Mid-size Business

Growth

Strategy

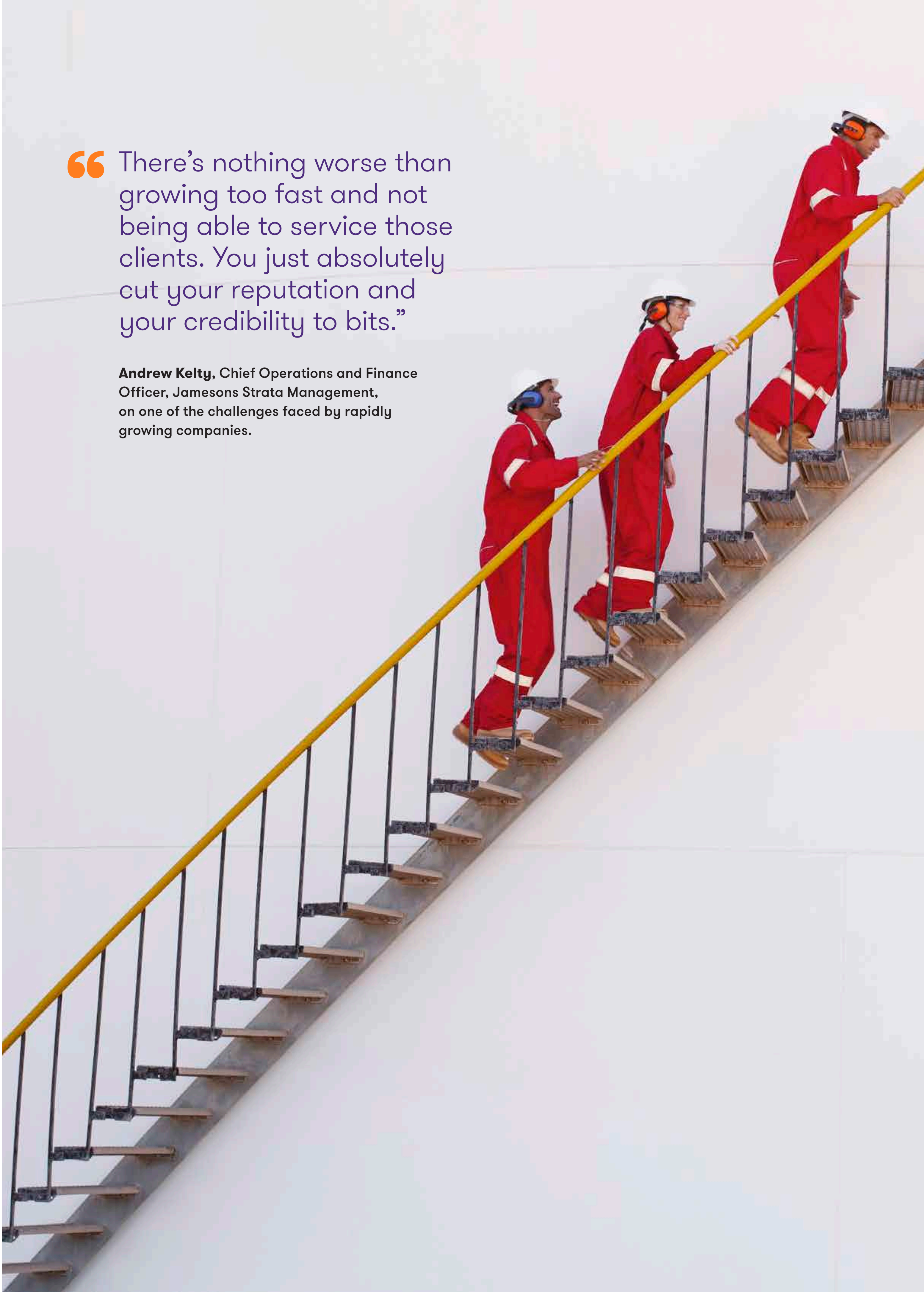
Growth Engines

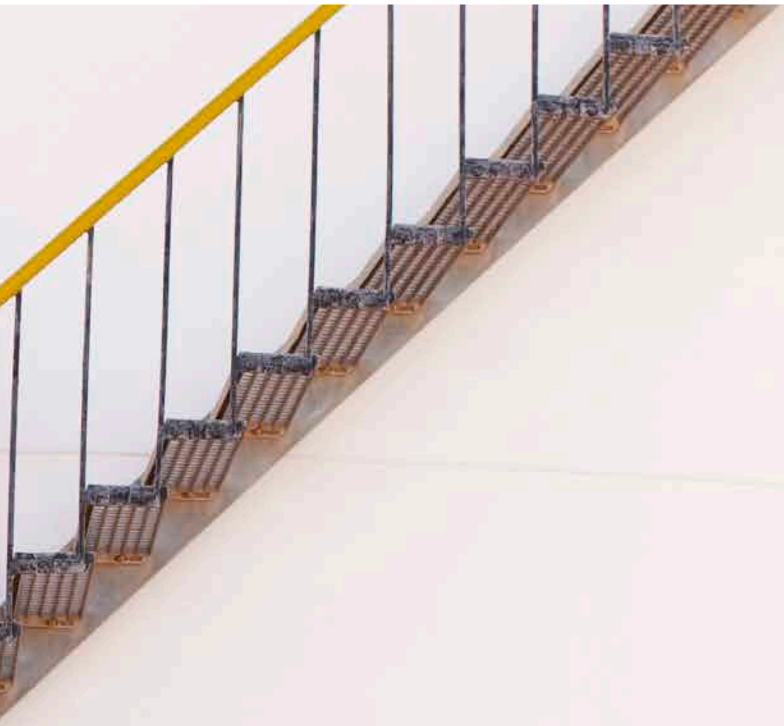
Four strategic shifts to accelerate growth in 2016

A MID-SIZE BUSINESS LEADER REPORT

“There’s nothing worse than growing too fast and not being able to service those clients. You just absolutely cut your reputation and your credibility to bits.”

