accenture
High performance. Delivered.

This article originally appeared
in the January 2007 issue of
Outlook
The journal of
high-performance business

No excuses

Five reasons every company should strive to achieve high performance

By Tim Breene and Paul F. Nunes

The list of reasons why companies and executives shy away from pursuing high performance is long. Accenture's extensive research into the characteristics of high performers, however, has revealed a number of powerful and counterintuitive arguments for going for it anyway.

Is high performance worth the effort? In the world of sports, it certainly is. Few Boston Red Sox fans will ever forget, for example, how the team won the American League pennant in 2004. After losing three straight games—and nearly the fourth—the team rallied to win four games in a row to take the best-of-seven League Championship Series, then went on to win the World Series for the first time since 1918.

The lesson about high performance: No matter how bad circumstances get, true high performers never quit striving to be the best.

In laying out the principles of strategy more than two decades ago, management guru Michael Porter made it clear that a company's success depends in part on the structure of the industry it competes in—that is, the circumstances it finds itself in. But Porter also argued that companies were more than passive pawns buffeted by market forces: They could, he insisted, use strategy to actively shape their industry's structure. According to this thinking, a company's future success, like that of any sports team, is largely its own to create.

Challenging path

Consistent with Porter's confidence, Accenture research has uncovered significant grounds for hope for companies that may seem constrained from reaching high performance by the troubled nature of their industries.

Based on our continuing research (a rigorous program now entering its fourth year) into the nature of high-performance business—including a detailed analysis of the similarities and differences among the more than 70 companies we determined to be high-performance businesses, as well as their competitors—we have identified five reasons why all companies should feel confident that they can achieve high performance—that is, if they are willing to go down the challenging path that leads to it.

1. High performance is less dependent on industry factors and current industry position than conventional wisdom would suggest.

Some industries seem forever cursed by too many competitors and not enough opportunities for companies to differentiate themselves. Yet our research indicates that over the long term, industry conditions, no matter how challenging, should not be an insurmountable barrier to high performance.

For example, we found that high-performance businesses exist in all but a tiny percentage of industries, even in those some would term unattractive (characterized generally by low growth and anemic shareholder returns). In 28 of the 31 industries we studied, we found at least one company that dramatically out-performed its peer set—our definition of a high-performance business.

Nor was this out-performance merely relative—that is, the high performers in unattractive industries were not merely the best of a bad lot. Nearly every high performer, including those in industries considered to be unattractive, beat the S&P 500 from 1998 to 2004—an admittedly low hurdle given that index's 4 percent compound annual growth rate (CAGR) over the same period. But, in general, the high-performance businesses had results that were significantly better than that.

The high-performance businesses' three-, five- and seven-year total return to shareholders (TRS) CAGRs were, on average, nearly three times as high as the average of the sample as a whole. And nearly a third of the companies had seven-year TRS CAGRs higher than 20 percent—more than five times the return of the S&P 500. This is an astounding level of out-performance considering the effect of compound growth.

To be sure, industry factors do exert at least a temporary influence on the total profit a company can achieve. But they do not permanently prevent companies from being extremely profitable, nor do they keep them from significantly outperforming industry competitors.

Take, for example, the automotive industry. Many of its largest players were unable to change their relatively poor performance during the years that make up the focus of our study. Yet Nissan, an incumbent company that as late as 1999 was on the brink of collapse, was able to turn in an overall record of high performance between 1998 and 2004. Despite considerable industry-analyst doubt concerning the future of the company, and major stakeholder Renault's then-recent recovery from deep financial

troubles, Nissan overcame difficult industry conditions. It did so by embracing new leadership and a new strategic direction that called for massive cost cuts and differentiating its vehicle lineup with unique designs.

Similarly, standouts have appeared in the low-growth rail industry. One North American company in particular pursued a two-part plan to achieve market-leading growth and profitability. It began by reducing operating costs dramatically and then engaged in several highly targeted takeovers. As a result, the company was able to outpace its more established peers, developing into a high-performance business while becoming one of the world's largest railways.

In addition to there being broad opportunity for high performance, there is also a surprising amount of room at the top. Jack Welch was famous for demanding that General Electric's businesses be No. 1 or No. 2 in their industries. But that requirement appears to be too stringent. We found that while roughly two-thirds of the industries we studied (21 of 31) have at least two high-performance businesses, more than a third (11 of 31) have at least three such businesses, and two industries have an astonishing six apiece. Consider, for example, the competitor set in which Wal-Mart and Target compete, where these companies share the high-performance stage with Tesco, Costco and Loblaw.

