

Competing for growth

Winning in the new economy







Ernst & Young has been working closely with businesses across the globe to help them respond to the unprecedented challenges of the financial crisis and changing economy.

Over the past two years, we have undertaken research and worked with thousands of companies around the world through programs such as *Opportunities in adversity*, *Lessons from change* and *Planning for growth*. Our work has identified a new performance agenda that leading companies are following as they seek to benefit from the new market environment.

One area of performance seems to be attracting more focus and management attention than all others, namely growth. More precisely, how can companies return to profitable and sustainable revenue growth in a new competitive environment?

During September and October 2010 we talked to over 1,400 senior executives from companies around the world to hear their experience, test our thinking and understand more about the actions they are taking to help their companies thrive.

Recognizing that industry sectors vary and performance is relative, we examined the distribution of companies across each sector. For each sector we identified the top and bottom quartiles for both EBITDA and revenue growth. There are "high" and "low" performers and we have explored the variation in their actions to seek to understand the difference in their performance.

In this report we explore the variation in focus and progress of these companies. We hope that their success will help you identify more effective programs of your own.

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Executive summary

Companies across all sectors and markets are expecting the new economy to be even more competitive than the old over the next two years, according to our survey of 1,400 executives from around the world. The increased competitive pressure extends across the value chain for labor, input materials and capital. And those from emerging markets expect competitiveness to increase the most, as companies from developed markets enter and local players intensify their focus.

Competition in the new economy is dynamic and being shaped by four macro-economic factors which, while not new, have a significantly more pronounced importance than before.

Market variation has increased

Emerging markets are growing, but there is a significant variation in performance across them. Similarly, some developed markets are doing better than expected, whereas others are struggling or continuing to decline.

The same variation in performance and forecast is true for market segments. There is a general re-emergence of increasingly cost-conscious buyers, but some luxury segments continue to thrive. Old purchase patterns are under pressure. Boundaries between buyer groups overlap and change, challenging the go-to-market assumptions of even the most established players.

The market is more volatile

Product life cycles continue to shorten as innovation is increased. Economic forecasts are being changed and measurements corrected on a quarterly basis – across almost all markets. This volatility is placing increased pressure on the supply chain, which must now accommodate rapid change.

There is pressure on margins

Expectations of price increases in the future are currently low – almost 60% of respondents expect a price rise that either only matches inflation or is below inflation. At the same time, many executives are experiencing both price erosion in their market and increased costs – for input and labor – in their production, raising on-going questions about their financial viability.

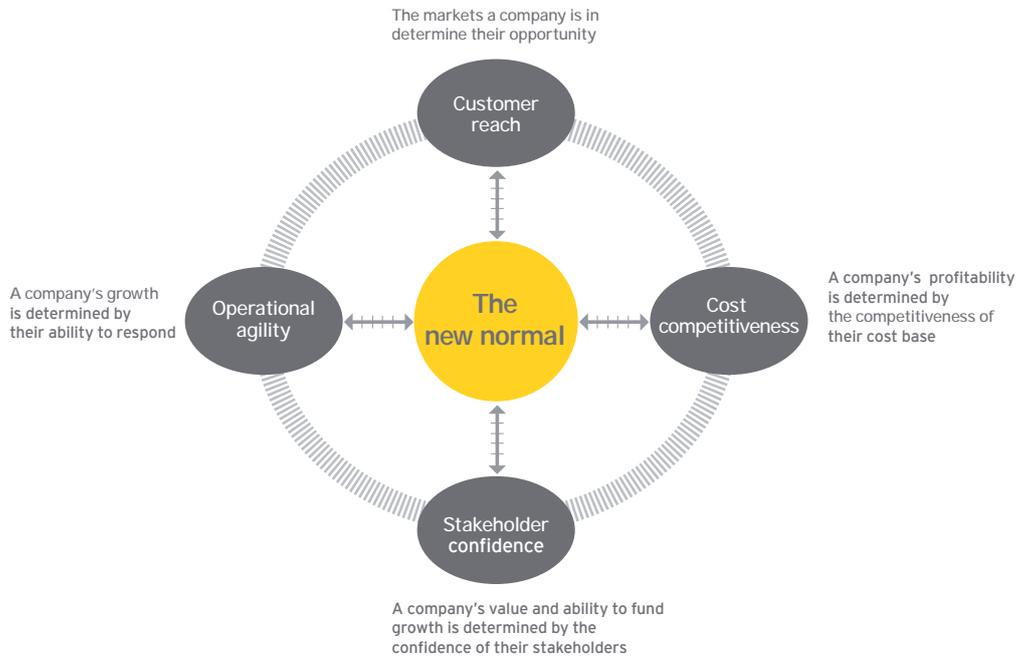
Stakeholders are nervous

Attracting and retaining talent remains a problem with vastly divergent approaches to staffing levels, both through the downturn and in the emergence of the new economy. Capital seems limited and there is caution about the risks that are faced, the new regulation that is almost certain to come and the fiscal retrenchment that is being implemented. There are growing demands for greater transparency and improved governance.



Competing for growth framework

Our research shows that high performing companies are significantly ahead of their competitors in four critical areas.



1 Customer reach

Maximizing the potential market opportunity for their product or service

- Focusing on the more profitable segments
- Broadening product service offer around current clients
- Prioritizing markets to compete in
- Reinforcing their brand and marketing efforts to increase awareness and mitigate price pressure

2 Operational agility

Improving their ability to deliver effectively in a fast-changing market

- Accelerating speed of response to get to market quicker
- Enhancing flexibility of their supply chain to respond to smaller but profitable opportunities
- Refocusing on innovation, especially at an incremental level

3 Cost competitiveness

Sustaining their economic viability

- Informing the pricing decision with full cost information
- Passing on the pressure to others in their "ecosystem"
- Sustaining cost-reduction efforts by focusing on process change, rather than just discretionary constraint
- Optimizing capital, wherever possible

4 Stakeholder confidence

Building stronger relationships with their stakeholders

- Identifying and explaining risk
- Anticipating regulatory change
- Enhancing their reporting
- Securing and developing their people

While companies may choose to focus on particular aspects of this competitive agenda as the basis of their strategy, we believe the four to be linked. A balanced approach is required and the ultimate competitive position is found when all are optimized.

What we found

The new normal

When we surveyed the market in January 2010, we found that companies were starting to “get back to business, but not back to normal.” It was clear that a new performance agenda was needed for a new type of market. But as the recession turns into a slow recovery, we would expect to see competition gradually return to pre-crisis levels. Instead, however, an overwhelming majority of our respondents – 85% – believe their market is going to get more competitive in the next two years. Forty-six percent say it is going to get significantly more competitive. Why would that be?

It has been apparent for some time that the economic turmoil of recent years is unlike the cyclical recessions of previous decades. Partly through its sheer scale but also through its impact on mega trends which have been developing for a number of years, the financial crisis and the measures taken to address it reveals a new economy that seems different from the one that we have been used to. Globalization has been underway for decades – similarly the impact of digital technology in production, distribution and communication, the massive demographic shifts and the increased mobility of capital – yet somehow the financial crisis has marked a tipping point when these factors have moved from being “long-term trends” to becoming immediate challenges.

Through our work with companies around the world, we are privileged to both witness and assist management from many organizations as they seek to help their companies prosper. We have used this insight as the basis for research so that through aggregating responses we can move to identify not only the shared perceptions of businesses but also the different actions that seem to be having most effect. By identifying the top and bottom quartile performers from different sectors – our high and low performers – and correlating their responses, we can move beyond reporting the good fortune of some sectors and some companies, to identifying potentially replicable sources of advantage. This is the basis for this report.

The market is more competitive

The market has been very difficult in the past two years – 70% of our respondents say their market has been more competitive in the past two years. This is a normal consequence of economic slowdown, as companies fight to keep market share and survive. Even in the emerging markets, where economic momentum was only slowed, companies are reporting increased competition as new players enter in search of growth.

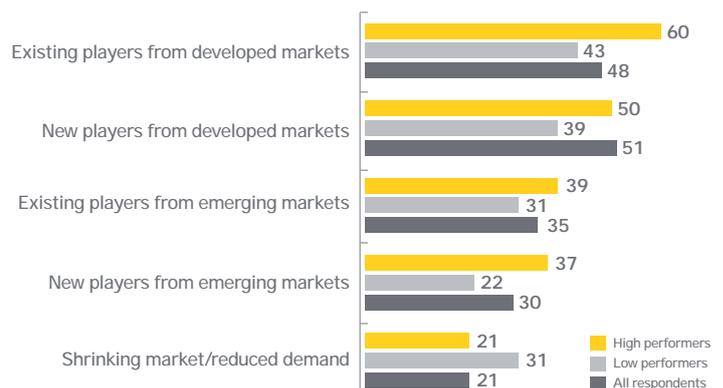
How competitive has the market been in the past two years, and how do you see it looking over the next two years?