Andrew Kelty, Chief Operations and Finance Officer, Jamesons Strata Management, on one of the challenges faced by rapidly growing companies.





Many mid-size businesses fall into one of two camps: those struggling to grow and those struggling with growth.

This split highlights the hallmark challenges for mid-size businesses. The first group have a solid engine, one that powered them off the line and past smaller businesses, but now they are stuck in the middle of the pack, in a different race, struggling to find the thrust they need to accelerate once again. The second challenge relates to growing pains, where companies shoot up too fast. Having found their formula for success, these companies rapidly gain more customers, orders, projects, people and locations than their infrastructure and leadership can handle.

This report* examines some key differences between these slower and faster growing groups, looking at examples of each and exploring four growth engines to power them forward in the years ahead.

*Our account is based on a recent Grant Thornton survey of Australian mid-size businesses. To analyse the results, we split respondents into two roughly equal cohorts: slower-growers and faster-growers. The former are expecting less than 5% nominal growth in the 2015-2016 financial year, and the latter forecast higher rates, ranging from a minimum of 5% but often far higher.

What faster growing mid-size businesses do differently

Many mid-size businesses fall into one of two camps: Those struggling to grow and those struggling with growth. Our study uncovered the key characteristics of fast growers, and the four growth engines to power them forward in the years ahead.

$10–$500m

Mid-size business are defined as having turnover between $10 - $500 million annually.

5%–60%

A faster-grower is a business that expects 5% - 60% nominal growth in FY2015-2016

Faster-growers are

Ambitious in their pursuit of growth

Entrepreneurial and innovative

Dynamic, agile and flexible

Increasingly export orientated

Faster-growers identify as

40% An industry leader

44% Mature

60% Well-managed

52% Stable

Faster-growers areas of concern

24% Understaffed

25% Frustrated with banks

What faster-growers do differently

Many faster growing mid-size businesses are powered by self-created engines, pioneered and developed through bold growth strategies including:

New products & services

They are closer to their customers and actively invest and manage their product development strategy, pipeline and process.

New markets

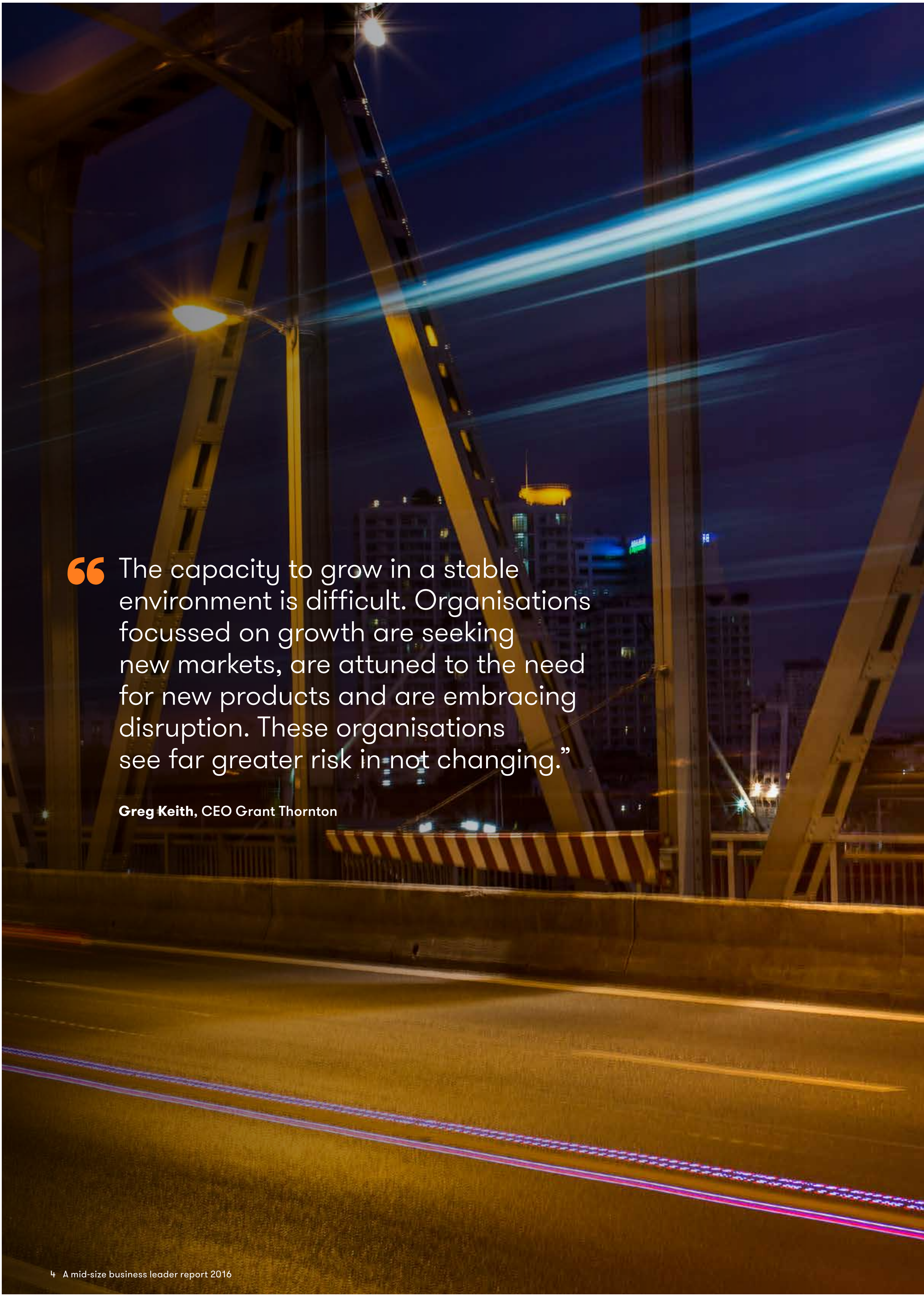
Think differently about new markets. In an increasingly digital world, companies can make a leap from local to global much earlier and easier.