It is also interesting to note that although some companies gain a temporary advantage by virtue of their primary national location (through factors related to government regulations, for example), high performance (or its absence) cannot be attributed to accidents of geography. Many high performers are multinational corporations without a true geographic center, while others, nominally headquartered in one country, have significant presences in many locations around the globe.

2. Industry-leading scale is not a requirement for high performance.

In a previous *Outlook* article, we debunked the myth that scale bestows competitive advantage in today's marketplace (see "Is bigger always better?" *Outlook*, October 2004). Although it may have been an advantage during the Industrial Revolution, scale is less important today for several reasons. For one, massive size brings its own "diseconomies" in the form of intractable complexity. For another, giant scale increases a company's vulnerability to disruption from new competitors that are exploiting new technologies, especially if the incumbent's assets are largely fixed.

Reinforcing previous findings, our recent cross-industry study of high-performance businesses found no correlation between size (which we measured as each company's percentage of the industry leader's revenue) and business performance. High-performance business Target, for example, was in the middle of the pack among its competitor set, seventh out of 16 competitors in revenues, both at the beginning and end of our seven-year evaluation period. But while size alone doesn't determine high performance, the biggest businesses can reach that level too. Wal-Mart, also a high performer, was the absolute leader in revenues in the industry during the same period.

In the personal care industry, Avon Products, another high-performance

business, ranked only seventh in revenues at the end of 2004, up slightly from being the eighth-largest company in its industry in 1997. In the food industry, high performer PepsiCo ranked just fourth in revenues among its peers in both 1997 and 2004.

In 2004, high-performance businesses ranked roughly in the middle of their peer sets, on average, in revenue terms. An examination of the standard deviation of their revenue ranking, however, reveals that high performers were broadly distributed.

The lesson is that companies should not be obsessed with becoming the biggest in their industry. While industry-leading bulk sometimes translates to a truly dominant position, such scale is not a determinant of high performance.

3. Sustained out-performance in both growth and profitability is a competitive reality today, and is a hallmark of high performance.

In the past, a traditional responsibility of senior leadership, particularly for chief strategists, was determining when a company should go for growth and when it should capture profits. The notion of "milking the cash cow" illustrates how business thinking has, for the longest time, held profit taking and expansion as strategic opposites, a viewpoint that is not entirely unfounded. After all, pursuing growth can be expensive, and use of the requisite resources puts pressure on profitability. Conversely, highly profitable companies with a relatively small base of devoted customers can find it hard to maintain profit levels when they scale to capture a less committed mass market.

Being bound by these assumptions, however, can produce self-limiting results. After all, investors shun high-growth companies with disappointing profits as surely as they turn away from profitable but shrinking ones. A 1998 Corporate Strategy Board study offers compelling evidence that companies failing to maintain strong revenue growth eventually stall out and rarely recover. And those that expand too quickly, beyond real demand, are likely to eventually face a painful contraction.

The good news is that companies need not accept this trade-off. Accenture research has found that high-performance businesses consistently outperform their peers in both growth and "spread" (a standard measure of profit, defined as the difference between the company's return on capital and its cost of borrowing that capital). Our evidence highlights that this ability to do both is a predominant feature of high performers.

A prime example of such a performer is Wrigley, the once-staid chewing-gum company. Under Bill Wrigley Jr., who took over as president and CEO in 1999, the company executed a strategy that allowed it to reap both growth and profits. Through acquisitions and overseas expansion, Wrigley broadened the company's product range. For example, it acquired several confectionary units from Kraft Foods, including the growing and profitable Altoids brand.

This strategic maneuvering enabled Wrigley to expand beyond its traditional sweet spot into faster-growing, higher-margin segments of the market. It also increased the company's revenue by a seven-year compound annual rate of nearly

11 percent (more than double the growth rate of the industry's two other high-performance businesses combined) while protecting its strong contribution margin.

Another high-performance business that has refused to accept the growth-versus-profits trade-off is Best Buy. While continuing to grow, the company has developed store formats based on its analytical assessments of profitable customer segments. For example, a "Barry" store is targeted to young men who want the latest audio and video equipment and contains a home theater store-within-a-store, while "Jill" stores are oriented to practical, short-on-time mothers. While some stores are based on a single format targeted at a single customer segment, other stores house up to all five of the formats the company has developed to date. This sophisticated approach helps the company maintain profitability while avoiding the trap of undifferentiated growth.