	2009	2010
High performers	69	86
Low performers	69	83
All respondents	70	85

% of respondents rating significantly more competitive and more competitive

As companies secure their survival, the focus is turning again to growth. Competition is perceived to be increasing throughout the value chain, from capital through to sale. But the greatest challenge is being faced in the market. Gone is the zero-sum game of a shrinking market, where companies only won through others losing, but gone too is the win/win era of the preceding decade, where competition was mainly around comparative rates of growth. Today's market is demanding, oversupplied and increasingly price sensitive. Most growth will have to be won from competitors. There will be very clear winners and, equally, very clear losers.

On which elements of your business have you been facing increased competition in the past two years?



% of respondents



So what has changed?

Competition in the new economy is being shaped by four macro-economic factors which, while not new, are now increasingly important for today's executives to address. Massive market variation, enhanced market volatility, sustained cost pressure and stakeholder concerns are key parts of the new reality, for all businesses.

Market variation has increased

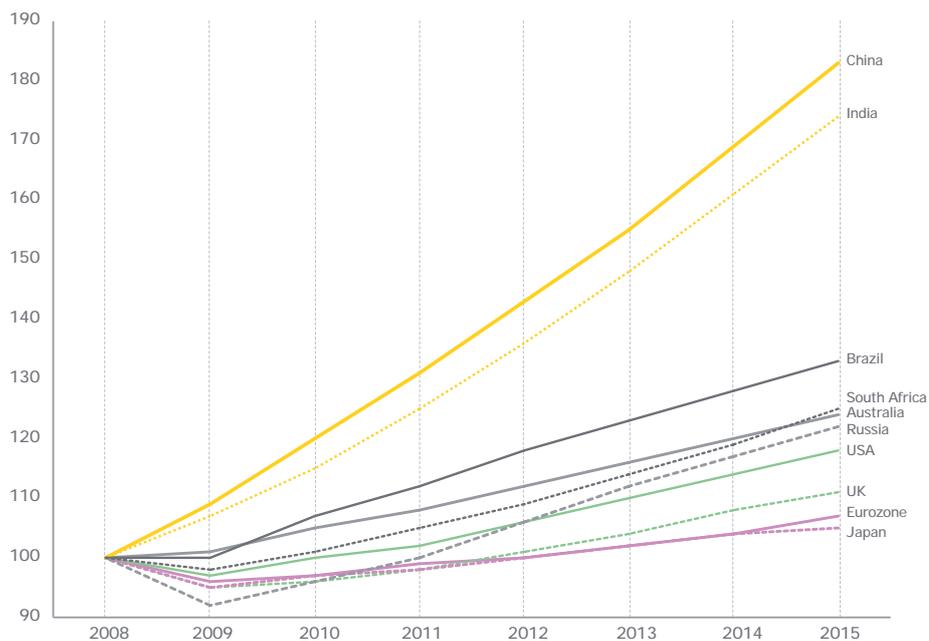
The recession hit all markets and segments, but to greatly differing degrees. This is reflected in the increased variation in national economic performance. This is not simply a case of emerging markets growing and developed markets declining. Emerging markets are growing – albeit slower than before – but there is a significant variation in performance across these countries. China and India, for example, are growing much faster than Brazil or Russia. Similarly, some developed markets are doing better than expected (Germany and Netherlands). Others, like the UK and USA, are struggling; others are continuing to decline.

Looking forward, variation in market performance is forecast to continue. Put starkly as examples, by 2015, China and India will have grown by 83% and 74% respectively while the UK and the Eurozone is forecast to have only grown by 11% and 7%.

Seventy-nine percent of respondents report that their market is now becoming more global. So while market variation has always been present, as the global economy becomes more interdependent, the effect of such variation has become more significant.

The same variation in performance and forecast is true for market segments. While there is a general re-emergence of increasingly cost-conscious buyers, some luxury segments continue to thrive. Old purchase patterns are under pressure and boundaries between buyer groups overlap and change. This builds on the increase in customer power that has already been evident, with increasing demand for customization facilitated by the broadening of distribution channels, partly driven by new media and technology. The go-to-market assumptions of even the most established players are being challenged.

GDP growth forecast in key markets



Source: Oxford Economics



The market is more volatile

Product trends have always come and gone, but now their life span is shorter as innovation is accelerated as a tactic to compete with low-cost players. Some 50% of respondents report increased market volatility, although this differs significantly from sector to sector. It is especially pronounced in service sectors but a major factor in all.

This increased volatility is also true for economic trends. A quarter of growth can be followed by a quarter – or worse, two – of decline. Economic forecasts are being changed and measurements corrected on a quarterly basis. For some time, this has been the experience in the emerging markets, where rapid change seems to be built into business models, but now it extends across almost all markets.

This volatility is placing increased pressure on the supply chain. Standardization – the basis for many production efficiencies – is under heavy pressure from customer demands for tailoring and the supply chain must now accommodate rapid change. The typical company is now embedded in an “ecosystem” of suppliers, collaborators and customers that can vary from market to market. Outsourcing is now mainstream, collaboration extensive.

Do you believe the market is more volatile?

By sector



% of respondents

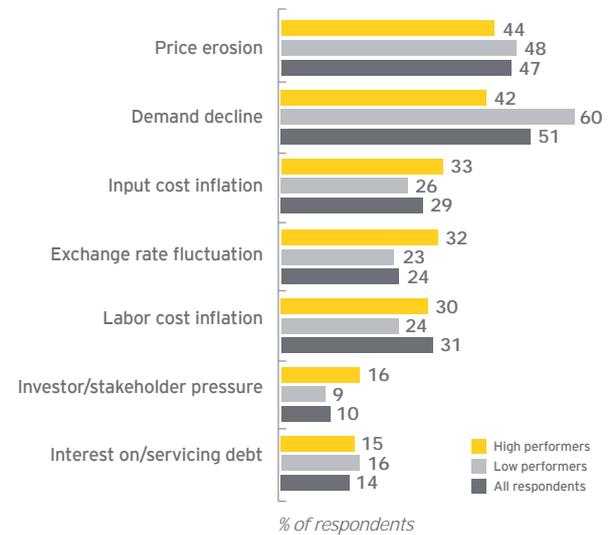
By geography



There is pressure on margins

Compared with last year, companies are reporting a slight improvement in EBITDA. The number reporting a fall has reduced from 33% to 21%, while the number reporting a 1%–5% increase has doubled to 26%. Maintaining this performance, however, is forecast to be a challenge.

Which cost pressures are most significant for your company?





Margin is a measure of supplier power over the market: it is high when there is a perception of high added value or supply is constrained. But that assumes that prices can be increased. Expectations of price increases in the future are currently low – almost 60% of respondents expect a price rise that either only matches inflation or is below inflation.

In addition to price erosion, margins are also under pressure from inflation in key inputs – 29% of respondents report input cost inflation and 31% report labor cost inflation. The emerging markets, in particular, are seeing rapid increases in labor costs due to increased competition.

Stakeholders are nervous

Following the greatest global recession since the 1930s, it is not surprising that all stakeholders are approaching the future with some nervousness. Investors lost money – an estimated trillion US dollars, or thereabouts. Regulators found themselves being questioned about the effectiveness of their regulatory regimes to prevent what, with hindsight, looks to have been an avoidable set of practices and events. That has led to increased discussion of more regulation, yet simultaneously a renewed focus on getting the balance right to ensure that growth can be supported.

Governments have endured seeing their revenues fall and their treasuries emptied, as they have had to bail out financial institutions and fund the consequences of recession on their economies and inhabitants.

Capital is perceived as limited and further constrained by banks seeking to rebuild their balance sheet strength. Companies – even high performers – are challenged as to how they will fund their growth plans.

The consequence for management is a disconcerting combination of caution and intent about the future, to the risks that are faced, the regulation that is almost certain to come and the fiscal retrenchment that is being implemented. At the same time, there are growing demands from investors and regulators for greater transparency and changes to accounting and reporting rules to achieve this.

Internal stakeholders are equally nervous following two years of cuts and constraint. Old practices have been challenged and loyalties have been questioned. The response of companies to managing their human resources through the downturn has diverged widely.