New technology

They invest in new technology in a timely way and see staying abreast of technology as a competitive edge.

New acquisitions

Leverage the benefits of acquisitions i.e. new resources (cashflow and/or skills), business synergies, risk diversification, economies of scale or direct access to new markets.



> "The capacity to grow in a stable environment is difficult. Organisations focussed on growth are seeking new markets, are attuned to the need for new products and are embracing disruption. These organisations see far greater risk in not changing."

Greg Keith, CEO Grant Thornton

Section 1

One segment, two speeds

As you might expect, a key difference between faster-growers and slower-growers is their relative stability.

While slower-growers may struggle to expand, they are often less volatile and enjoy quite steady predictability. Almost three quarters (72%) of slower-growers in our survey describe their businesses as stable – something particularly valuable in the tough economic conditions we see today. By comparison, just half (52%) of respondents from faster-growers feel they are running a stable business.

"Invariably any change is risky and an uncomfortable experience for leaders during times of growth. Accepting that uncertainty is inevitable is also important. Knowing how to lead successfully through periods of excessive change, ambiguity and increasing complexity is often what defines exceptional leadership in my view," says Rory Gregg, Partner – Leadership, Talent and Culture, Grant Thornton Australia. "In my experience, a high growth and performing culture often has its genesis in a leader's capacity to lead through this uncertainty and tolerate the discomfort. Learning how to manage these two variables is often what defines fast growth leaders."

Faster-growers need lenders to back them

Another key difference between the two groups is access to finance. Faster-growers are often hungry for funds to feed an appetite for expansion. Often this takes the form of wish-lists of projects and strategies, ready to go if the requisite finance can be secured. Being denied funds can be very difficult to take in these cases, where some are forced to watch big opportunities drift away.

It's no surprise then that one quarter of faster-growers in our study say they are frustrated with banks. But tellingly, not a single slower-grower reported the same feeling. While faster-growers have big plans and depend on lenders to back them, slower-growers often have access to ample funds, just no big plans to invest in.

Survey sample split by expected nominal growth rate

48%

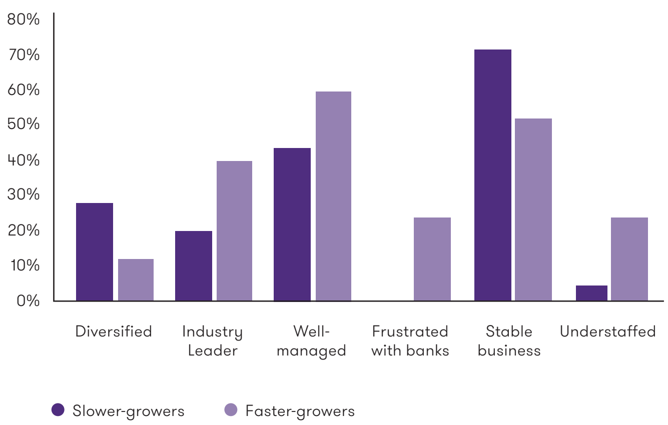
Slower-growers (less than 5%)

52%

Faster-growers (5% to 60%)

Signature differences: Slower growers vs faster growers

Terms applicable to your business



Faster-growers: lean and hungry for talent

Six times as many faster-growers in our survey reported being understaffed when compared with slower-growers. Inevitably, rapid growth runs ahead of available resources. Protech, an industrial recruitment consulting firm, is very familiar with this issue. "My principal challenge remains finding the right staff. All our strategies and thought processes centre around getting the right people on board," says CEO Marc Meili, who forecasts growth of about 20% in the year ahead.

Often faster-growers burst into new territory only to find themselves hitting new talent barriers where they are not only understaffed, but also lacking skill-sets they never needed before. This is most critical right at the top, where more specialised management skills are needed to cope with new challenges including geographic expansion, bigger teams, financial complexity and acquisitions, to name just a few examples.

