development is particularly outstanding. The training is required at every level of the



Cooper Industries: Getting connected

Good customer relationship management is key to pricing power and thus to high performance in this sector (see story). Houston-based Cooper Industries, a maker of electrical products, tools and hardware, has excelled in this area.

In 2001, Cooper launched what it calls the Cooper Connection to improve distributor relationships in the electrical products segment, which accounts for 83 percent of the company's revenues. The program, which focuses on tying Cooper's independent distributor base directly into the company's sales efforts, consists of two parts.

First, Cooper developed cross-selling initiatives by leveraging the customer base common to all five of its electrical products businesses. Distributors are rewarded for adding to or expanding the Cooper lines they carry. Meanwhile, the company's sales force effectiveness program is intended 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 successfully driven synergies right across Cooper's sales channels, contributing significantly to supply chain efficiencies. But it's not the company's only productivity and growth initiative. Cooper has been a leader, too, in low-cost-country sourcing, moving more and more of its production facilities to Eastern Europe, Mexico and South America, as well as to China and other Asian countries.

Cooper's globalization program has two strategic goals: to increase revenues from developing markets, and to take advantage of low-cost production opportunities. On both counts, the company is making good progress. Non-US revenues reached 29 percent of the company total in 2004, up from 22 percent in 2000. Also in 2004, Cooper sourced \$350 million worth of materials from China; plans to open a new product development and sourcing center in Shanghai should help ensure that this figure increases significantly in the future.

company, and all executives are expected to complete executive leadership training, a seven-step process that typically takes two years to finish. By year-end 2004, more than 90 percent of Danaher executives had completed the program.

Danaher also has been a model of employee productivity, although the high performers as a group are not particularly outstanding in this respect. Indeed, as we noted above, despite the fact that Japanese industrial/electrical products producers consistently score high in this important measure, none of them makes the grade on other industry-specific measures of high performance.

We took a look at the Japanese productivity champion, Daikin Industries, to try to determine why this is so—and were immediately struck by just how good the Osaka-headquartered global leader in air-conditioning systems and

fluorochemicals is at making the most of what it has.

Daikin adheres scrupulously to a policy of optimizing the capacity of its existing facilities, whether plant, product portfolio or payroll. The company motivates its employees to improve their expertise through a *Meister* certification program, which effectively qualifies more experienced workers to train younger colleagues and thus, of course, contributes to payroll control. To be sure, Daikin has invested heavily in IT to facilitate employee training, and it continuously invests in R&D generally, a differentiation strategy that helps maintain its premium pricing structure. Yet most of the scientists in Daikin's upcoming 30 billion-yen, 1,500-strong R&D center will be drawn from within the company, rather than newly recruited, and a good part of the company's research is outsourced to leading universities.

KONE Corporation: Aiming high

Finland-based KONE Corporation specializes in transporting people and goods. It is the world's fourth-largest elevator and escalator maker and one of the biggest players in the expanding global market for automatic-door services.

The company has been in the forefront of the movement to outsource noncore business competencies among industrial equipment providers (see story), but it is as a provider of innovative service offerings that KONE really stands out.

KONE offers its elevator customers a maintenance contract with a performance guarantee (known as KONE Optimum) as well as elevator self-checks and remote automatic communication with its service centers (KoneXion). These initiatives allow the company to continuously monitor the condition of its customers' elevators, reducing elevator downtime and cutting out unnecessary maintenance visits while still ensuring that maintenance takes place before a problem occurs.

The programs have enabled KONE to boost the efficiency of its service staff by better prioritizing the work in hand. This

improves the routing of service calls, which can be bundled together, and makes those calls more efficient, since the company's technicians know just which tools and spare parts to bring to each job.

The data gathered through KONE's monitoring systems also provide important insights into the evolving needs of its customers, so the company can continuously update and improve its service concept and offer new, value-added services. KONE Optimum customers, for example, now also enjoy the benefits of technology upgrades scheduled over time, thanks to a modular modernization solution that renews working components of existing elevators without having to replace the entire machine.

