

The Growth–Profitability Trade Off: Method or Myth?



Whether or not you're a believer in "green shoots," it's likely that you're watching closely for signs of a swing from cost cutting back to growth mandates. But every growth initiative comes with inherent costs and risks as well as benefits, which raises this question: Can you pursue meaningful growth without sacrificing the next quarter's numbers?

Here's the debate:

	Point	Counterpoint
There's a method for low-investment growth. <i>Judicious choices can help you grow without sacrificing near term financial stability</i>	Surgical investments to mine existing customers or enhance existing products could yield new revenue and enhance core growth through share retention or expansion. Investments like these can be calibrated to manage risk while achieving growth.	Typically companies pursue multiple small initiatives, with fragmented resources and attention. This incremental, often uncontrolled approach results in significant "investment" leakage that affects financial performance without yielding growth.
	If you make small investments and validate and shape ideas as they move through "growth gates," it will help control investment risks and enhance probability of success.	Organizations rally around big bets. It is also challenging to create a disciplined, structured process to evaluate the probability a growth initiative will succeed.
	Optimizing your portfolio of customers, products and geographies typically yields investment resources to enable "addition by subtraction" without sacrificing financial performance. But this requires investment allocation and pruning discipline.	Trying to divest and grow at the same time can dilute corporate focus and hurt a company in the long run.

	Point	Counterpoint
<p>No way, it's a myth.</p> <p><i>Everyone knows you have to spend money to make money.</i></p>	<p>Growth that matters requires an investment that matters – a significant application of assets and managerial attention.</p>	<p>Different kinds of growth come with different levels of investment and profiles of risk. For example, you can bet big to expand business – or hold a portfolio of small investments in completely new businesses and in existing business expansion.</p>
	<p>Only a small percentage of growth investments pan out – otherwise, everyone would be doing it all the time. Painless growth is a mirage.</p>	<p>Because the probability of success isn't high, companies need to invest more in screening and testing so they can focus on investments with high potential. Growth requirements are inevitable, but companies that commit and focus can separate themselves from the pack.</p>
	<p>It's mathematically impossible. There's always a short-term hit when you're investing in growth.</p>	<p>Sometimes, investment resources can be carved out through optimization of existing business. Even if there is a short-term hit, the market will value the move if it's linked to a clear shot at medium-to-longer term success.</p>



My take

Ragu Gurumurthy, Principal, Strategy and Operations, Deloitte Consulting LLP

Companies are torn between investing in growth and maintaining their current business performance. Even in good times, management and capital are scarce resources, so executives have to make choices. Our research suggests that the market rewards growth over a six- to eight-year period, so a persistent growth strategy yields longer term shareholder value.

Companies that bring clear commitments to growth typically generate more predictable outcomes. It's important to address growth at multiple levels – some at a corporate level, and others at the business unit level. Companies should maintain an overall growth outlook at the highest level to track against overall growth objectives, maintain a healthy portfolio of initiatives and optimize resource allocation. There are different types of growth – core, edge-out and non-linear – each of which brings a different level of risk, potential return and investment required.

One advantage of pursuing core growth is that it allows companies to focus close to the core businesses they already know – steering clear of unfamiliar service lines or new kinds of customers. That means fewer learning curves and less anxiety. As you identify your own profitable growth opportunities, be sure you're using the right metrics. For example, it can take years to see shareholder value delivered from an investment in growth. That means you'll want to identify leading indicators of performance – such as market share and competitive positioning – rather than trailing indicators like share price. Once you set your sights on the prize, don't waver. We've seen companies waste resources due to a stop-start approach depending on which measures are used.

A sound low-investment growth strategy is a real opportunity – not a guarantee – for sustained profitability. However, if your plan falls short in execution, it could fail to generate the growth you desire, add unforeseen costs, or both.

A view from Telecommunications

Mumtaz Ahmed, Principal, Strategy and Operations, Deloitte Consulting LLP

In the last five years, growth in the telecom sector has come from wireless and broadband data – both of which are connectivity-based services. But broadband will hit a saturation point in the next four to five years, and wireless voice may already have hit a saturation point.

New growth in this industry will have to come from non-connectivity services such as consumer IT support, information security, and remote data backup. The time to invest in that growth is now, while there's still some residual growth in the connectivity-based services and margins are healthy. If companies wait too long, the older services will cool off, liquidity for growth investment shrink, and room to maneuver will decrease. Growth could also be driven by international expansion.

Growth through new services or expansion is effective, but I wouldn't call it low-cost or low risk. Telcos can create non-linear growth, add customer value and enhance "stickiness" by investing in service bundles that enlarge current offerings and build on their unique assets – like infrastructure and brand awareness.

This isn't breakthrough thinking – telcos have considered this, but it requires aggressive execution and trying a few different options. You own the platform. What can you add to it?

A view from Insurance

Bernard Tubiana, Principal, Strategy and Operations, Deloitte Consulting LLP

Growth in insurance usually takes more capital than in other industries, because companies have to pay out commissions (even where those expenses get deferred) and put away reserves for the products they offer. This applies to traditional growth patterns in insurance, such as new product offerings, investments in the sales and distribution channel or diversification.

Yet there are opportunities to achieve growth while improving a carrier's cost profile. One example is automation through self-service Web portals, which reduces cost while enhancing utility for the distribution channel or the end-customer. Companies can also attain organic growth through improved efficacy, much as other businesses do: Word-of-mouth referrals are cheaper than advertising and other marketing efforts. Retaining accounts take less investment than winning new ones.

Of course, there's always the option of buying market share through aggressive pricing or otherwise taking on reckless risk by lowering underwriting standards. However, that's an unsustainable proposition as adverse selection, and the marketplace more generally, are unforgiving to carriers that venture that way.

That leaves growth through mergers and acquisitions, growth around the margins, achieved by small improvements in efficacy, and growth through product, service and business model innovation. Because of required regulatory filings, new ideas are immediately visible to competitors. But even a few months' lead time on a hot product innovation can produce healthy margins. It's a sustained race with no finish line, but one you can't sit out.

For more information, please visit: www.deloitte.com/us/debates/growthprofittradeoff.

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