Slower-growers are less confident of their leadership ability

Aside from keeping a close handle on growth, the majority of leaders at faster-growing mid-size businesses consider their companies to be well managed. Slower-growers were less confident, with only 44% describing their own businesses as well managed. Similarly, slower-growers were half as likely to call their business an industry leader. So what would better management be doing differently at slower-growing businesses? And what would it take for them to become industry leaders? The answers to both questions are explored in the growth strategies we cover in the next section.

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Marc Meili, CEO

Section 2

Four mould-breaking growth strategies

Many faster-growing mid-size businesses are powered by self-created engines, pioneered and developed through bold growth strategies.

Often these strategies involve breaking new ground through diversification, modernisation, internationalisation or acquisition. Their challenge is to make the most of the opportunities they create, and often that requires considerable organisational change.

The challenge for slower-growers is to generate their own power source to drive themselves out of their comfort zone and pursue new opportunities. This kind of change involves companies doing something different – adding a new growth engine, beyond primary, or incremental, growth strategies like operational efficiency, cost control, sales and marketing. This section explores four growth engines, alongside candid perspectives on them from mid-size business leaders.

For each growth strategy we track the relative importance placed on them by our two groups, revealing some key variations. For example, fast growing businesses in our study place more importance on international markets and acquisitions when compared to slow growers, while more slow growers see new technology as important to their growth strategy. In the case of new products and services however, both groups placed approximately equal weight on this critical growth engine; but it's how this engine is fired that creates the difference in the speed of growth.

The challenge for slower-growers is to generate their own power source to drive themselves out of their comfort zone and pursue new opportunities.

1

New products and services

No business can survive in a rapidly changing world without developing new products and services, so it's not surprising to see little difference in the extent to which faster and slower growers prioritise new product development. But faster-growers go about this very differently from their slower growing counterparts.

Faster-growing companies tend to actively manage their product development strategy, pipeline and process. They are often closer to their customers, so they understand what new products and services are most needed; and they invest in the product development process so they can reduce time to market. Many are acutely aware that to stay ahead they need to remain in tune with their customers, adapting products and services to their evolving needs.

An alternative to creating new offerings in their existing market segment is to diversify into completely new or adjacent segment. One business endeavouring to do this is Geelong-based MHG Asia Pacific, Australia's only manufacturer of OEM automotive glass. With key customers Toyota, Holden and Ford all shutting down inside the next two years, MHG urgently needs a new way to grow. "We are working very hard on our diversification strategy," says CEO David Chuter. "We're tapping into the network of people we know, including consultants, to catalyse or fast-track our journey into new industries."

MHG exemplifies what can happen when the survival imperative kicks in. Their challenge is to find the point of difference that can be leveraged in new markets. Chuter believes this includes the disciplines and processes they have built from working in the automotive industry – strengths that will enable them to survive on volume sensitive margins in a range of industries beyond automotive. He believes the need to change will fire up a new growth engine for the future of the business.

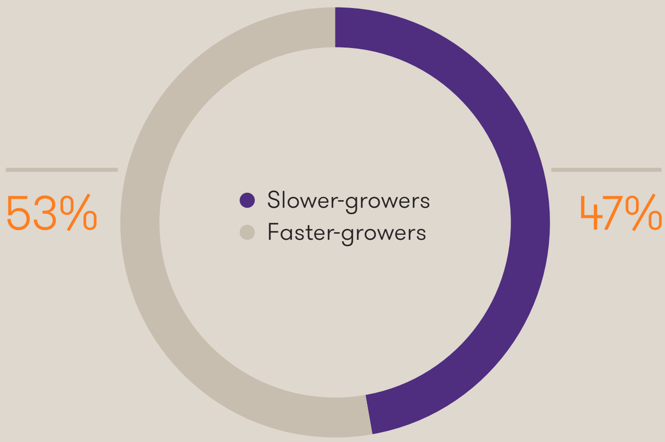
Those already experiencing fast, sustained growth often have a continuous mandate to invent new offerings. "I think you've got to stay relevant and you've got to make sure that you have a unique point of difference," says Nancy Clay, Commercial Manager at Natures Organics, a manufacturer of over 120 personal care and household cleaning products. The company grew at 10-20% a year for two decades before settling into a slower-growing rhythm in recent years. Despite now shipping 50 million units per year, the company is anything but complacent about their growth prospects. As Clay puts it, "If somebody else is doing what you're doing, you are going to be very quickly targeted".

Bottom line

"Disruption can often act as a growth accelerator. But many companies stick too rigidly to what they know, even as the world changes around them. It takes courage to invest upfront in new products and services with no guarantee of a return. What some mid-size business leaders don't think about is the risk they run by not developing anything new – leaving them exposed to market change and competitor innovations."

Mark Phillips, Partner – Performance Improvement
Grant Thornton Australia

Growth strategy importance:
New products & services



2

New technology

Companies have used new technology to gain an advantage for centuries. But there are periods in history where the opportunities offered by new technologies, and risks of falling behind them, become especially great. This was the case in the early decades of the industrial revolution, and is certainly the case today, as the digital revolution generates new opportunities and challenges on a near-monthly basis.

Many faster-growing businesses already benefit from a competitive edge underpinned by new technology. Slower-growing businesses, on the other hand, are often in a desperate race to catch up – something that perhaps explains why this is the only growth strategy considered important to the future of slower-growers than faster-growers.

One company using technology to accelerate their growth rate is Canstar, a retail finance ratings business. It has driven an aggressive strategy to modernise its digital business and expects growth of 15-20% per annum over the next few years as a result. “A little over three years ago our digital business was zero,” says Canstar CFO Chris Mitchell. “Next year it’ll be our biggest business - on a run rate basis it’s almost our biggest business now.”