By focusing on its core business, really getting to know its customers and investing in the technologies that ensure those customers get what they want, KONE has secured its place among the high-performance businesses in this sector.

What emerges is a strikingly lean organization, and although our wider research reveals leanness to be a necessary capability, it is not, by itself, enough to achieve high performance.

The six high performers in this industry are not only lean; they also pursue growth aggressively, continuously innovating to maintain product differentiation and making sure they sustain the supply chain flexibility to seize the initiative wherever an opportunity may arise. It is their mastery of all four of the pillars and component core capabilities underpinning high performance in this sector that explains their success.

About the author

Thomas H. Walsh is a senior manager in the Accenture Automotive and Industrial Products/Strategy group. With 10 years' experience working with major industrial products manufacturers, Mr. Walsh's areas of focus include supply chain strategy, sales and marketing,

service parts management and product development. Prior to joining Accenture, he worked at Ford Motor Company, where he held a variety of positions within product engineering, manufacturing, product planning and strategy, and marketing and sales. Mr. Walsh is based in Chicago.

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By the numbers On the rebound

The following charts offer a snapshot of the industrial products industry.

Industrial products market

Industrial products is a large market that is fragmented and diversified with four major industry segments and multiple subsegments.

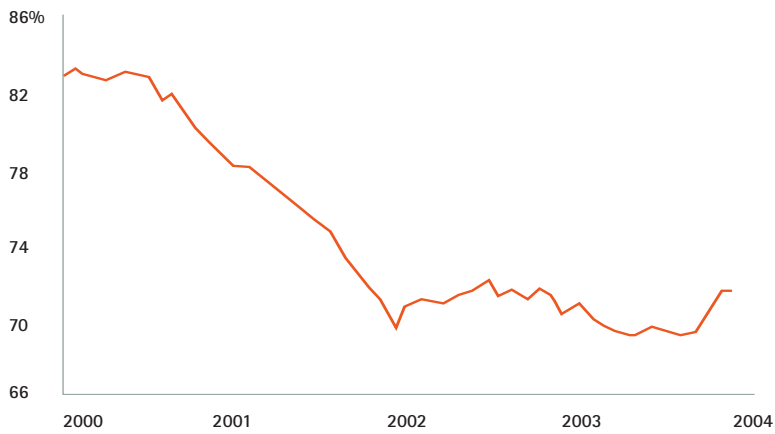
- North American market, \$630 billion/148 companies
- Global market, \$2,485 billion/515 companies

<p>Industrial/electrical</p> <ul style="list-style-type: none"> ■ \$350 billion 74 companies ■ \$975 billion 250 companies <ul style="list-style-type: none"> • General industrial equipment • Power generation • HVAC • Automation • General electrical equipment 	<p>Consumer durables</p> <ul style="list-style-type: none"> ■ \$70 billion 18 companies ■ \$300 billion 55 companies <ul style="list-style-type: none"> • Home appliances • Hand tools • Recreational equipment • Office furnishings
<p>Heavy equipment</p> <ul style="list-style-type: none"> ■ \$80 billion 18 companies ■ \$210 billion 40 companies <ul style="list-style-type: none"> • Construction machinery and equipment • Agricultural machinery and equipment • Mining machinery • Railroad equipment • Shipbuilding 	<p>Construction</p> <ul style="list-style-type: none"> ■ \$130 billion 38 companies ■ \$1,000 billion 170 companies <ul style="list-style-type: none"> • Civil works • Residential and non-residential building • Roads and highways • Industrial construction

SOURCE: ACCENTURE 2005

The industry in the United States faced economic challenges in the early part of the decade when the country was in recession. Capacity utilization fell from 82 percent in 2000 to less than 70 percent in 2003.