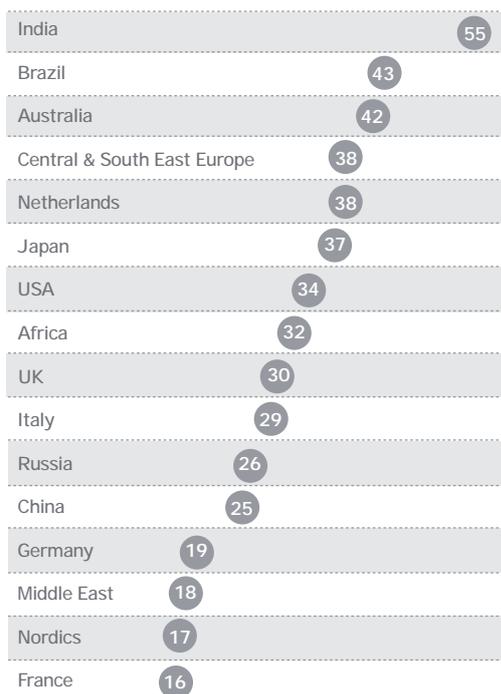
Labor cost inflation

By sector



% of respondents

By geography



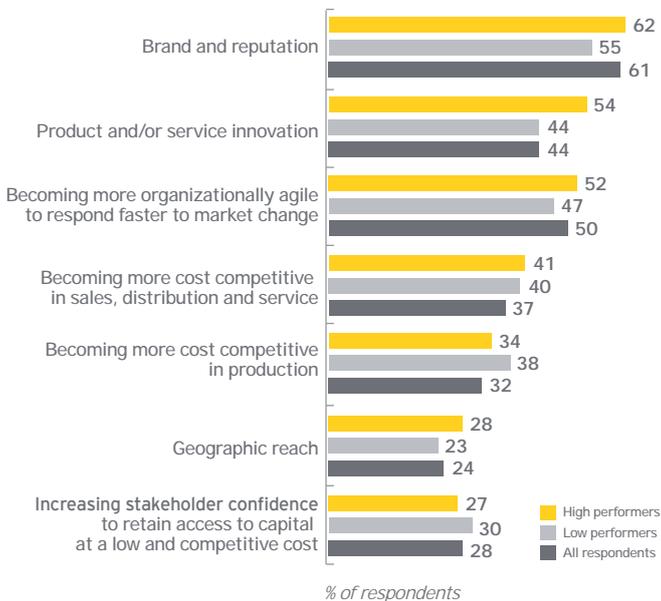


Finding a new balance

Success in the new economy will depend on whether companies can respond to these four macro-challenges by improving customer reach, operational agility, cost competitiveness and stakeholder confidence. While companies may choose to emphasize some of these factors over others, we believe they are closely linked and an appropriate balance needs to be achieved.

Traditional strategy thinking has argued that competitive success is based on choice and focus. Stakeholder compliance is treated as a given and market efficiency is assumed in most models. For competitive advantage, it is argued, companies need to choose whether to focus on customer intimacy, product innovation or cost-efficiency. The worst position is to be stuck between stools, with no points of absolute competitive advantage.

Which factors do you consider most critical to your company in being competitive over the next two years?



But given the power of the economic drivers impacting the new economy, we believe that competitive success will be based on getting the right balance of the following four areas:

1 Customer reach

The markets and segments that a company can reach effectively determine the size of the *opportunity* it faces. A company that is focused on its domestic market will have a lower potential opportunity than one that is operating across many borders.

2 Operational agility

The *growth* of a company is determined by how effectively it can meet the needs of its chosen markets and, increasingly, by how quickly it can respond to the opportunities that emerge in a changing market.

3 Cost competitiveness

The *profit* of a company is determined by whether it can win the sale at a price above its costs that delivers a satisfactory level of return for its needs and those of its stakeholders. Such cost management needs to be embedded across the supply chain on a long-term basis.

4 Stakeholder confidence

The *value* of a company is determined by the confidence of the investment community in the company's ability to manage the risks in its market to deliver its forecast level of return. This depends on confidence in risk management, regulatory compliance and the delivery of sufficient transparency through the firm's reporting system. Increasingly it also depends on demonstrating that a company has the talent to deliver its plans.



Achieving balance across the growth framework



There clearly remains considerable tension between these four goals that requires a company to make a strategic choice as to where it focuses. Players can still choose to compete through being the cheapest, the newest or perceived as the best. The implications of these choices are significant and extend throughout a company's operation and organization.

But focus should not obscure the critical linkages between each of these areas:

- The markets a company chooses to compete in determine the scale of the opportunity that it has, but also the risk, regulatory and reporting landscape in which it operates and the challenges for its supply chain. These markets will be more varied than before.
- The growth rate achieved is a reflection of a company's success in meeting the needs of the market it is seeking to serve. Flexibility and speed will be critical factors in achieving this, but these need to be delivered at a price that wins in the market and drives an appropriate profit for stakeholders.

- Cost competitiveness plays a critical role in determining which markets and segments a company can profitably serve. It drives the pricing decision upon which market success will depend but it also determines the investments that can be funded to achieve agility.
- The effectiveness with which a company reports both its opportunities and performance builds its financial reputation and hence both its value and its ability to fund its future plans.
- All these goals are dependent on a company's ability to attract, deploy and retain the talent it needs to deliver its strategy.

While focus remains important, returning to growth profitably requires an organization to consider its performance on all four dimensions of this framework.

Winning in the market may require best-in-class performance in one of these key dimensions, but long-term success is built on a company's comparative performance in all of them.

Customer reach

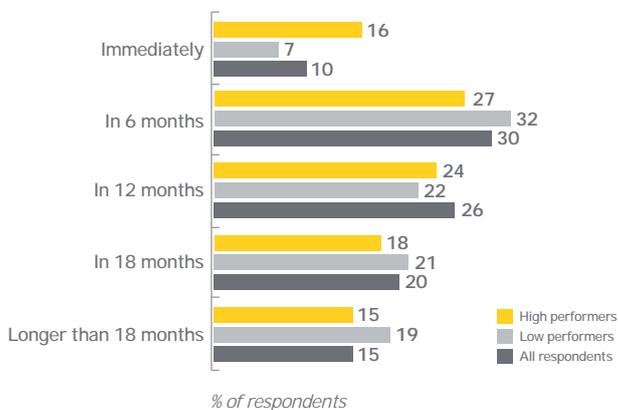


Maximizing reach – and opportunity

Growth is a reflection of how effectively a company can meet the demands of a market. The scale of opportunity is therefore determined by the size of the market that a company can reach. Customer reach is a good starting point for any discussion on growth. Given the sheer size of some of the emerging markets and their relative economic growth, they are often cited as likely sources of growth. But our survey suggests this is not always where companies will find competitive success.

When asked, some 60% of respondents believed that it would take over a year before they would break even in a new market – time to break even is only slightly shorter with high performers than the others. Not surprisingly, companies that are struggling to improve growth and profit may think twice before starting with new market entry.

Time to break even in entering a new geographical market



And, in our experience, they would be right to be cautious. Entering new markets may well be the right thing to do, but in the short to medium term there are other initiatives that high performers seem to be focusing on which may have a more immediate return. Only when these questions have been addressed should new market entry be considered.

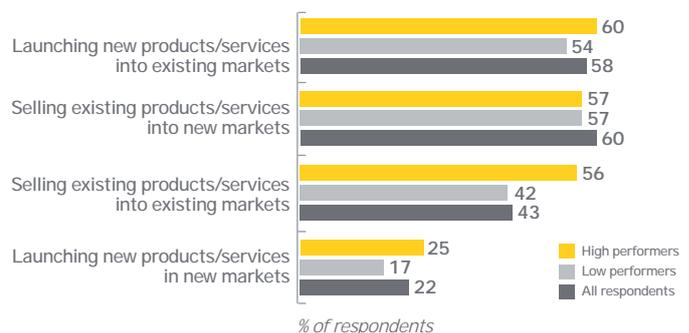
Focus on segment – who is your buyer?

Segmentation is at the heart of local marketing: identifying areas of difference that can form the basis for a sharper proposition. The past two years have reinforced how dynamic this segmentation process is, covering a broad range of product/service features and both tangible and intangible dimensions. Consequently, there has been a lot of change in both how it is being undertaken and the segments that result. Most marked has been the re-emergence of a cost-conscious commodity segment balanced to some degree by the emergence of branded value opportunities in some of the emerging markets.

It remains true that the cheapest route to market is through an existing relationship. High performers have been investing more time and resource in seeking to both secure and strengthen their position with current customers. While 35% of respondents reported having increased their focus on the most profitable customer and product segments, a full 45% of high performers reported that this was one of their top priorities.

Similarly, there is a focus on developing new distribution routes to serve the existing client base and enhanced marketing activities to maximize the current opportunity.

Which of the following tactics have been most effective in driving growth for your company?

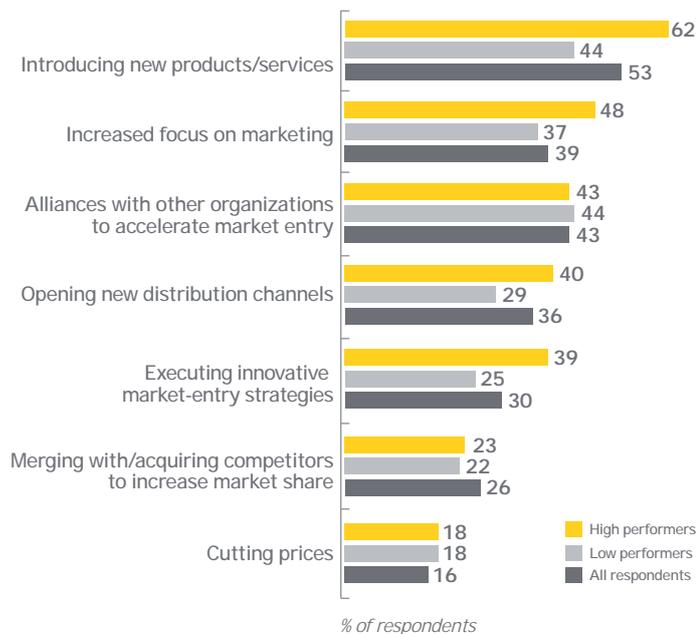




Broaden product/service offer – what are you selling?