Clearly, companies that recognize that growth and profitability are not only attainable strategic allies but also a characteristic of high performance have an advantage over competitors. (For a related article, see "A winning playbook forprofitable growth," *Outlook*, January 2007.)

About Accenture's High Performance Business research

Accenture's High Performance Business initiative is unparalleled in scope—a multi-million-dollar global research program spanning thousands of companies across the globe. We have conducted in-depth analysis on more than 700 of these companies (60 percent from outside the United States), representing 31 industry-based competitor sets. In total, these companies represent more than 80 percent of the combined market value of their respective industries. To assess the companies, we used Accenture's patent pending method of performance evaluation. We assessed the five core areas of business performance by analyzing 13 specific financial metrics from publicly available sources, evaluating each for statistically significant out-performance of peers. The core areas are:

- Growth, as measured by revenue expansion.
- Profitability, as measured by the spread between the return on capital and the cost of capital.
- Positioning for the future, as measured by the portion of share price that cannot be explained by current earnings (what we call future value) and by the portion of the industry total each company's future value represents.
- Longevity, as measured by the duration of out-performance in total return to shareholders, a performance area important to our requirement of sustained value creation over time.
- Consistency, as measured by the percentage of time out-performance has been achieved, defined for this purpose as exceeding the peer set median, in profitability, growth and positioning for the future.

This approach led to the identification of more than 70 high-performance businesses, the analysis of which forms the basis of this article.

4. The benefits of pursuing high performance can accrue well before actual operating measures improve.

Given how the market tends to punish companies for missing their earnings projections, it is easy to think that a company's share price cannot improve until its financial results do.

Yet our research confirms that high performance is not just about delivering for investors today. Wall Street, our analysis shows, amply rewards companies that demonstrate not only day-to-day operational excellence but also the development of strong capabilities and the creation of a powerful long-term strategic vision.

To these companies, the Street grants what Accenture calls "future value," which we define as the portion of a company's market value that remains after subtracting the value of its current business operations in perpetuity.

Over the course of the seven-year period we studied, high-performance businesses far exceeded their peers in demonstrating to Wall Street that they deserve a high proportion of future value in their overall market values. High-performance businesses have, on average, nearly twice the median amount of future value in their industries, resulting in a 20 percent to 50 percent premium being placed on their overall enterprise values due to the Street's confidence in their ability to deliver growth in the long term.

High performers avoid a myopic fixation on measures of current success. Like 3M, which at one time required that 30 percent of revenues come from products that had been introduced within the previous four years, high-performance businesses stimulate a culture of innovation that keeps them from falling behind the competition. (For more on future value, see "Do investors have an accurate picture of your company's value?" *Outlook*, September 2006.)

The lesson is that companies can move more quickly down the path to high performance than they might imagine by doing what high performers do: creating the three building blocks of high performance. High performers actively manage and grow the future-value component of their market value by identifying and communicating to investors the right market focus and position for their company, by creating distinctive and world-class capabilities that make future success possible and by creating a high-performance anatomy that guarantees their ability to execute superbly over the long haul.

5. Even above-average performers have a lot to gain from becoming high-performance businesses.

The great is the enemy of the good, runs a common aphorism—which is another way of saying that it may not always be wise to try too hard to be the best when there are diminishing returns. In fact, there are times when simply being good might actually be very, very good, and certainly good enough. But this is not the case in business performance.

Companies should never stop striving to be the best. Our analysis shows that the gap in revenue growth and spread between high performers and mere above-average performers is every bit as large as the gap between above-average and average performers, for example, and the gap between average and underperforming companies. High performers average over five more percentage points of cumulative

growth each year than the above-average performers in their industries, and a full point of additional average spread each year.

