



A philosophical approach to high performance

Achieving strong growth and healthy margins as an industrial products maker is much more than a numbers game, says Danaher CEO Larry Culp, who has driven the Japanese concept of continuous improvement throughout the enterprise.

Danaher Corporation is one of the world's leading suppliers of innovative products, services and technologies in its field. From water treatment systems to the motors and controls that power packaging equipment and lift trucks, from blood gas analyzers for hospitals to the marking and tracking technologies used in product identification, the company's output mirrors the diversity of this vast and vital segment of the similarly sprawling industrial products sector. Danaher also meets Accenture's industry-specific criteria for a high-performance business in this sector (see "Engineers of growth," page 8).

Danaher's name derives from *dana*, the Celtic word for "swift-flowing," and it is indeed one of the fastest-growing companies in the industry, with revenues increasing at a compound annual rate of 18.5 percent for the past decade. The strong top-line growth has not been achieved at the expense of margin; indeed, the operating margin at this \$8 billion company has almost doubled since the early 1990s.

Danaher is organized into six strategic "platforms"—electronic test, motion, environmental, product identification, medical technologies and mechanics' hand tools—designed to support long-term growth. Seven complementary niche businesses—among them, Jacobs Vehicle Systems; Delta Consolidated Industries, which makes tool-storage equipment for trucks; and Hennessy Industries, the largest full-line wheel service equipment maker in

North America—help strengthen cash flow.

The product identification and medical technologies platforms, as well as numerous "bolt-on" acquisitions, have been added since 42-year-old H. Lawrence "Larry" Culp Jr. became Danaher CEO and president in 2001. And under his leadership, the Washington, D.C.-based-products maker has evolved into a global powerhouse: Almost half of its fiscal 2004

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Larry Culp

CEO, Danaher Corporation

Born:

1963 in Washington, D.C.

Education:

B.A. from Washington College, Chestertown, Maryland, 1985

MBA from Harvard Business School, 1990

Professional highlights:

Joined Danaher in 1990 at Veeder-Root, a Danaher subsidiary

President of Veeder-Root in April 1993

Danaher group executive and corporate officer in 1995

Executive vice president in 1999

Chief operating officer in July 2000

President and CEO in May 2001

revenues were generated outside the United States.

According to Culp, much of the credit for this stellar performance goes to the Danaher Business System, which is based on the Japanese philosophy of *kaizen*, or continuous improvement. The DBS was originally an attempt to imitate the enormously successful Toyota Production System, a so-called lean manufacturing initiative. But the DBS has evolved into something far more comprehensive, a process encompassing not just production but also strategic planning, employee training, customer service and product development—in short, the entire business.

The Danaher Business System operates on two, interrelated levels. At the level of daily management, so-called *kaizen* events or initiatives make pragmatic use of a diverse range of tools—including Six Sigma and value-stream mapping techniques—to eliminate excess inventory, waiting time, overproduction or quality defects. The initiatives, which run continuously, analyze business processes step-by-step to identify sources of waste and develop a standardized working system that will avoid them precisely because it's repeatable.

It's the second level of the system, though, that really differentiates the DBS. *Hoshin kanri*, or policy deployment, sets aggressive breakthrough targets across the company, usually limited to a few each year and typically related to a product line or geographic expansion—into China, for example. These are set at the senior management level and then deployed through the corporate hierarchy so that each associate knows exactly what he or she has to do to achieve the breakthrough. "Tracking boards" at the end of each production unit in every Danaher facility

reflect, in detail, the progress made toward the breakthrough, often by shift. Coupled with the rigorous DBS training that all Danaher employees undergo, the system helps explain the company's outstanding productivity—something most of its peers still struggle to sustain.

The DBS, maintains Culp, is "the most valuable asset we have, even though it doesn't appear on the balance sheet." In an interview with *Outlook* Industry Editor Wendy Cooper, he explained why.

Outlook: What makes the Danaher Business System different from similar productivity initiatives?

Culp: Two things. First, it really does define our culture and who we are, as much as it defines how we do what we do—our day-to-day approach to the business. Having a systematic approach to both the soft side and the hard side of the business, an approach where one feeds off the other, has been fundamental to our success.