Part of the process of maximizing the return from existing customers is introducing a broader range of products and services to better meet their needs – both across the value and the life cycle. This is the top priority for high performers. Effective account management is believed by high performers as being the greatest source of growth for the next two years.

What action is your company taking to increase sales?



When we explore how companies are seeking to increase sales, it is evident that a broad range of tactics are being used. While overall the focus was on new products, joint ventures and increased marketing, the picture for high performers was particularly distinctive. High performers are innovating new products, increasing marketing, opening new distribution channels and innovating market-entry approaches to reach those markets more effectively.

While low performers are focused on cost competition, high performers are driving into new markets and product areas.

Many companies in developed markets have recognized that innovating new services and products is central to their competitive strategy. Interestingly, leading players are focusing on incremental innovation around distinct buyer groups.

Effective account management is perceived by high performers as being the greatest source of growth for the next two years.

Customer reach



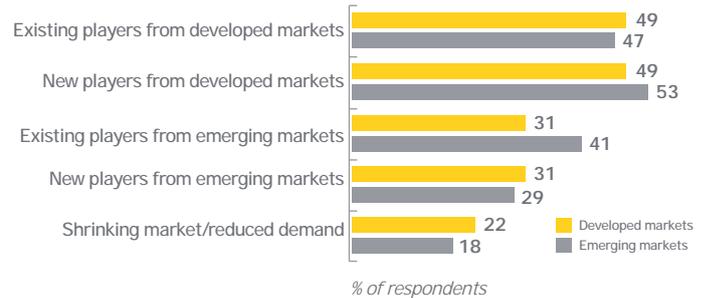
Prioritize market – where are you selling it?

By some margin, the focus of all our respondents has been on finding growth from existing markets, both in terms of selling more existing products into these markets and selling new products and services to their existing client base. But leading performers are also ahead of others in identifying the “thread that connects” groups across national borders and in following that thinking to establish new operations and outlets.

When respondents were asked where they thought their growth would come from in the next two years, 60% cited developed markets as the likely source – down from the 67% who had achieved most growth in these markets in the past two years.

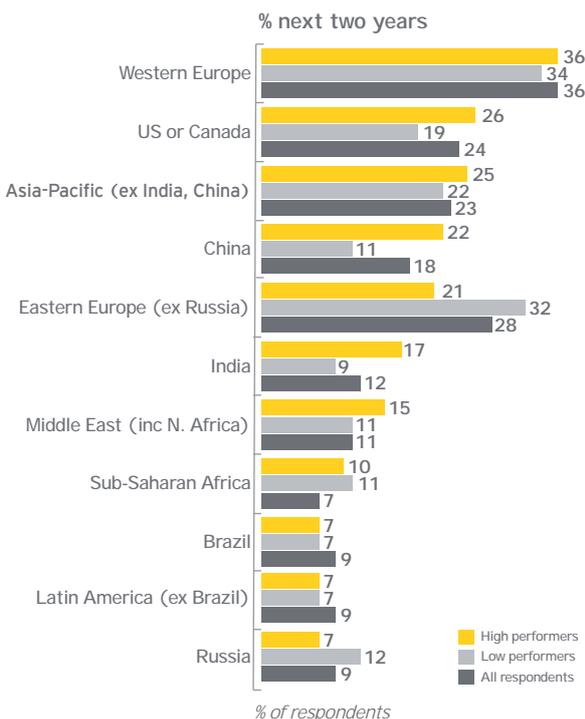
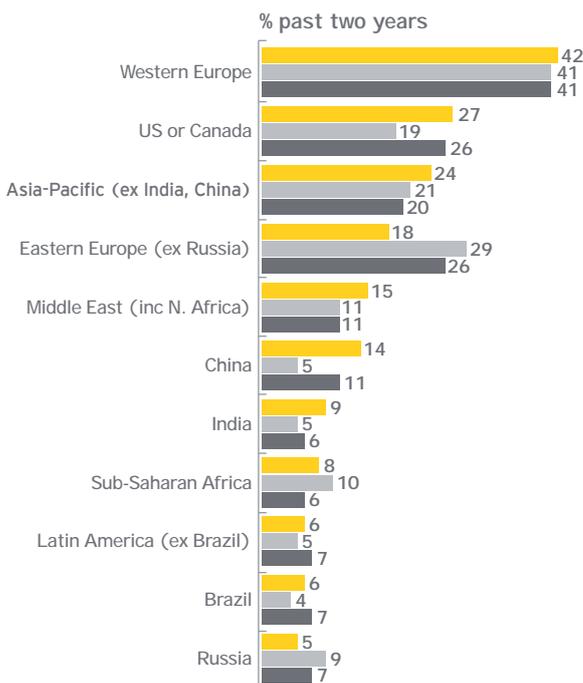
There does appear to be a difference in the markets that high performers expect to see their growth coming from in the next two years. They are significantly more optimistic about China, India and other parts of Asia Pacific than other parts of the world. The slight decrease in focus on Western Europe, and increased focus on Africa and Latin America is shared by low performers.

Which factors have driven the increased competitiveness of your market over the past two years?



Compared to our research last year for *Lessons from change*, however, respondents are expressing less optimism for the emerging markets as a source of short-term growth. This may be explained by a growing recognition of the cost and challenge in both entering and winning in these complex markets. There also seems to be a significant increase in competition within emerging markets. In addition to entrants from developed markets, there is evidence that established local players in those markets are refocusing their efforts on the local market.

What growth have you experienced over the past two years and what growth do you anticipate over the next two years?





Our previous research indicated a high level of regionalization underlying most globalization headlines. When companies choose to cross borders, they tend to choose adjacent markets within their region. While 76% of high performers see their market becoming more global, an equal proportion – 75% of high performers – believe that it is important to focus on building regional strength. In almost all cases, companies are looking to their own region as their first source of cross-border opportunity, but subsequent interests vary significantly:

- North America looks to China (27%) and Western Europe (27%) before Asia Pacific (20%)
- Western Europe looks to Eastern Europe (46%) before North America (20%), Asia Pacific (17%) and China (16%)
- Japan looks to North America (35%) before Western Europe (31%), China (29%) and India (18%)
- India looks to North America (39%) and Asia Pacific (38%), before Western Europe (16%) and China (13%)
- China focuses on Asia Pacific (35%) before turning to North America (15%) and India (14%)
- The Middle East focuses on Eastern Europe (12%) and Asia Pacific (10%)

Reinforce your brand and marketing – why would they buy from you?

One of the most striking findings from our research is the prominent role of branding and marketing in respondents' growth aspirations. For the past two years, one of the major trends we have witnessed is cost reduction, particularly in support functions. Marketing has typically been included as a cost in this and has, consequently, suffered. But as companies turn their attention back to growth, there seems to be recognition – especially among high performers – of marketing as a driver of growth that goes beyond sales support. Marketing builds awareness to establish products in new markets, and branding builds differentiation and loyalty, mitigating the impact of price reduction. It remains a truism that companies compete on price only when they have failed to achieve a meaningful differentiation based on performance or perception.

Of particular note is the growing importance of branding in emerging markets in creating a value segment, often for the first time. Leading performers seem to recognize that branding can play a central role in taking existing products into new markets and building barriers to new competitors in existing markets.

Key questions for management

Knowing your buyers

- How detailed, complete, current and accurate is your customer information?
- When did you last review your segmentation?
- How has the changed economy impacted on your customers?

Identifying your products or services

- Which are your most profitable products or services?
- Where are they on their product life-cycle?
- What are the key trends in your market?
- What processes are applied to identify and prioritize new ideas?
- What role does your customer play in your innovation strategy?

Understanding your market opportunities

- Which markets offer the greatest mid-term opportunity for you?
- How will you reach/enter them?
- What is different about those markets?
- Why will you win?

Creating your value proposition

- How powerful is your brand?
- What reasons – other than price – can influence your buyer's decision?

Operational agility



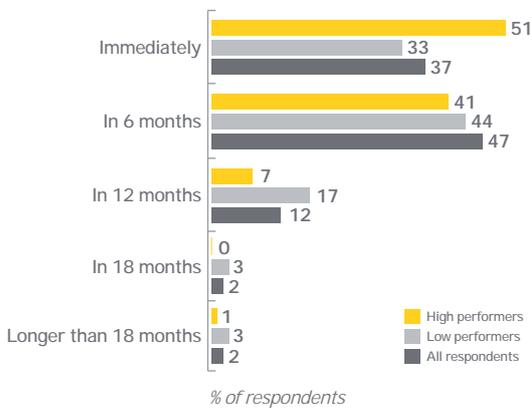
Responding quickly to market changes

While the potential opportunity for a company is determined by the market it can reach, its growth is determined by its actual ability to produce and deploy products or services into that market more effectively than its competitors. How closely is management paying attention to the market and how quickly can an organization respond to changes in the market? This is a challenge for the supply chain to attain operational agility. Over 50% of respondents reported that their market is becoming more volatile and operational agility is the second highest rated factor in companies' planned approach to growth. Fifty percent also recognize that it is critical.

