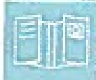
SPOTLIGHT

ARTWORK
Margaret Neill, *Scout*, 2010
Oil on canvas

Reigniting Growth

How to reverse a sudden slowdown *BY CHRIS ZOOK AND JAMES ALLEN*



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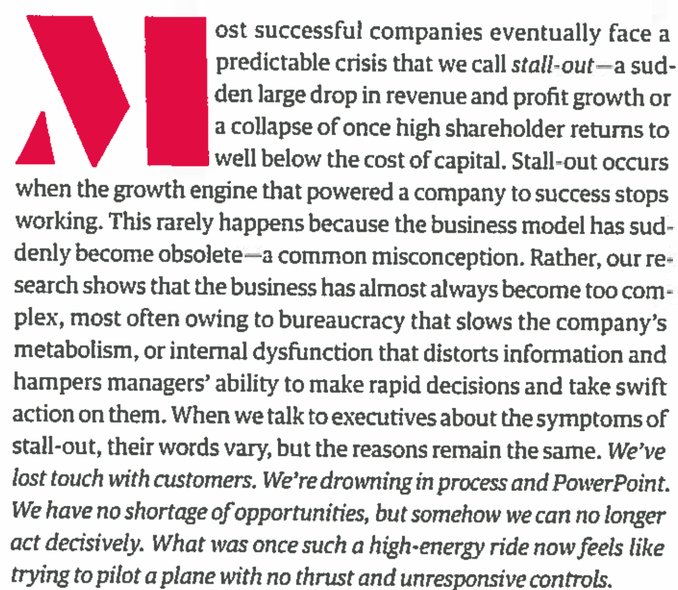
They are the coauthors of several books, including *The Founder's Mentality: How to Overcome the Predictable Crises of Growth* (Harvard Business Review Press, forthcoming).



Most successful companies eventually face a predictable crisis that we call *stall-out*—a sudden large drop in revenue and profit growth or a collapse of once high shareholder returns to well below the cost of capital. Stall-out occurs when the growth engine that powered a company to success stops working. This rarely happens because the business model has suddenly become obsolete—a common misconception. Rather, our research shows that the business has almost always become too complex, most often owing to bureaucracy that slows the company's metabolism, or internal dysfunction that distorts information and hampers managers' ability to make rapid decisions and take swift action on them. When we talk to executives about the symptoms of stall-out, their words vary, but the reasons remain the same. *We've lost touch with customers. We're drowning in process and PowerPoint. We have no shortage of opportunities, but somehow we can no longer act decisively. What was once such a high-energy ride now feels like trying to pilot a plane with no thrust and unresponsive controls.*

In an analysis of 8,000 global companies, we found that two-thirds of those successful enough to reach $500 million in revenue faced stall-out over the 15 years ending in 2013—including notables such as Panasonic, Time Warner, Carrefour, Bristol-Myers Squibb, Alcatel-Lucent, Philips, Sony, and Mazda. More alarming still, for 50 large companies in prolonged stall-out, we found that the onset had usually been sudden: Momentum fell sharply over just a year or two, with growth rates dropping from double digits to low single digits or even negative numbers—a finding consistent with past research (see "When Growth Stalls," HBR, March 2008).

To be sure, external forces put pressure on incumbent companies. Strategy—the external chessboard of business—still matters. Yet competitive strategies are more similar than they used to be, more easily copied, and of shorter duration. The roots of success or failure increasingly lie in the ability of companies to remain fast, perceptive, innovative, and adaptable. Internally thriving companies can respond to shifts in their competitive environments, identifying—and executing—strategies that sustain their dominance. When we polled 377 business leaders, 94% of those in companies with revenue of more than $5 billion told us that internal dysfunction—not lack of opportunity or unmatchable competitor capabilities—was now the main barrier to their continued profitable growth.

When stall-out occurs, it is almost always connected to creeping complexity.

Yes, stall-out may be predictable, but it can be overcome. We argue in a forthcoming book that most companies with sustainable growth share attitudes and behaviors: (1) They view themselves as business insurgents, fighting in behalf of underserved customers; (2) they have an obsession with the front line, where the business meets the customer; and (3) they foster a mindset that includes a deep sense of responsibility for how resources are used and for long-term results. Because these qualities are most vibrant in companies led by bold, ambitious founders, we call them "the founder's mentality." Since 2000, returns to shareholders in large public companies where the founder is still involved have been three times those for other companies. But any leadership team can harness the revitalizing effects of the founder's mentality. In some cases, a once-dominant mindset has been lost over time and may need to be rebuilt from a few vestiges. But these three qualities can help any company restart its growth engine by removing gunk and complexity that has built up over the years, inhibiting the clean execution of strategy.

1 Rediscover Your Insurgent Mission

When stall-out occurs, it is almost always connected to creeping complexity. "No single bad decision or tactic or person was to blame," Howard Schultz said after returning to the CEO position at Starbucks in 2008 amid shrinking revenue, collapsing margins, and a decline in stock price of more than 75%. Starbucks's stall-out was sudden and dramatic, he acknowledged, but it resulted from damage that had been "slow and quiet, incremental, like a single loose thread that unravels a sweater inch by inch."

To begin tackling stall-out, companies need to strip away complexity and excess cost in order to liberate resources, narrow focus, and harness the vigor that drove the company's early growth. We studied 10 successful rescue-and-rebirth operations and found that all of them involved reducing operating costs by at least 8% and sometimes more than 25%.

