DENTON/NEELY & CO., LLC
Management Consultants

The Top-line Growth Imperative

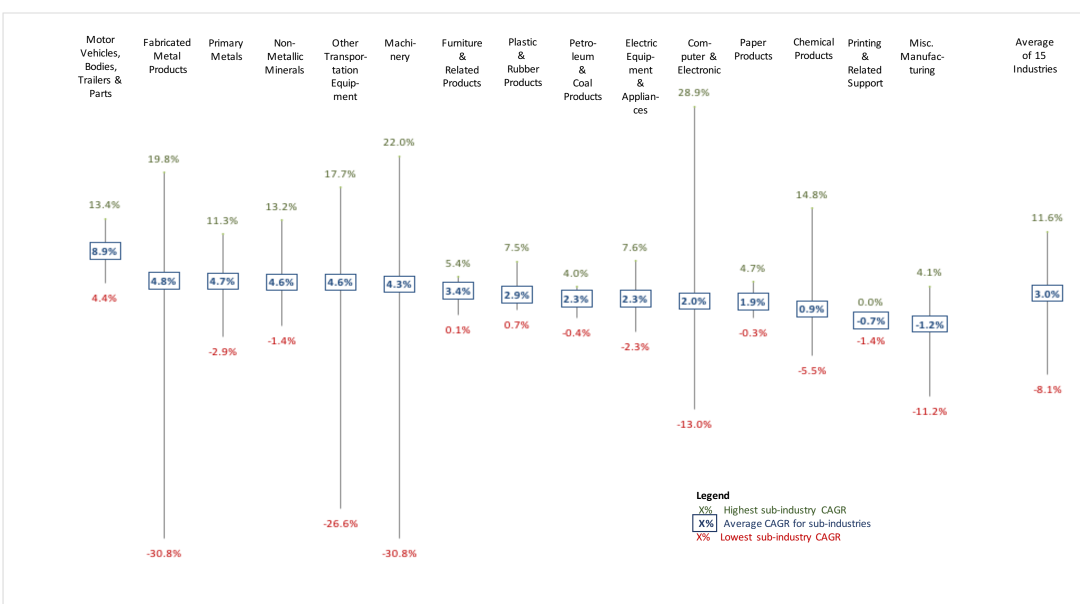
The current environment of slow economic growth amidst favorable commodity, labor and financing costs creates a challenge for company managements. Conditions could shift to even slower growth with higher costs, pressuring cash flow and profit. While the default response is often cost containment, we argue that increased attention needs to be given to market and customer segmentation to reveal strategic pathways to organic growth.

The US economy has been in a slow growth mode for several years, and it is unlikely to experience meaningful acceleration before the next recession. Meanwhile, stock market indexes and private equity EBITDA multiples suggest that businesses (generally) are achieving valuations based on favorable labor, commodity and debt financing costs. Because the next leg for these cost drivers is likely to be higher, companies will be under increasing pressure to generate top-line growth.

A fourth quarter 2015 survey of leaders in middle market companies points to decelerating rates of current and anticipated business expansion. This may come as no surprise, given weak growth in the overall economy. The macro environment, however, offers an incomplete explanation for how individual companies perform in this regard. Strategic choices about markets and the array of offerings to customers can be more important.

Consider the following. While the years 2010 – 2014 produced only modest to moderate economic growth, the average compound annual growth rate (CAGR) of output for 15 industries in the Manufacturing sector was 3%. Yet one-fifth of them did not keep pace with GDP growth of 1.9% (CAGR) during the period. Moreover, output in 25% of 197 sub-industries was either flat or contracting, and while nearly half (43%) lagged GDP growth, several outpaced GDP by a significant margin (Figure 1).

Figure 1. Growth trends in 15 selected manufacturing industries and sub-industries 2010 - 2014
Quantity output, compound annual annual rates (%)

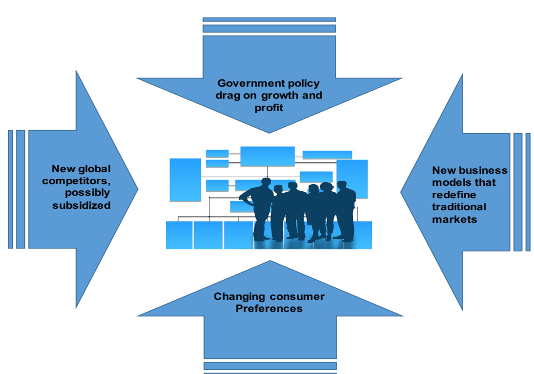


Sharply divergent outcomes at the industry and sub-industry levels suggests that companies growing in step with the broad economy may nevertheless be underperforming, and their portfolio of offerings could be mismatched to what markets will demand in the future. We think similar variation exists across sectors of the economy and that marketplace developments can accelerate rapidly, catching executives off guard in otherwise stable situations.

Companies need a clear understanding about what is driving their market sectors and customer segments in order to maximize strategic advantage and growth potential. Paper Products (shown in Exhibit 1) is an illustrative case. Overall, this industry has grown in step with GDP while its sub-sectors have been impacted positively or negatively by changes in other industries. Demand for Printing Papers has declined as consumers have shifted to reading on electronic devices. In contrast, demand for Corrugated Cartons has expanded with significant growth in online retailing. Neither development was obvious to producers of these goods several years ago. Companies need to stay light on their feet, working to improve not only their cost efficiency but also customer relevance.

Some spectacular successes have emerged in recent years, particularly among young enterprises that have used technology to disrupt traditional industries. Amazon's effect on retailing and Uber's impact on transportation are two examples. Systematic appraisals of markets and customer segments can provide companies with insights for early responses to challenges posed by fast scaling disruptors, new global competitors, regulatory policies, and migrating consumer preferences.

Figure 2. Disruptors to Company Strategies Requiring Early Detection



We advocate that companies redouble their efforts to deliver top-line growth, matching the attention given to cost productivity. Carrying out an effective market segmentation exercise can be a key first step to this end, providing executives with strategic insight into how to expand both the range and quality of their participation in markets. Generating profitable growth through the economic cycle demonstrates relevance to customers, with organic growth offering the strongest measure of a firm's capabilities for sensing and satisfying emerging opportunities.

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