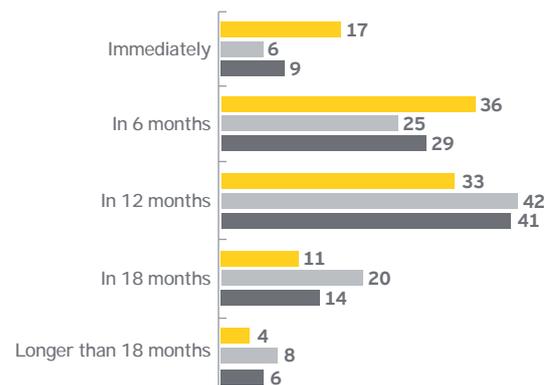
We asked respondents about how quickly they could respond to sudden changes in demand or price for their product.

How quickly could your company ... ?

Respond to a 25% increase in demand



Ensure profitable operations when facing a 25% reduction in demand

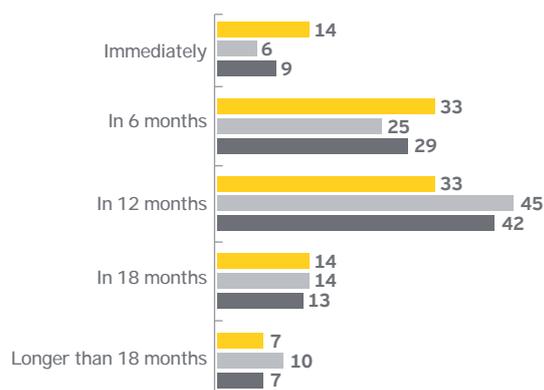


A large majority felt they could respond to a 25% increase in demand either immediately or within six months. Given that utilization of productive capacity is low – some 70% only, for example, in the Eurozone – rapid response is achievable, albeit at the seemingly high cost of excess capacity. Far fewer, however, can return quickly to profit when faced with a sudden decline in either demand or price.

This is one of the areas of biggest difference between high and low performers – the organization's ability to quickly react to a major market demand or price shift. High performers have invested in the processes, execution and management talent to maximize their response to change. Equally they have protected these capabilities during the downturn.

These two challenges of speed and flexibility have traditionally been regarded as contradictory. Companies could choose to centralize decision-making and standardize product and production for speed of response. Or, alternatively, they could choose to decentralize and adopt modular processes and structures to become more flexible. The new challenge for the best in class is how to achieve both.

Return to profit following a 25% reduction in price





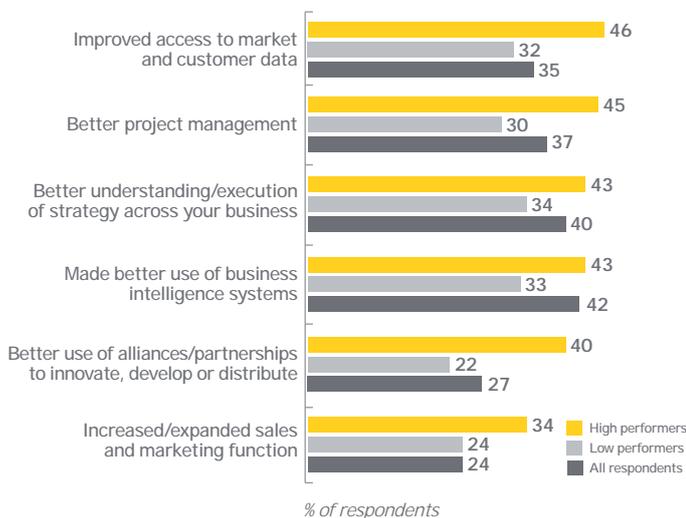
Accelerate speed of response

Speed of action is a major challenge to large companies who are often outmaneuvered by smaller players. This is true of subsidiaries in new markets, where local players are often both better informed and more empowered to move quickly in response to trends. This has been particularly evident in the case of companies moving to invest in markets such as India or Turkey.

Centralization and standardization – the traditional approaches to driving speed and cost-efficiency – are both under renewed focus. Many companies moved to centralize during the crisis when survival was at stake but most recognize that the center is a long way away from any market. Rather than simply decentralizing, however, we are seeing leading players move to differential control models where different parts of their operation are governed in different ways.

High performers are further ahead across a range of acceleration programs, but the dominant trend is the major effort by some companies to get ahead of the demand curve by improving their understanding of market drivers and trends. High performers are increasing their market analysis capability and making a significantly greater use of business intelligence systems and improved access to data. Most companies use data to perform actions rather than to base decisions on, even though one of the challenges for most companies is putting in place effective governance and executive decision-making processes. Here we see clear evidence that high performers have moved to devolve authority closer to the market and to increase frequency of the decision-making cycle.

Which actions has your company taken to increase its speed to market over the past two years?



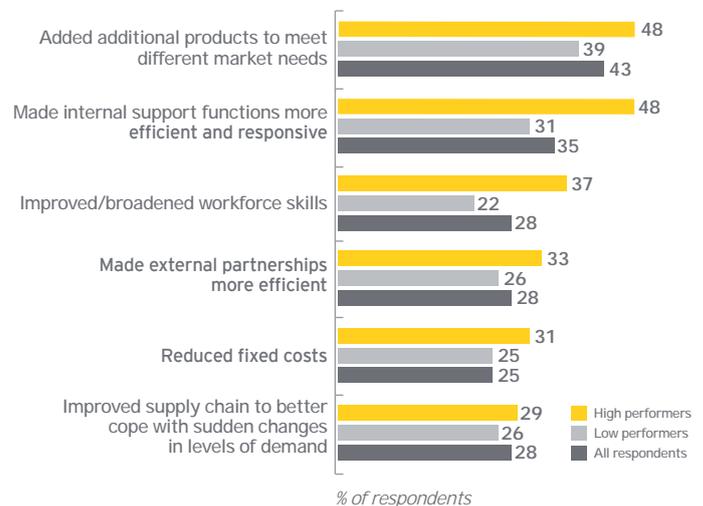
Create flexible work/delivery platforms

In addition to speeding up decision-making, leading performers are also seeking to increase flexibility across the supply chain to respond to diversity of demand as well as volatility of change. The scale of transformation required in many supply chains should not be underestimated. The response of companies is partly dependent on what they do internally, but also how they interface with partners and suppliers across their “ecosystem.”

Internally, high performers are building flexibility through adopting a modular approach to their organization. There is some evidence to suggest that newer companies from emerging markets are more flexible than their more established developed market rivals, giving some credence to the perception that established ways of operating can become significant internal barriers to change. Broadening the product mix is clearly one way of responding to volatile demand, but high performers are also significantly ahead in addressing these internal barriers, whether increasing engagement with the workforce or improving the responsiveness of support functions.

Externally, companies have been acting to increase the responsiveness of their wider value chain partners. While this is partly a mechanism to reduce fixed costs, there is also a push to increase the effectiveness of these external relationships. Clearly there is a cost to driving third-party change, but flexibility sometimes appears easier to achieve with partners than internally, where the supplier/client relationship is obscured.

Which actions has your company taken to increase its flexibility over the past two years?



Operational agility



Master innovation management

One of the critical areas for competitive success is innovation. Seventy-one percent say that product or service innovation is most important in becoming more competitive again and this presents arguably the greatest challenge to an organization. Innovation management is the application of external evolution on internal business processes. As external evolution becomes more varied and volatile, the challenge increases.

The approach to innovation varies by sector, but we are increasingly seeing fundamental “platform innovation” being carried out in collaboration with other companies – sometimes even competitors – whereas product innovation is done as close to the market as possible. Interestingly, while high performers have undertaken more central R&D than low performers, a significant 63% report that incremental product/service improvement has been more successful than transformational innovation.

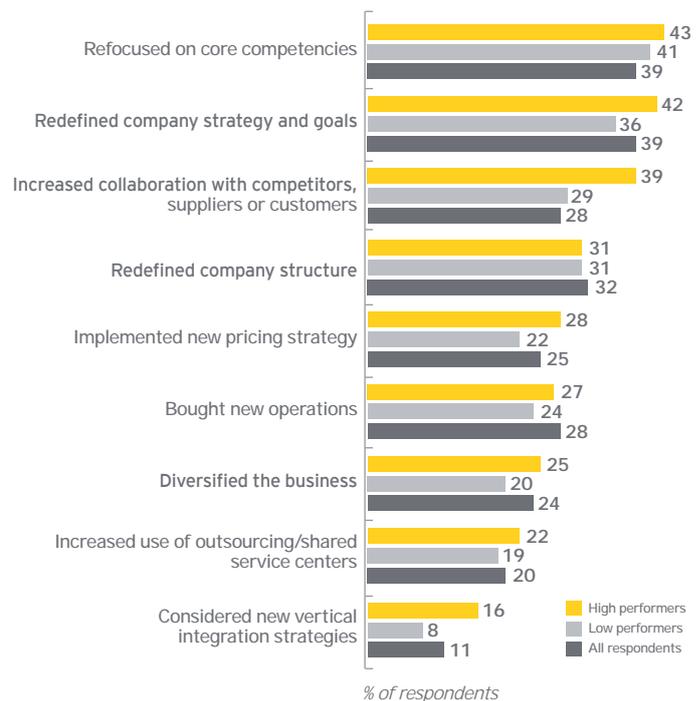
Paradoxically, perhaps, effective competition requires improved collaboration.