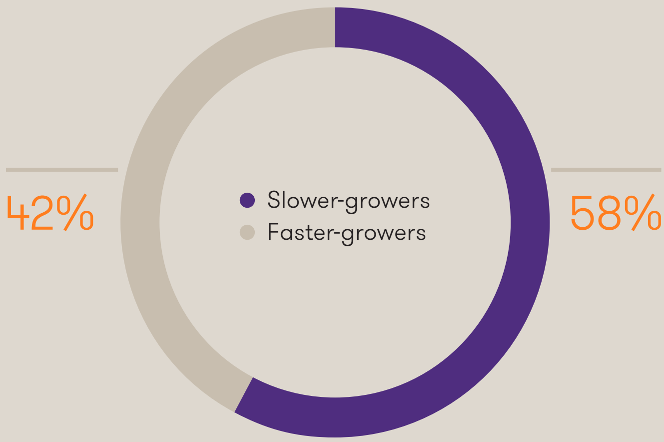
As Mitchell points out, when it comes to digital, Australia is a few years behind countries like the UK and US in some areas. Many industries are striving to emulate business models from those countries in order to stay at the front of the trend but making sure you don’t fall behind in such a fast changing game is no mean feat. ICE Design, a fashion retailer, is one such example.. As COO Gavin Fielding puts it, “You actually have to reinvent yourself and start from scratch just to remain competitive with companies that have done this for two or three years before you have.” The company has recently invested $350,000 in a new digital platform (launched in August 2015) which Fielding believes will close the gap with competitors.

Bottom line

“Adding a technological edge to your business can go far beyond building an e-commerce capability. Businesses need to ensure that their technology foundation combines to link through to customer facing technology. This means business need and business leaders dictating technology priorities not the technologists. Like it or not, companies are now in a digital arms race – often on a global scale – and none can afford to fall too far behind.”

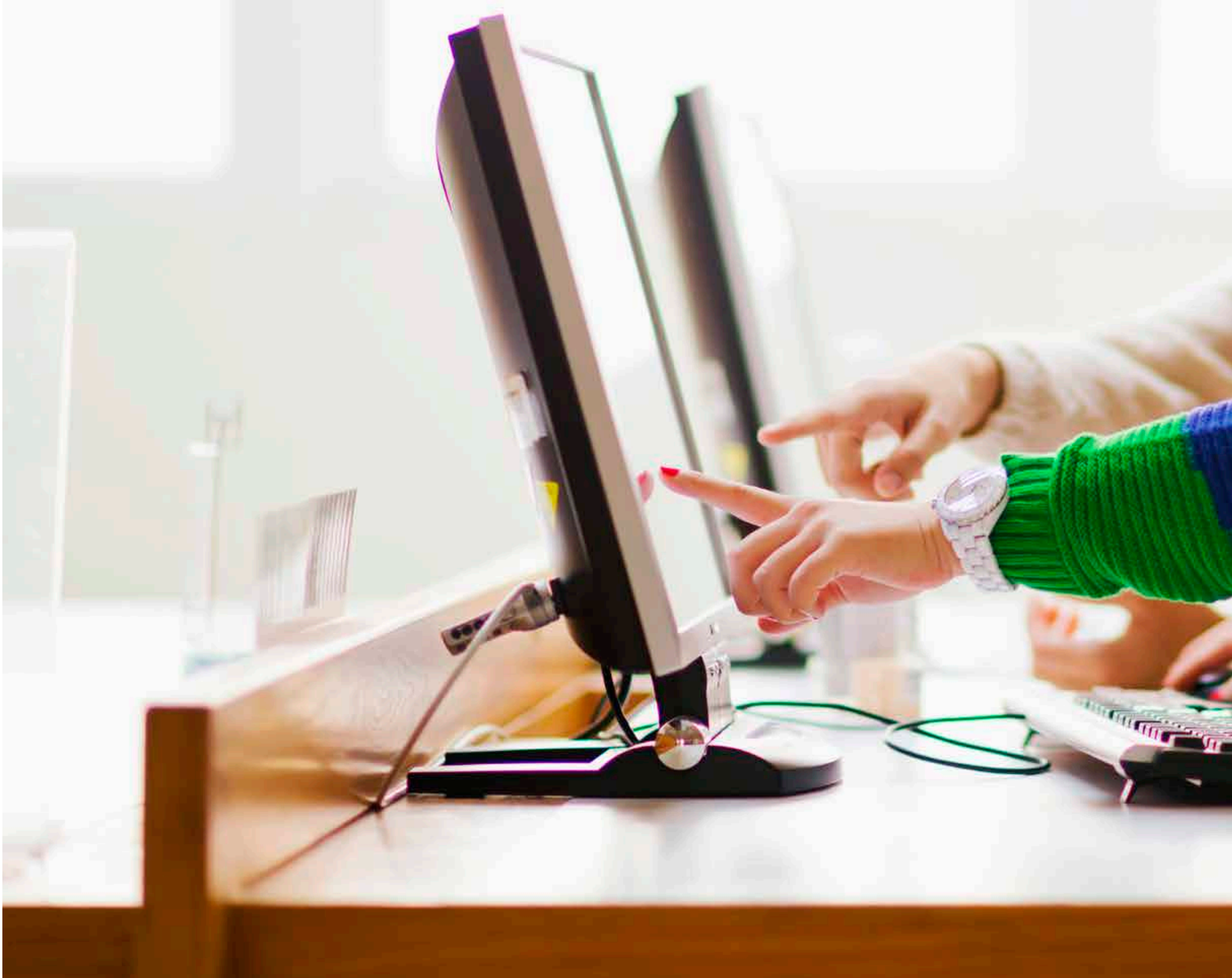
Alex Gelman, Partner – Technology Advisory & Solutions
Grant Thornton Australia