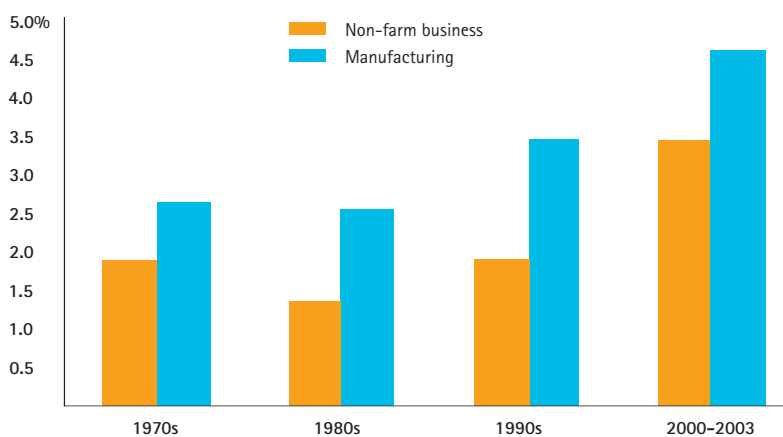
Capacity utilization (PII index)



SOURCE: HAVER ANALYTICS

At the same time, manufacturing productivity improved by nearly 5 percent in the period from 2000–2003, a much better improvement than in non-farm business.

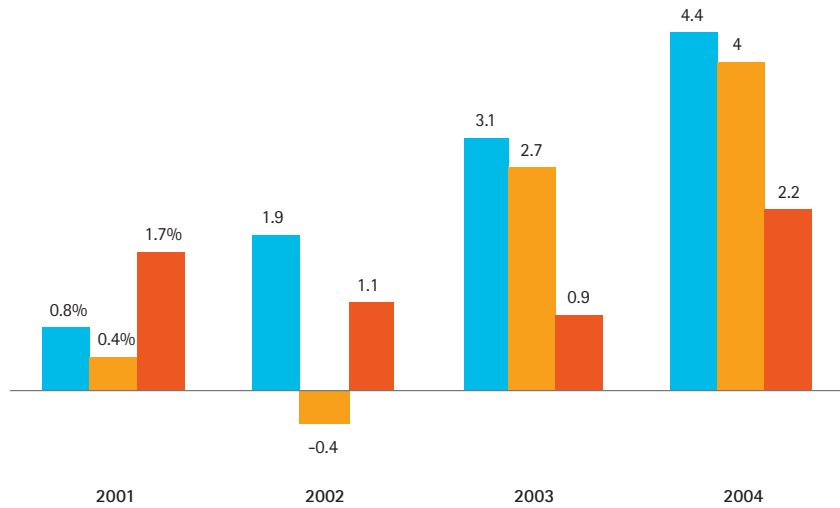
Manufacturing productivity



SOURCE: LABOR DEPARTMENT

However, with improving GDP growth in 2004 in the United States . . .

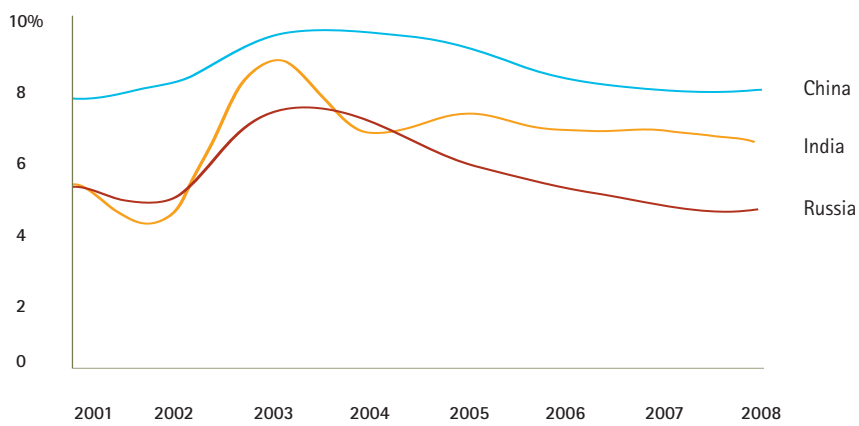
Economic growth indicators



SOURCE: ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, BASED ON 2000 PRICES AND 2000 EXCHANGE RATES