Improve collaboration

Companies continue to redefine their strategies and refocus their company onto its core competence and the data – one year on from our *Lessons from change* report – suggests that many of the big changes have already been made. Far fewer companies – especially high performers – report that they are changing their company structure compared with last year. The major difference between high performers and others is in the areas of increasing collaboration across their “ecosystems” of suppliers, customers and even competitors. Paradoxically, perhaps, effective competition requires improved collaboration.

Implementing new pricing strategies and increasing the use of shared service centers and outsourcing are also areas where there is a notable difference, with high performers significantly more optimistic about their ability to increase price. The increased use of outsourcing should not obscure the significant changes occurring within this area, with some companies bringing some high-risk, high-value activities back in-house. Although it is the lowest response, there is strong evidence that high performers are more likely to have undertaken vertical integration to secure distribution.

What changes has your company made to its business model over the past two years?





Key questions for management

Accelerating your processes

- How well do you know your customer and monitor changes in demand?
- How fast are you compared to your competition?
- How do you identify and eliminate inefficiencies?
- How do you evaluate the players in your supply chain?
- How well do you use your management information systems and data?
- How well integrated in your IT systems are your suppliers and customers?

Enhancing supply chain flexibility

- Have you considered taking sales and operations planning beyond supply chain to become demand driven and financially oriented?
- What is the role of IT in optimizing your operational flexibility?
- To what extent was your supply chain able to respond to the last change in demand from your customers? How flexible is your supply chain; from supplier choice through manufacturer to customer?
- Can you out execute your competitor to drive change through the organization?

Improving innovation management

- How does your innovation process work? How are your stakeholders involved in this process?
- Are there new and specific implications for innovation and innovation management?
- Who is in charge and are they dedicated to leading this process? Do they have the support of the management?
- Have you designated funds to develop new products/services?

Re-engineering your business model

- How much effort do you spend on your continuous improvement processes especially in the business support functions?
- Are your service functions aligned?
- Are your business units flexible enough to add or reduce functions on demand?
- Do you have the in-house capability to assess the organizations business model effectively?

Cost competitiveness



Reducing cost is only part of the story

Cost competitiveness determines whether a company can meet the demand for its products and services – at a profit. Becoming more cost competitive in sales distribution and service, and in production, are two of the top five factors that companies expect to be most critical over the next two years. For the past two years, reducing cost has been a constant focus of management around the world and has dominated thinking in this area. But cost has only ever been part of the story.

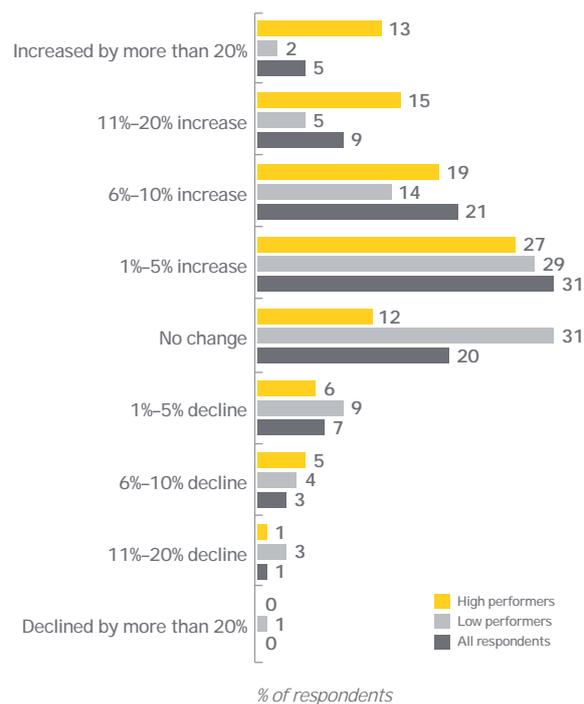
Inform the pricing decision

Cost competitiveness starts with pricing – more specifically, seeking to maintain as much control of the pricing decision as possible. Looking ahead, 31% of respondents expect their prices to stay the same or decline and a further 31% expect their prices to increase by only 1% to 5%, essentially only keeping pace with inflation. In contrast, 47% of high performers believe they will be able to increase their prices in excess of 5%.

Again the difference between high and low performers is dramatic. High performers have created products that better respond to market needs and warrant higher prices. Branding and innovation clearly play a critical role in supporting this price position, but equally important is the pricing process. Some 28% of high performers report having implemented a new pricing strategy in the past two years as they have re-examined where value is created and for whom. Leading players seek to understand process-wide costs and where their product or service is in the value life cycle. Equally, they act to ensure this understanding is available to inform the pricing decision. “Loss leaders lead to losses” is true only when the organization fails to realize the wider economic benefit that was sought.

“Loss leaders lead to losses” is true only when the organization fails to realize the wider economic benefit that was sought.

Over the next two years, how do you expect prices for your company's products or services to change?

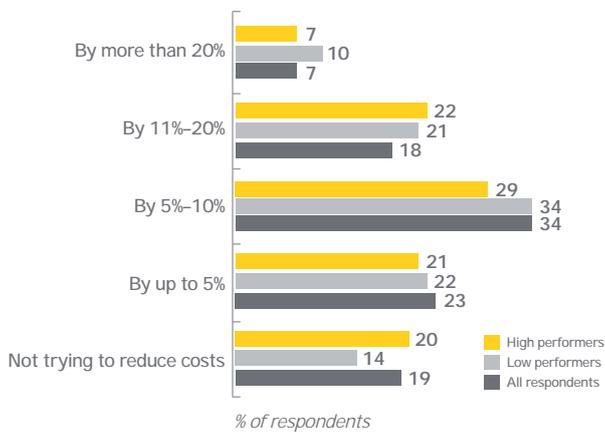




Sustained cost reduction

Cost reduction, however, remains a key focus for management. Even today, as the focus turns to growth, only 19% of companies are not trying to reduce cost.

By how much is your company trying to reduce its total costs?



But if all companies have learnt how to cut costs over the past few years, some are still challenged by how to focus their efforts. All respondents are still engaged in headcount adjustment and implementing shared services but this doesn't explain the difference in performance between the two groups. Instead the actions of high performers are focused in three areas:

- Investing in the processes, tools and training to achieve greater productivity
- Focusing their marketing efforts on better serving the most profitable customer segments
- Seeking better commercial terms from partners

All face the challenge of sustaining the reduction as they refocus on growth. Much of the effort in the past two years has focused on reducing discretionary spend such as travel, overtime or training. Improvements in sustained cost competitiveness, however, are driven by progress in making fundamental changes to key processes.

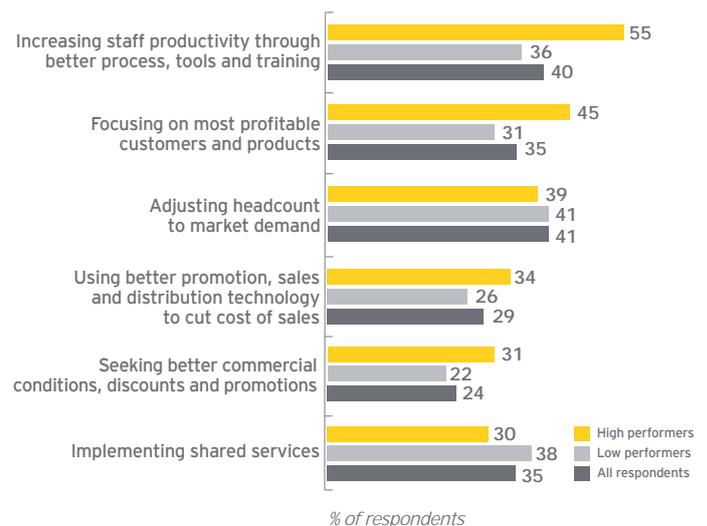
Pass on the pressure

As shown earlier (on page 7), it is apparent that companies are facing cost pressures throughout the value chain, not just in the market. The response to this needs to be holistic, so it extends beyond their own operations.

The past two years saw many companies move to secure their own position by putting in place tougher contracts with their suppliers and partners. However, leading performers see the external sections of the value chain as fundamental to competitiveness, both through partnerships and the supply chain. Another source of differential performance has been the speed and effectiveness with which high performers have sought better commercial conditions, discounts and promotion support from their partners.