Growth strategy importance:
New technology



> You have to stay at the core of new technologies, because otherwise, you become irrelevant. We've got machines out there at the moment that will run 200 bottles a minute. If you look at some of our competitors, they're probably running at 60 because they haven't invested."

Nancy Clay, Commercial Manager of Natures Organics on how manufacturers compete with their factories as much as with the products they make there.



3

New markets

Just 16% of the businesses we spoke to are looking at international markets as a source of growth and two thirds of those were faster-growing companies. It's high time more mid-size businesses started to think more globally. Australia's proximity to major economies in the Asia-Pacific is a key advantage relative to competitors from Europe, Africa and the Americas. Some Australian mid-size business have taken this opportunity and reaped handsome returns.

A case in point is Fibre King, an engineering company in the packaging equipment business. Founded 89 years ago as a small blacksmithing workshop in Brisbane, the business and, indeed, the industry entered a difficult period post the global financial crisis. Capital expenditure by clients was significantly curtailed, forcing Fibre King to downsize its workforce. A few years on and the company has delivered 20% year on year growth for the three years to 2014-2015 – a turnaround that is entirely down to the company's international growth strategy.

When the company was struggling in 2012, CEO Earle Roberts - a 20-year veteran of the business - took decisive action. "We pressed ahead with our plans to transition from being an Australian company that exports, to being a proper global business."

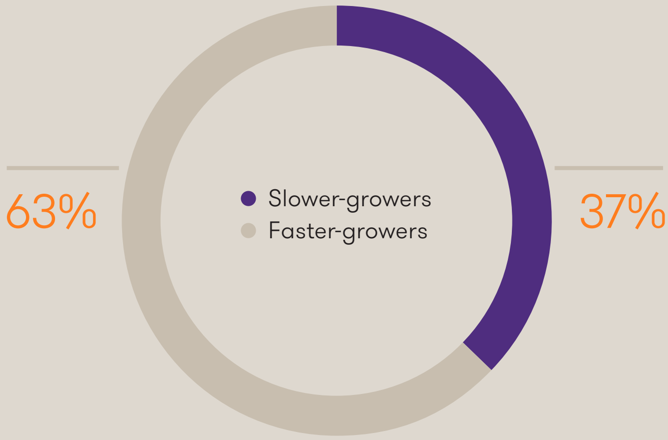
The key was the establishment of a major factory in Thailand. "I think the investment we made in Thailand has been critical to raising our visibility with the major multinationals," says Roberts, "If you look at the population density through South-East Asia, including India and China - you've got half the world's population in a fairly small geographic space." Fibre King now generates 70% of its sales outside Australia.

Bottom line

"In the past, companies would follow a set pattern on the road to international business. First attaining a dominant market position in their home State, then building a national business model before expanding across borders. Today's companies need to think differently about new markets. In an increasing digital world, companies can make a leap from local to global much earlier and easier. Many start-ups don't feel constrained by location and go to where the markets are, pursue a robust new market understanding and then plant seeds through digital channels. Mid-size business need to take a lead from their book and analyse customer value and supply chains across industries and geographies and reap the rewards."

Richard Gruppetta, Partner – Asia Advisory
Grant Thornton Australia.

Growth strategy importance:
New markets



4

New acquisitions

Apart from potentially exponential increases in revenue and market share, acquisitions offer a host of other benefits, including new resources (such as cash flows and skills), business synergies, risk diversification, economies of scale and direct access to new markets. Not to mention a potential reduction in competition.

It is perhaps surprising then that only 14% of mid-size companies we spoke to consider acquisitions an important growth strategy. The majority (71%) of those were faster-growing businesses. Protech, the industrial recruitment company, is one such example, “The consolidation that’s happening in our industry definitely presents itself as an opportunity,” says CEO Meili. “Over the last 12 months, M&A deals have become real discussions for the first time.”

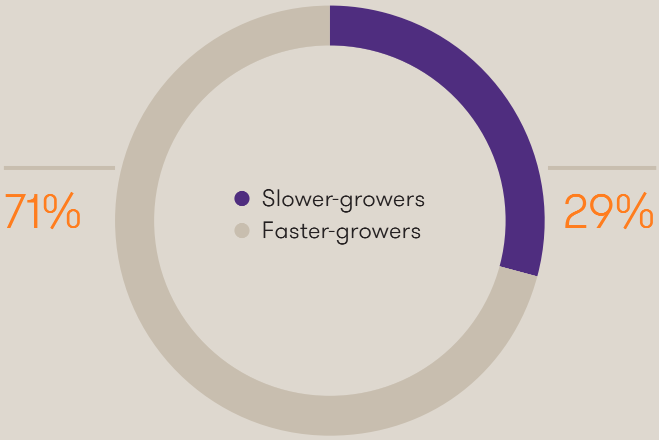
Like many mid-size businesses however, Protech’s M&A discussions come in two varieties: buy, or be bought? It often isn’t clear whether to prepare to be the big fish or the little fish, but as its industry consolidates, Protech’s next move will have a major impact on its future. “Our industry is heading a very specific way - it’s going either large or boutique. If we were to choose to generalize our services then we clearly need to be acquired and become part of the bigger pond,” says Meili. “If we choose to stay boutique we can still become larger by protecting the edge we have as a customer-focused, specialist operation.”