Second, DBS is lived from the top of the organization. Our leadership team grew up with this system. It's been rooted in our core values. It's an approach that originated in our manufacturing operations but which now impacts every functional discipline in the business. It's part of an integrated, long-term approach to running the business.

Can you give me some examples?

Leaders at Danaher don't get full credit for their performance if it has not been delivered in a way that's consistent with DBS. If you have achieved the numbers as a leader but without the core values, without really making sure that you have an outstanding team in your business, if you are not customer-focused, we will say, "Hey, great numbers, but we're concerned that they are not sustainable."

If someone has grown up simply delivering the numbers but not doing it in a way consistent with our values and our approach, then that's probably someone who is better off being a leader somewhere else.

By the same token, if someone is working very hard to live our core values, doing their utmost to use the DBS tools to drive results, but some of the results perhaps aren't as they should be, we have time for that person. Because they are culturally aligned, we will work with them to make them successful. We have helped a lot of people through their cultural transition into Danaher, and they have become exceptional leaders for us on all dimensions.

How relevant is the DBS to other industries?

It's highly relevant in almost any industry—and across functions. The whole idea of lean production is as applicable in the back-office operation and accounts receivable or in other financial operations as it is on the manufacturing floor. You could take some of these practices into financial services or into health care and have similar impact.

The key is not necessarily the application of any one tool at a particular point in time but the sustained application of these tools, cemented into the culture, over a long period of time.

How has the DBS evolved since you've been CEO?

Over the last four or five years, we've been trying to take the same disciplined approach from manufacturing into the functions, particularly with an eye to innovation, in order to drive accelerated organic growth. It wasn't as if we weren't doing that already, but I think we have been more rigorous and more disciplined in developing best practices, benchmarks and

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the like to make sure that our marketers or salespeople, our research scientists and engineers understand what DBS means in their functions.

How important is customer insight to the innovation process, and how do you go about developing it?

At the end of the day, DBS is not about us, it's about our relationship with our customers. One of our core values is "customers talk, we listen." The voice of the customer is the starting point for the DBS.

How do you implement it—since execution is where any number of great ideas fall short?

We employ a number of methodologies—some very precise and analytical, others broader and more exploratory in nature—that help us go out and solicit inputs from customers so that we can characterize and segment markets—all the way down to making sure we have features that will really excite particular customers in and around a specific market. We also have a tool, which we call "ideation," which is more creative, more open-ended and geared toward hearing what customers don't say, anticipating what they are going to need.

Can you explain how ideation works?

We actually spend time going out and observing what an electrical engineer really does in the course of the day or while working on some particular job. It allows us to see things that the engineer himself often doesn't articulate.

Not every idea that comes out of that process is practical or gets funded, but

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when we begin to formalize our product plans, we do try to ensure we have the richest possible set of insights.

And those insights help you manage your product portfolio?

That's exactly right. Once the product is conceived, it can be shaped by other influences during the course of the development cycle, but rapid execution is crucial. We are not vain enough to think that if we have an idea, we are the only ones in the world with it. It often becomes a race to get that product launched and to market in an aggressive and creative way.

Many of the fundamentals of rapid cycle time from manufacturing apply within the engineering groups. Take our Radiometer business in Denmark, a clinical care diagnostics company. They have been very active users of Accelerated Product Development, a DBS tool, and have seen very sharp reductions in the order of 25 to 30 percent in their product development cycle time as a result.

How important is pricing?

We probably will see almost a full point of our growth this year come from price. And even though we do experience price pressure from certain commodities, I think when we tally up the figures at year's end, we will have a positive purchasing variance, which means we will have reduced cost more than we have been impacted by cost increases.

How have you managed it?

It's largely due to our low-cost regional sourcing and production

initiatives. We are trying to globalize our approach to both procurement and production with a long-term stretch goal of having 40 percent of our procurement volume and 40 percent of our manufacturing located in low-cost regions.

We have been making excellent progress. In China today, we have approximately a \$400 million business, growing at 20 percent, and 13 manufacturing facilities. The business there serves each of our six strategic platforms, both in terms of in-country production for export and local distribution.