This needs to be handled sensitively given the increased importance of collaboration with suppliers and customers shown by high performers in renewing their business models.

Which techniques is your company employing to cut costs – strategically and tactically?



Cost competitiveness



Optimize capital

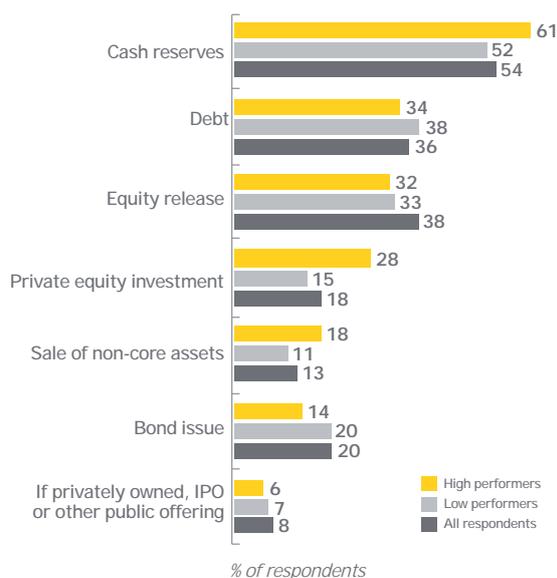
There is no escaping the fact that growth has a cost. Many companies have cut back significantly on their resources and are now challenged by how they will resource their growth.

Financing is a critical issue in cost competitiveness and one of the most marked characteristics in how companies are planning their growth is their apparent nervousness to go to the capital markets. Fifty-four percent of all respondents plan to finance their future growth from cash reserves. This may be influenced by constraints on bank funding, but the fact that this figure rises to 61% for high performers suggests that this is more a conscious management choice than an imposed market reality.

Other research has suggested that companies continue to have excessive amounts of working capital tied up in their operations. If cash reserves are going to be the primary source of funding for growth, further efforts to reduce working capital will remain an area of focus.

Given the low interest rate environment, just over a third of respondents are considering the use of debt to fund their growth, but this does not differ between categories of performers. Bond issues and IPOs are not far up the priority list for high performers, although that may just reflect the fact they have little need for them. Private equity, however, seems to be a significantly preferred investment option.

How is your company's growth strategy to be financed?



Our findings from this study reinforce what we are seeing in our quarterly *Capital Confidence Barometer*. Despite improving capital conditions and a decrease in the number of companies that said they were restricted in pursuing inorganic opportunities, those that are actively looking for an acquisition fell by a quarter. Only 26% of respondents to this survey were looking to merge or acquire a competitor to increase market share – and this was not a driver of differential performance. Organic growth is the capital allocation priority and more management time will consequently be spent on performance improvement and the realization of operational synergies.



Key questions for management

Informing your pricing

- Do you understand your true comparative position?
- Do you understand what drives your customers' value assessment?
- How are your sales teams supported?

Sustaining cost reduction

- Is cost reduction an ongoing strategic priority?
- Do you have a process to measure and monitor progress?
- Do you benchmark internally or externally?

Optimizing working capital

- Do you have a process to monitor working capital?
- Do you measure the impact of changes on working capital?
- Are you measuring working capital as an issue across your entire supply chain?

Optimizing your use of capital

- How will you fund your growth plans?
- How does your cost of capital compare with your competition?
- What options exist to reduce it?
- How do you control capital allocation?



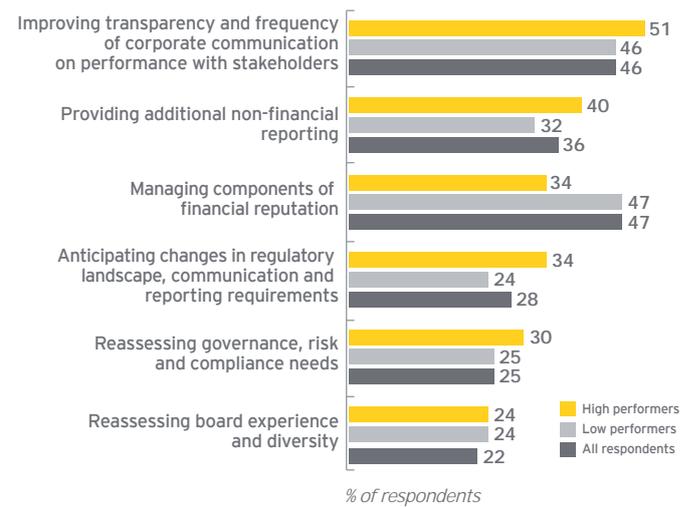
Taking a proactive approach

Trust has been a major victim of the downturn – both externally and internally – and the perception of risk has increased. Consequently, the area of stakeholder management has been one of the biggest areas of change in how companies compete. Whether through choice or external demand, businesses are moving from a compliance mindset to managing their stakeholders more proactively. The competition for capital is tough; the competition for confidence may be tougher.

Recessions always damage the confidence of both internal and external stakeholders. Internally management has had to act to cut costs – redundancies and changes in established working patterns have often been the consequence. Regardless of intention, the impact on internal engagement has been significant and mostly negative. Similarly with external stakeholders, many are uncertain of the future but fairly certain of what they have been experiencing. Confidence in management competence has been damaged.

Externally, it is already apparent that there will be significant changes in market regulation, especially – but not only – within financial services. Equally, as audit regulation is event driven in response to crises, there is a wave of accounting changes planned that will have a significant impact on what, and how, companies report. All will be affected, but not all are equally prepared. The current research confirms our earlier findings that high performers are significantly more attentive to stakeholder management than other companies.

Which practices to strengthen stakeholder confidence has your company adopted over the past two years?

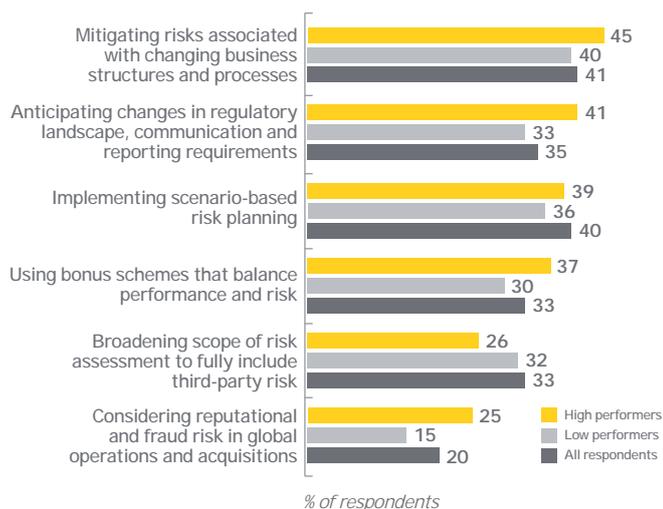




Identify and explain risk

Following the financial crisis, there is a growing focus on the type of cataclysmic risk that can happen to a business but has a very low probability – the “black swan” risk that exists despite the fact that no one had any evidence to predict or imagine it. It is argued that it was this type of risk that underlay the failure of many risk management systems during the crisis. Whether or not this is the case, or whether the world has actually got more risky, the perception of risk has increased.

Which risk management techniques is your company currently using?



Stakeholder confidence starts with risk and, more explicitly, the processes that a company puts in place to identify and explain the risks that it faces. Internally, management needs robust systems of risk mitigation and management, but many analysts put a heavier emphasis on the clarity of risk explanation in forming their views on investment.

Compared with our research last year, there has been a significant change in how companies are approaching risk management. There has been a 42% increase in those who have factored risk mitigation in their change programs, 50% increase in those who include third-party risk in the scope of their risk assessment and a full 73% increase in those who have moved to implement scenario-based risk planning.

Leading players are doing significantly more to identify and explain the risk that they see in their market. They are much more aware of the human dimension of risk being significantly ahead ensuring that their reward and remuneration programs balance performance and risk. This is also reflected in how they approach third parties with much greater awareness of reputational and fraud risks in both their global operations and acquisitions. Equally, they are significantly more aware of the risks that might arise from the changes that they are driving in their own business processes and structure.

The risk function has tended to evolve in companies in a rather piecemeal fashion in response to external developments. Earlier work by Ernst & Young identified that 73% of companies have seven or more risk functions in their organization and there is great value to be achieved from ensuring that these are aligned.

Stakeholder confidence



Anticipate regulatory compliance

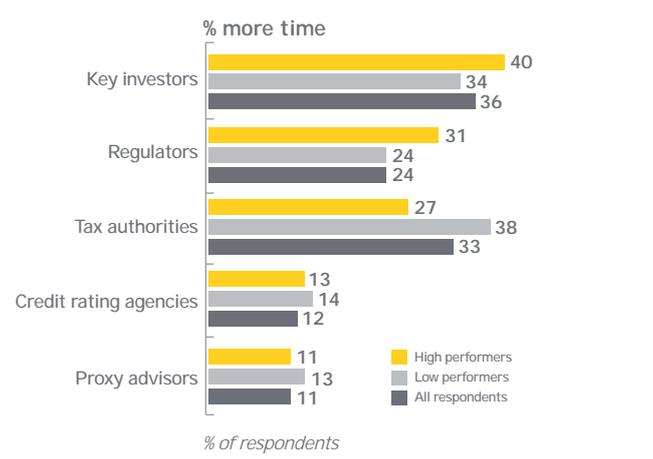
Regulation can be seen as the structural response to risk, but typically it is the institutional response to disaster.

