

Which way to grow: horizontally or vertically?



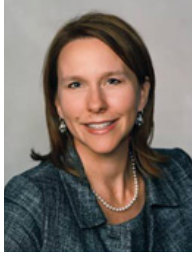
A few months ago, the question was “time to grow?” We’re past that now. If you made the right early-recession moves and have a decent store of cash and liquid assets, it’s time to think about where to invest them. In the early days of recovery, should you expand your vertical strength? Or broaden your business with horizontal expansion?

Here’s the debate:

	Point	Counterpoint
Grow vertically <i>A bigger role in your core business is there for the taking. If you don’t do it, a competitor will.</i>	You’ve pared operations to fit your core business. Stay focused.	Everyone else is focusing too. If you expect to catch anyone sleeping, guess again. Think outside the box.
	The future will be volatile and fragmented. Big horizontal enterprises are dinosaurs. So be the best fragment you can.	All your eggs in one basket? You’re kidding, right?
	Great businesses have to master their supply systems. In a vertical system, you can gain more visibility – and more clout.	Can you really run the up- and downstream operations better than your existing supply base? Do you really need to invest – or can you just restructure your relationships?

	Point	Counterpoint
Grow horizontally <i>Cherry-pick opportunities that complement your strengths.</i>	We all just got rocked by factors no one could control. It makes good sense to diversify risk.	There’s risk everywhere. If you’re going to bet your business, bet on something you’re good at.
	Business models are completely up for grabs right now. Horizontal growth can create new options.	It’s going to be tough enough to win in one category. Now you want to win in a whole spectrum of them? Don’t spread yourself thin.
	There’s a lot to learn from other sectors. Broadening your footprint is a smart investment in new areas of expertise.	An investment in one area usually short-changes another. But if you have the resources to expand in both directions, go for it.

My take



Kelly Marchese

Principal, Manufacturing Operations, Deloitte Consulting LLP

In a previous Debate, we asked whether it was time to start moving forward – time to let go of the crisis mindset and start plotting growth moves for the post-recession world. That doesn't seem to be the question any more. If you're still here to read this, it's go time.

But where?

Grabbing market share in distressed times is familiar advice. The rationale: Competitors are weak and taking initiative can create advantage. The market territory you seize now will be prized and profitable when the economy rebounds. That kind of thinking argues for vertical approach to growth. Whatever you do, do more of it – and do it better.

But this isn't an ordinary down cycle, if such a thing exists. We don't know how long it's going to last and it's already clear that big things are changing. The main thing you know about the post-recession landscape is that you don't know much about it. So why place your bets narrowly? Smart horizontal investments could insulate you from whatever turbulence lies ahead.

If you're in a position to do both – to expand both horizontally and vertically – chances are you don't need anyone's advice. But most companies today count themselves lucky if they have even one of these options on the table. Which is the right one for you?

If you believe supply constraints are in your industry's future, you can stay a step ahead by acquiring or developing your own supply sources. The investments you make now can give you proactive control of margins that will pay off later. If you predict that your industry will grow into new consumer channels, you can head in that vertical direction – or you could opt for a pure, direct move against your competitors' market share, either by targeting their clients or through strategic acquisitions.

Whatever course you choose, if you have the resources, this is the time to be aggressive.

It's not an easy decision, but all other things being equal, I come down on the side of vertical. No matter what the environment, focus tends to win out over dissolution.

A view from the retail sector

Rod Sides, Principal, Performance Improvement, Deloitte Consulting LLP

Retail has been among the sectors most heavily impacted by the downturn, but now is a time for growth. Saving your way to prosperity is not a viable strategy in this downturn – and many retailers have proven this with their corporate lives. Growth is an imperative. The question is how.

My view is that growth should be driven by selective horizontal strategies. Picking the right strategy is critical.

There's a glut of available retail space, but there's also a general feeling that the U.S. market is "over-stored." So growth via new store development or acquisition of another concept isn't an option I'd recommend. Increased inventory and assortment has not been productive, because product turns have remained relatively flat. Unless you can identify an unmet customer need, expanding into more product categories with larger inventory investments isn't a viable solution either.

So what is a viable option?

The downturn has depressed store traffic, but Internet sales have defied the trend. Many of the bigger players are moving aggressively in this space, but the net evens the playing field for retailers of all sizes. Established retailers face the complexity of integrating brand messaging, product offerings, promotional offers and price integrity across multiple channels, so smaller enterprises can move quickly to capture market share.