Bottom line

“Some of the reasons companies don’t have a proactive M&A strategy are complacency and a low risk appetite, born of fear of failure. They are also often put off by the integration challenges associated with clashes in systems, management and cultures. But the risk of failure can be mitigated by a strategic and disciplined approach to selecting the right target. Some mid-size businesses have become so good at this that successful M&A has become a core-competency. With the skills and personnel in place, they can maximise the transformative benefits of acquisitions.”

Paul Gooley, Partner – Corporate Finance
Grant Thornton Australia

Growth strategy importance:
New acquisitions



Section 3

Business conditions and the growth outlook

Like any business strategy, the four growth engines we've looked at are impacted by wider economic conditions and external forces which business can't control.

In some cases these are significant enough to threaten growth initiatives. Developing new products and services often depends on available skills; but new technologies can instantly transform the playing field. Meanwhile, market bubbles can inflate company valuations, acquisitions can add complexity and volatility in emerging markets can disrupt international business plans.

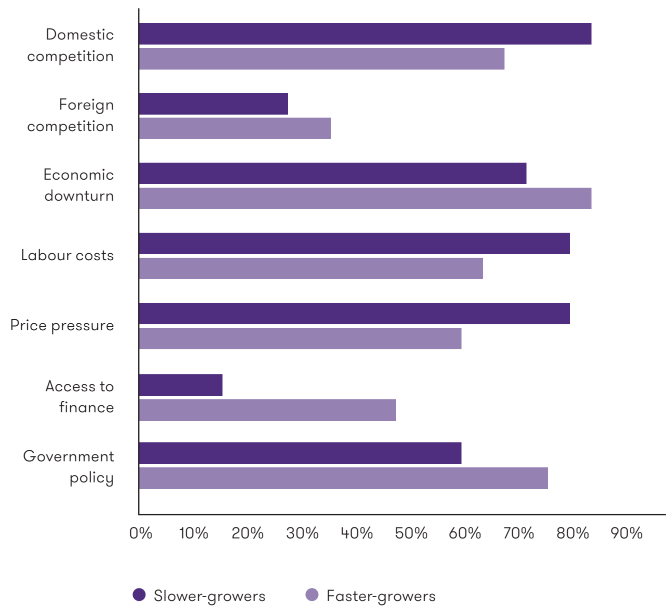
So what issues do Australian mid-size business owners and leaders focus on when considering growth strategies? In keeping with most of our findings, the answer is different for fast and slower-growth companies.