When we bring a new business into Danaher, it may not have tremendous experience in China. But we have been able to leverage the existing Danaher infrastructure for these new companies' benefit.

What about other low-cost countries, like India?

The most significant progress we have made in India to date is with our global product development initiative, where we are trying to take full advantage of the outstanding new product development resources that are available there. We have about 250 Indian engineers working on new products right now for the global market.

You go to India, I think, in part because of the productivity gain; you stay because of the quality and the rapid cycle time that those resources contribute to your new product development processes.

We're also manufacturing and sourcing in Eastern Europe, ultimately, as in India and China, for a global market.

What role do services play in your growth strategy?

Obviously, for us to grow our busi-

ness we need to help our customers solve problems and seize opportunities in their own businesses. We ship a physical product to them, but that really is often just the first part of the conversation. The challenge for us is to find opportunities to add value to the physical product.

Take our Gilbarco Veeder-Root business, for example, which supplies environmental control systems for the retail petroleum market. We own and operate that equipment for a number of our customers.

Even in a business that you might think doesn't offer service opportunities, like our Matco mobile distribution hand tool business, which focuses, typically, on the professional automobile mechanic, our network of distributors also provide delivery and financing around the physical product. There are lots of different opportunities for us as we move forward. And what really excites us is that this is an area where we think we have yet to fully evaluate all possibilities.

You've been averaging 10 acquisitions a year for the past decade—suggesting overdependence on inorganic growth, according to some analysts. What percentage of your future growth will come from acquisitions?

To define Danaher as an acquisition machine, as many do, is to really miss the point of what this organization is about. If [the] government were to outlaw acquisitions tomorrow, we would still be exceptionally excited about our future, because our organic growth potential is in the 5 to 7 percent range. We have leadership positions in terrific industries, and our portfolio of companies is as good if not better than any other portfolio out there. What we have been able to do, at a fairly aggressive pace over a very long period of time,

is to actively pursue acquisitions that complement what we do organically.

We brought on 12 new companies, about \$1.2 billion of revenue, over the last year, and that's something we feel very good about because the prices paid will allow us to create value for the Danaher shareholder. There is still value to be had in this M&A environment, but I never want us to do the wrong deal—to see through the right acquisition at the wrong price or the wrong acquisition at the right price—simply in order to make a sales target.

So how do you ensure you're doing the right deal?

Our discipline as an acquirer is the real reason we have been as successful as we have with our acquisitions and why our investors continue to support an acquisition strategy as a complement to what we do organically.

We look first at strategic fit, then at our organizational ability to tackle the transaction, and finally at the financial considerations. Any transaction you have seen us complete has successfully overcome all three of those hurdles.

When the pricing dynamic is judged to be detrimental to the Danaher shareholder, we are quite comfortable walking away. We have also walked away from transactions where we thought the integration task or the cultural transformation involved would be too great.

You've been exceptionally good at post-merger integration. How big a role does the DBS play in the process?

We need to make sure we add value when we buy a company. So when we look strategically at a business, we try to determine if the DBS is applicable and if we will be able to

create value from the target company. Then, at the organizational level, we try to see if we have the ability to put the requisite talent into the business to seize that value.

There have been some transactions where we saw a wonderful company but one that, frankly, required a fair bit of talent from Danaher; other companies have required little more than a couple of DBS training sessions and some ongoing support from one of our senior leaders. But typically, we find all this out during the course of due diligence. All the work takes place before we do the deal.

We will spend a lot of time early on, sometimes even before we own the company, providing DBS training and education so that the senior leadership team and the mid-management ranks understand what this is all about. It makes the post-merger work much easier.

Is there anything in particular that keeps you awake at night?

There are lots of questions out there at the macroeconomic level, but in terms of the end market for our major businesses and our geographic diversity, I love the cards that we are holding.

Probably the No. 1 issue for me—and this hasn't changed in my years as CEO—is the organizational side of the business. Our success has created a lot of interest in the DBS. Many people would like to replicate it, and the best way they think to do that is by hiring our talents, so we have become a real recruiting target of late.

That's perhaps a compliment—but it also creates a challenge for us to retain the tremendous talent that we have onboard today. By the way, the key to DBS is culture. And you can't copy culture.