Now is the time for retailers to shift their business models and take advantage of the market. The change will take work, but it can yield a lower cost operating model for the long-term.

A view from the M&A perspective

John Powers, Principal, M&A Consultative Services, Deloitte Consulting LLP

I can't help giving the trite but true consultant answer: It depends. I've seen companies grow successfully through both horizontal and vertical acquisitions. But in this climate of tight credit, I believe most companies can get a bigger bang for their buck through a vertical acquisition. There will be a time to shift to a horizontal focus, but it isn't upon us yet.

Leveraging your core strengths with a vertical move will enable higher synergies. It will shorten time to value. And this approach offers flexibility – the chance to acquire assets or brands instead of entire companies. New customers, products and branches can be quickly integrated into an existing platform, and many of these vertical moves will be accretive in weeks. Horizontal mega-deals might take years to deliver benefits.

Horizontal growth takes integration, and that means more work, more capital and more time. There are also fewer natural synergies. Expanding into areas adjacent to your current business can seem natural, but those operations may require completely different skills. This is not to say that horizontal acquisitions never make sense. For example, acquisition can be a fast, market-responsive way to add a services business to a retail operation (analogous to Best Buy's Geek Squad or CVS Pharmacy's Minute Clinic) while picking up the critical management team as part of the deal.

Still, I think there is more upside with vertical moves at the moment. This is based on my belief that the recovery or rebound will be choppy at best, and may be far off. The safe bet now is to leverage what you have to consolidate your competition. When you feel the point of inflection (from low growth to high growth) is 12 months away or less, that will be the moment to expand horizontally through acquisition. If you start envisioning a pipeline of horizontal moves now, you'll be ready to move then.

A view from the Aerospace and Defense sector

Tom Captain, Vice Chairman, Global and U.S. Aerospace & Defense Leader, Deloitte LLP

I believe growth in the commercial aircraft market, which represents one-third of the aerospace and defense sector, will focus on the vertical side. Players in that space need to capture more business through deeper penetration of the markets they're already in.

For components suppliers and maintenance providers, that will probably include M&A activity, as companies chase economies of scale. But the moves will be vertical in nature. We won't see an aerostructures builder trying to buy an engine or avionics maker, or vice versa. For aircraft manufacturers, growth means new orders for better planes. The winners in this market will be the best innovators. Acquisition isn't a meaningful paradigm for them because there are already so few players.

Where can they find those new orders in this economy? The battle cry is, "go east." In China alone, 600 million people will join the middle class in the next 20 years, and their demand for leisure, business and freight travel will grow accordingly. Already, city-pair passenger routes that would rate small, commuter craft in the United States are served in China by twin-aisle craft. One-third of the world's commercial aircraft production over the next two decades will be associated with that nation.

It's important to remember that cycles in the commercial aircraft market lag behind changes in the general economy. We're finding that 2009, which will go down as an historic low point for many businesses, will actually be a record year for aircraft delivery, because the orders were placed long ago. At the same time, this is shaping up to be a record low year for new aircraft orders, and we will probably see a resulting falloff in production next year even if the larger economy is in a rebound.

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

For further information about this debate, please contact:

Kelly Marchese

Principal
Manufacturing Operations
Deloitte Consulting LLP
kmarchese@deloitte.com

Rod Sides

Principal
Performance Improvement
Deloitte Consulting LLP
rsides@deloitte.com

John Powers

Principal
M&A Consultative Services
Deloitte Consulting LLP
jpowers@deloitte.com

Tom Captain

Vice Chairman
Global and U.S. Aerospace &
Defense Leader
Deloitte LLP
tcaptain@deloitte.com

Related Insight:

[The Five Business Dimensions Organizations Should Pay Attention to During a Downturn](#)

Volatile times challenge managers to make decisions that balance risks and rewards in the face of great uncertainty. By making appropriate financial, operational, governance and risk management changes now, businesses can better position themselves to maintain cash flow and to effectively weather the current economic storm.

[Seven Secrets to Downturn Survival](#)

Existing cost management programs may not be sufficient to survive and thrive in a downturn. Strategies requiring a higher level of attention on strategic structural improvements may help organizations prosper during an economic downturn and may provide sustainable advantages.

Related Content:

Library: [Deloitte Debates](#)

Services: [Consulting](#)

Overview: [Strategy & Operations](#)

Industries: [Retail](#) and [Aerospace & Defense](#)

This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.