It would be hard to underestimate the impact of the downturn on some of the leading regulatory institutions whose frameworks were found wanting.

At the time of writing, there are many new regulations being developed, including banking, taxation, corporate governance, environmental controls, immigration controls, pension provision and corporate social responsibility. The consequences of these changes will be significant and potentially broader than intended.

Thirty-five percent of all respondents are seeking to anticipate the regulatory changes, both as a defense and a source of opportunity. This rises to 41% with high performers. Management is also spending more time communicating with the key stakeholders. Dialogue with investors and regulators to help them understand your market, strategy and performance seems to be rewarded.

Which key stakeholders have your executives been spending more time with over the past two years?



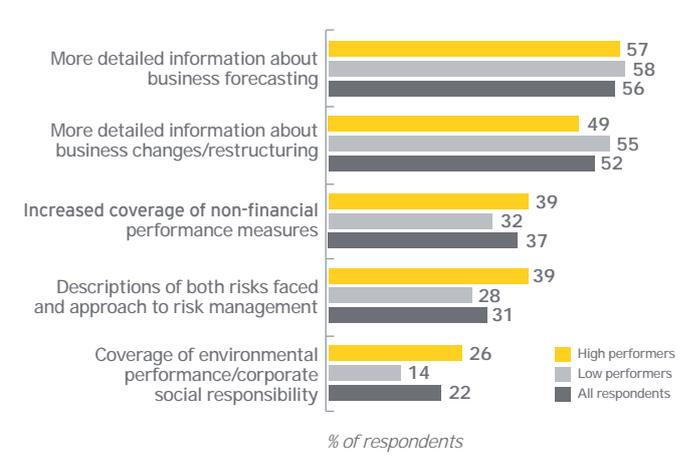
Regulation can be seen as the structural response to risk, but typically it is the institutional response to disaster.

Enhance reporting

For public companies, it is only when good news is communicated that increases in share price can be achieved. Forty-six percent of respondents indicated that they were seeking to improve the transparency and frequency of corporate communication on their performance with stakeholders.

But when we drill down into these findings, it is apparent that, while there are big differences in the amount of detail given on forecasting and changes to the business, these findings do not explain the difference in performance. The major differences arise in the non-financial area – identifying risk and risk management, increasing non-financial performance measures and significantly increased coverage of environmental and corporate social reporting issues.

What aspects of reporting is your company using to improve transparency with its financial stakeholders?





Re-engaging with internal stakeholders

One of the key differences between high and low performers relates to the focus and progress they have made in re-engaging with their internal stakeholders – most critically their talent. Although we didn't address "people issues" directly in our research, time and again, we have seen significant differences in responses on these issues. High performers are almost 70% more focused on improving and broadening their workforce's skills, 56% more focused on equipping their teams to be more productive and 26% more focused on improved communication. High performers also report facing significantly higher labor cost inflation than lower performers because they are focused on attracting and retaining key talent.

Our previous research and experience with many clients have shown that high performing companies reacted differently to the downturn than their competitors. Cutting headcount was not a top response and alternatives to redundancy were actively explored.

Consequently, these companies have seen less disengagement from their workforces and have less distance to recover. Today they are rewarded by facing the challenge of growth with the talent to attain it.

Key questions for management

Risk

- Has your risk profile and appetite changed?
- Are controls optimal for the current business environment?
- How confident are key stakeholders on risk management effectiveness?
- How are judgments being communicated?

Regulation

- Are the implications of regulatory change being monitored and impact on the business model being considered?
- Will they affect operational agility and cost base?
- Is the regulatory framework in new markets properly understood?

Reporting

- How does your reporting compare to your peers – how transparent do you appear?
- Are reporting changes fully understood and evaluated?
- Are you involved in influencing the outcome of consultation processes – either directly or indirectly?

Re-engagement

- How do you measure the engagement of your workforce?
- How does your workforce morale compare with your competitors?
- How loyal is your key talent?



Conclusion

A changing focus: from finance to management effectiveness

The past two years have been some of the hardest for business that today's executives will ever experience. It was to provide a source of reference and advice after the financial crash of 2008 that Ernst & Young launched its *Opportunities in adversity* program. In this we argued that performance was relative and that there was, consequently, a course of action that executives could take, whatever the difficulties that faced their company. Later, in our *Lessons from change* program, we identified the new performance agenda that was being formed by the changing market environment and the actions of high performers. The research for *Competing for growth* has moved to focus on a subset of that performance agenda that seems to be challenging many companies, namely returning to profitable growth.

Our research and day-to-day work with businesses around the world suggests there is not going to be an early return to the business conditions that drove growth in the past decade. The economic forecast for the coming years is for a slow recovery and some slowdown even in the faster growing emerging markets, as demand in developed markets remains weak. To grow and succeed in such an environment will require that companies intensify their competitive efforts. It is clear from our findings that executives are well aware of this challenge.

Success is likely to be driven by considered and connected programs that deliver advantage and an effective execution of those objectives that are timely, focused and consistently leveraged across the organization. To this end, we have identified a series of actions that high-performing companies have progressed more fully than low performers. These suggest priorities for companies that seek to grow.

All these issues need to be addressed – and the list is not exhaustive – but depending on where a company is currently positioned, there may be some areas that will yield greater returns than others. Focusing on current clients, for example, is more of a priority than entering new markets. Similarly improving current communications to stakeholders is a relatively lower cost route to improved returns than innovation.

Our research confirms that many companies continue to struggle to attain and certainly sustain consistently strong performance. Many others find themselves not ready for growth or too weak to fund the options that are most likely to succeed. Nevertheless, our work has confirmed that there are meaningful actions that management can take to improve their performance – whatever the position of the company. The high performing companies in the major sectors are demonstrably executing against those areas and that, in turn, is delivering a competitive advantage in achieving growth.

The research over the past two years perhaps suggests another trend in business – away from the mysteries of funding and financing towards the operational work of management. If the past decade has been one when finance and financing seemed to dominate the board agenda, perhaps the coming decade will be one more focused on management effectiveness.



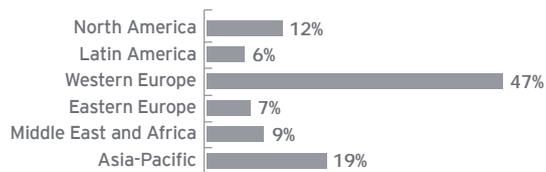
High performance summary



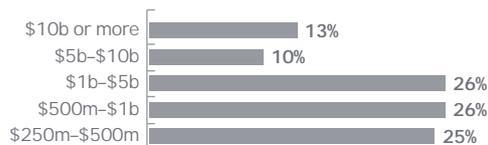
About this report

This study was conducted by Ernst & Young with the support from the Economist Intelligence Unit (EIU) between 1 September and 15 October 2010. Globally, over 1,400 C-suite, board directors and senior managers responded.

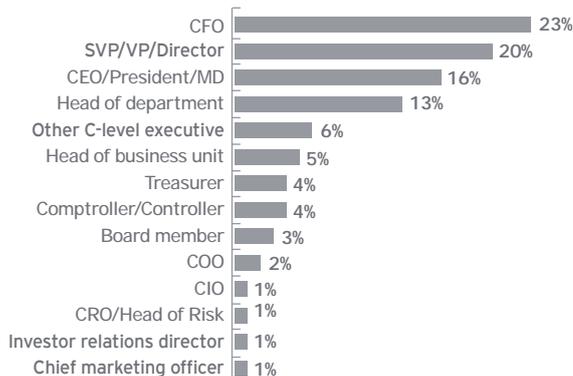
Geography (HQ)



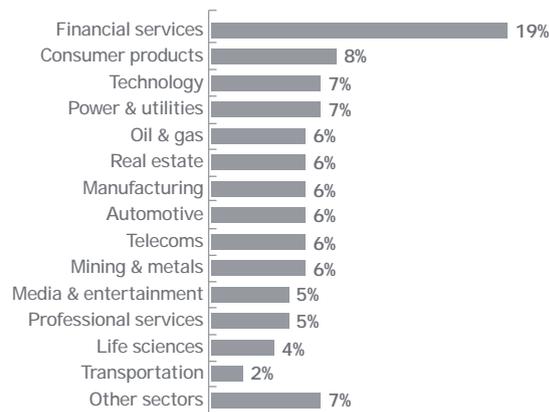
Revenue (annual global revenue USD)



Role



Sector



For more information about our findings for your sector or your country, please contact your local Ernst & Young office. Or for an abridged version, please go to ey.com/competing-for-growth.

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