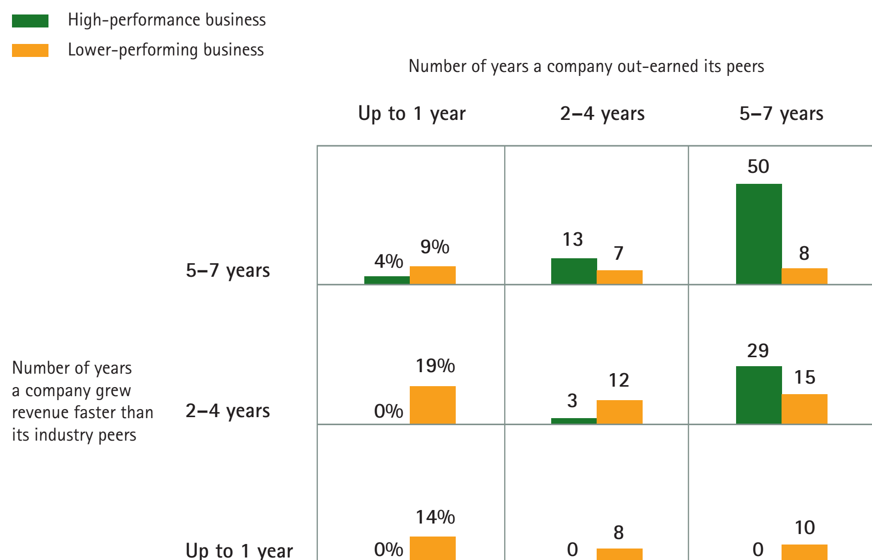
The constant, near-linear improvement in business results that propels companies into the high-performance category underscores why it is important that companies never quit trying to improve their performance. This is especially true for longtime players that may be beginning to doubt their ability to remain great, or to become great again. Our research found that neither relatively new entrants nor well-established incumbents have an edge when it comes to achieving high performance.

It identified several industries that have at least one high-performance incumbent and one high-performance new entrant. In the hypermarkets industry, for example, both Loblaw (founded in 1919) and Costco (founded in 1983) are high-performance businesses. In the airlines industry, Thai Airways (founded in 1960) and Ryanair (founded in 1985) are both high performers, as are Sanofi-Aventis (with origins dating back to 1834) and Amgen (founded in 1980) in pharmaceuticals. The moral: Moving to high performance from even an above-average rank pays off handsomely and is a worthy, achievable goal for any company.

High-performance businesses deliver both industry-leading growth and profitability

Half of high-performance businesses consistently grew both revenue and profits faster than their industry competitors for at least five years from 1998 to 2004. Almost the entire set of high-performance businesses outperformed their competitors on both measures for at least two years.

Percentage of companies that both outgrew and out-earned their industries, by the number of years of out-performance, 1998–2004.



Source: Accenture analysis

Companies can cite many reasons for giving up on high performance. Perhaps the industry structure has a crumbling foundation, or there's the equivalent of a "neighborhood bully" in the industry. And then there's the belief that being good is good enough.

The problem with these reasons, and others, is that they don't stand up to scrutiny in light of Accenture's empirical research. Companies can achieve high performance even in unattractive industries. They can do so even when the markets demand both growth and profits, when a dominant player seems to enjoy unfair advantages and when long-term bets are years away from paying off. For true high performers, then, "wait 'til next year" is never an option—and difficult circumstances are just one more opportunity for achieving something great.

About the authors

Tim Breene is Accenture's chief strategy and corporate development officer. Since joining the company in 1995, Mr. Breene has held a number of senior positions, including group chief executive of Accenture Business Consulting, managing partner of Accenture Strategic Services and managing partner of the company's global service lines. Mr. Breene, who is based in Wellesley, Massachusetts, is a member of the Accenture Executive Leadership Team.

tim.breene@accenture.com

Paul F. Nunes is an executive research fellow at the Accenture Institute for High Performance Business in Wellesley, Massachusetts, where he directs studies of business and marketing strategy. In addition, he is the *Outlook* senior contributing editor. His work has regularly appeared in *Harvard Business Review* and other publications. His most recent book is *Mass Affluence: Seven New Rules of Marketing to Today's Consumers* (Harvard Business School Press, 2004).

paul.f.nunes@accenture.com

Eric M. Lowitt, a senior specialist in growth and strategy at the Accenture Institute for High Performance Business in Wellesley, Massachusetts, and **Craig M. Savarese**, a Chicago-based senior manager in Accenture Strategy, also contributed to this article.

Outlook is published by Accenture.
© 2007 Accenture.
All rights reserved.

The views and opinions in this article should not be viewed as professional advice with respect to your business.

Accenture, its logo, and High Performance Delivered are trademarks of Accenture.

The use herein of trademarks that may be owned by others is not an assertion of ownership of such trademarks by Accenture nor intended to imply an association between Accenture and the lawful owners of such trademarks.

For more information about Accenture, please visit www.accenture.com

• Consulting • Technology • Outsourcing

accenture