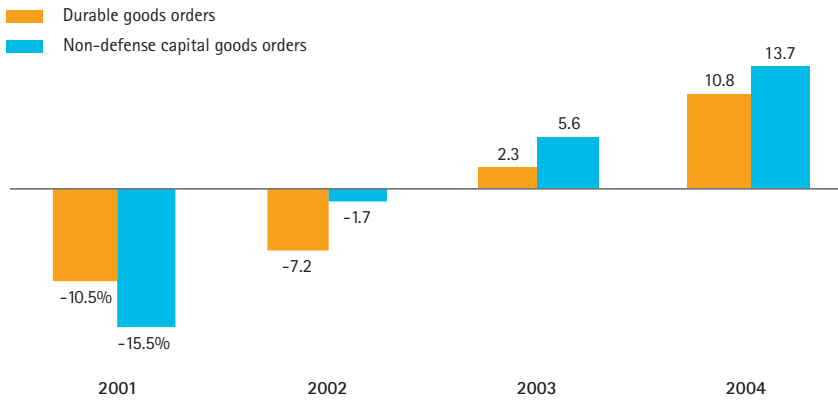
. . . and in emerging markets . . .

Emerging markets GDP real growth



SOURCE: ECONOMIST INTELLIGENCE UNIT—VIEWSWIRE, 2005

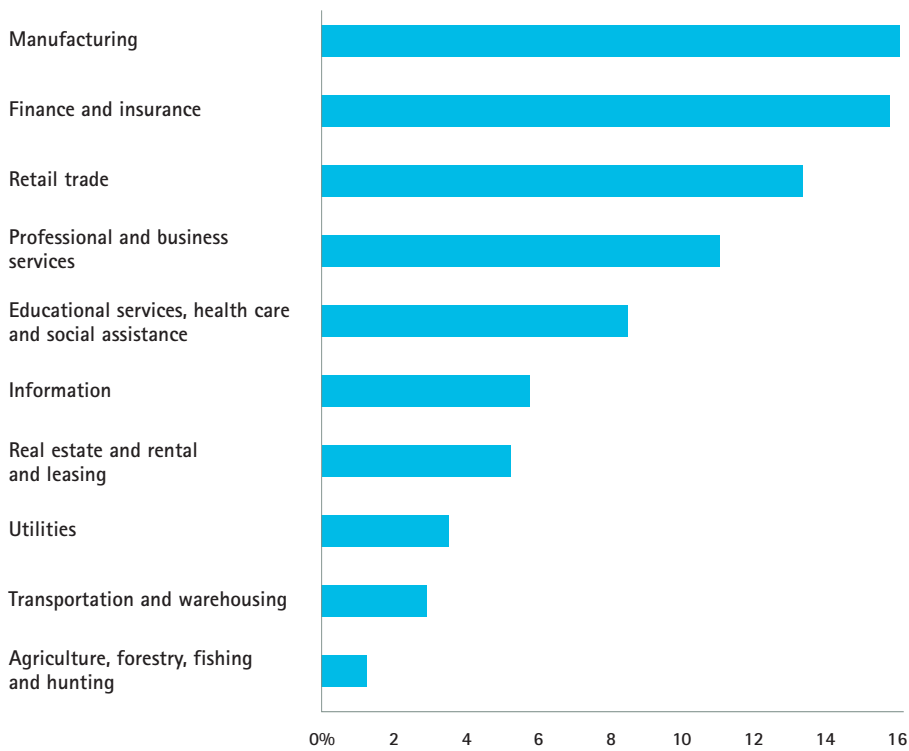
... demand for US durable and capital goods improved as well.



SOURCE: HAVER ANALYTICS

In fact, manufacturing contributed more growth to the US economy than any other sector in 2003–2004.

% change in output 2003–2004



SOURCE: U.S. DEPARTMENT OF COMMERCE