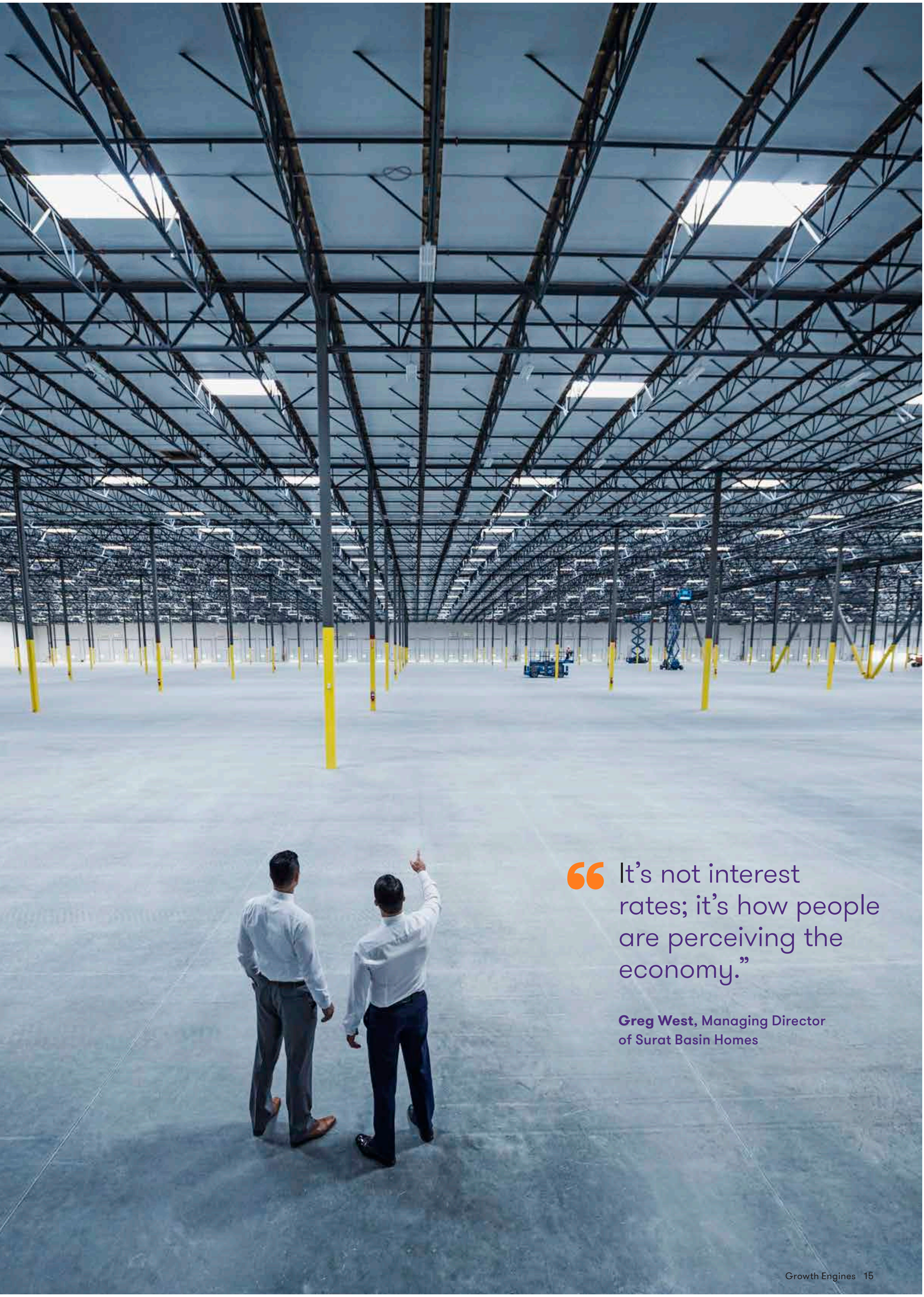
Lying awake for different reasons

Faster-growers are more concerned with issues like access to finance, government policy, economic conditions and foreign competition. Slower-growers are occupied by domestic competition, labour costs and price pressure. This latter group have often outgrown their business model and are more concerned with margin erosion and market share. Meanwhile, fast-growth companies can absorb cost increases more readily thanks to healthy revenue streams, but are more dependent on debt and vulnerable to adverse economic conditions.

Key threats: slower vs faster growers

Proportion identified as major threats in the next five years





> It’s not interest rates; it’s how people are perceiving the economy.”

Greg West, Managing Director of Surat Basin Homes

Business conditions are better than sentiment suggests

Despite the less-than-positive economic outlook – budget deficits for the foreseeable future, and subdued global commodity prices – the latest figures point to a better-than-expected outlook, with steady growth predicted for Q2 2016.1 In its latest (March 2016 1 quarter) figures, the Australian Bureau of Statistics reported a GDP uptick of 1.1 per cent, seasonally adjusted, driven by exports, which contributed 1.0 percentage points to the final figure.2

While trading conditions are robust, the resources boom fallout is yet to bottom. "I think the sharpness of the downturn has affected a lot of mid-size businesses," says Greg West, Managing Director of Surat Basin Homes, a Queensland-based property developer. "You talk to every taxi driver, you talk to every business – no-one's got confidence long term; no-one knows where it's going to go. It's not interest rates; it's how people perceive the economy."

Recent research suggests West's assessment is spot on. The latest NAB business survey for May 2016 reveals business conditions continue to rebound in both mining and non-mining states, but sentiment remains stubbornly subdued. NAB chief economist Alan Oster said, "The RBA's cut to interest rates did not help lift business confidence as we had hoped, even as sales activity continues to improve … uncertainty around the upcoming election might be a factor here, but mixed results across industries suggest that other factors are at play." Additionally, it is interesting to note that despite below-average business confidence, there was a strong kick-up in reported capital expenditure by firms in the survey. This, together with strong profits and falls in spare capacity suggests that prospects for business spending and employment are improving.

As some of the companies featured in this report demonstrate, conditions remain supportive for those with the right growth strategy. While tough times may lie ahead for some, our conversations with mid-size business leaders revealed that, despite their differences, almost all Australian mid-size businesses have enough grit to survive tougher times – and very often, more than enough.

Despite below-average business confidence, there was a strong kick-up in reported capital expenditure by firms in the survey. This, together with strong profits and falls in spare capacity suggests that prospects for business spending and employment are improving.

1 NAB Monthly Business Survey, May 2016, NAB Group Economics, (http://business.nab.com.au/nab-monthly-business-survey-may-2016-17259/), accessed 15 June 2016

2 5206.0 Australian National Accounts: National Income, Expenditure and Product, Mar 2016, Australian Bureau of Statistics, 2 March 2016 (http://www.abs.gov.au/ausstats/abs@.nsf/mf/5206.0), accessed 15 June 2016

3 ibid

About this research

This report is based on a quantitative survey and in-depth interviews with C-suite leaders and owners of Australian mid-size businesses (annual revenue $10-$500 million) conducted in 2015.

The survey polled 50 executives across multiple industries, including manufacturing; food and beverage; real estate and construction; aged care; energy and resources; healthcare and professional services.

We also interviewed an additional 30 C-suite leaders of mid-size businesses to gather qualitative insights and examples to complement the data. We would like to thank each of them for their participation.

Interviewees directly featured in this report include:

Andrew Kelty	Chief Operations and Finance Officer, Jamesons Strata Management
Chris Mitchell	CFO, Canstar
David Chuter	CEO, MHG Asia Pacific
Earle Roberts	CEO, Fibre King
Gavin Fielding	COO, ICE Design
Greg West	Managing Director, Surat Basin Homes
Marc Meili	CEO, Protech
Nancy Clay	Commercial Manager, Natures Organics

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