Successful attacks on complexity are led from the top down and proceed in a sequence. First the company must shed noncore assets and businesses. Next it must develop a simpler strategy for the remaining businesses. Then it can attack complexity in the core processes. Finally, it can focus on reducing product complexity in design, variations, and customization. We've seen leadership teams attempt transformation in the reverse order, only to become trapped in details and wear down the organization before getting to what really makes most transformations successful: reducing high-level complexity and cost.

We have found that as companies grow in size, internal budget processes become democratic, spreading resources evenly across businesses and opportunities. But democratic investment in the face of crisis is a sure path to mediocrity. The opposite is needed to reverse stall-out. At companies where it was avoided,

Idea in Brief

THE PROBLEM
Growing companies often face the predictable crisis of stall-out—a sudden large drop in revenue and profit growth. The culprits are usually complexity and bureaucracy.

THE SOLUTION
Leaders need to rediscover the "founder's mentality"—attitudes and behaviors that are strongly associated with founding management teams and can revitalize the business.

THE PRINCIPLES
Stalling companies should drastically reduce complexity and excess cost, refresh the mission, and configure the organization to focus obsessively on the business's front line. Finally, they should instill an owner's mindset that eschews bureaucracy and celebrates speed and accountability.

leaders had made bold investment decisions to redifferentiate the company, usually establishing a major new capability that set off waves of growth.

Once back in shape, companies must renew their view of themselves as business insurgents. This does not require promoting a martial culture or abusing the metaphor of "waging war" on competitors. Rather, companies should view their customers as underserved and their industries as setting insufficient standards, and should constantly emphasize what is special about themselves. Bold goals—not just the aim of living to fight another day—will sustain growth. As they become very large, organizations may find maintaining an insurgent mission hard, but it's not impossible. Google's mission to "organize the world's information," for example, is at once specific to Google and nearly infinite in its ambition.

A company should even be prepared to shrink significantly if that's what is needed to regroup, redeploy, and restart profitable growth. Consider the case of Perpetual, the oldest trust company in Australia, which recovered from stall-out by reducing its operating costs by 20%, stripping away noncore businesses, and rejuvenating around its founder's original mission.

Established in 1886 to manage trusts and estates for Australia's scions, Perpetual led the market for most of its history. But as it grew, it diversified into 11 new business areas, and by 2011 the company was struggling. Its share price had fallen from a high of $84 to $24 in only four years. Profits were down by nearly 70%, with no bottom in sight. Shareholders were calling publicly for a major overhaul, and the company had hired its third CEO in 12 months, Geoff Lloyd.

When he arrived, he "found an organization that was internally competitive and externally cooperative," Lloyd told us. "We had grown incredibly complex over time by entering more businesses, and we were not the leader in most of them." Lloyd concluded that to save Perpetual, he would have to return the company to its core mission: the protection of Australia's wealth. That, he realized, meant making the company "faster, more confident, and, above all, simpler."

Lloyd began by replacing 10 of the 11 members of the management team with people who had no vested interest in past decisions. With his new staff in place, he launched Transformation 2015, five initiatives designed to bring about swift complexity reduction at all levels. One was the "portfolio" initiative, which reduced the number of businesses from 11 to three (just two businesses were responsible for about 95% of profits), cut real estate holdings by half, and eliminated more than 100 legacy funding structures. Another, the "operating model" initiative, reduced the staff at headquarters by more than 50%. Lloyd and his team found that back-office support, staff functions, and redundant controls accounted for 60% of total costs. In other words, the company was putting only 40% of its money toward sales, customer service, and investment—its core activities. Furthermore, it was relying on more than 3,000 computer systems and applications.

Cutting back—on businesses, staff, computer systems, and more—was central to the transformation plan. But Lloyd and his team also crafted a plan to gain market share by investing in the company's core. He convened town hall meetings, which had never before been held at Perpetual, to discuss the company's situation and its future and to reignite enthusiasm for its core values. "We labored over the wording of our mission and strategy," Lloyd told us, explaining that he felt it was essential for employees to refocus on the founding principles of the company. In the process, he learned a remarkable

thing: Perpetual's original trust business was so strong that it still had its first customer—125 years later.

His strategies brought about a stunning turnaround. Perpetual's stock price has more than doubled since Lloyd took over; employee engagement has measurably increased; the company is gaining share in its core markets; and net profits have tripled.

2 Obsess over Your Business's Front Line

Companies that sustain growth live and breathe the front line of their business. This obsession, which can often be traced back to a strong founder, shows up in three ways: an elevated status for frontline employees, a preoccupation with individual customers at all levels of the company, and an institutional curiosity about the details of the business. A frontline obsession is most obvious in "high-touch" consumer businesses such as luxury hospitality. But the trait can exist in subtler ways in a range of industries: Consider the product obsession of Steve Jobs and the legendary attention to detail of the wine pioneer Robert Mondavi, who believed in the saying "The best fertilizer for a vineyard is the owner's footsteps."

The Home Depot, the largest home-improvement retailer in the world, provides an example of how losing a frontline obsession can lead to stall-out—and how renewing it can reignite growth. The company's initial success could be traced to its remarkable founders, Bernard Marcus and Arthur Blank, who devoted themselves to building a close advisory relationship with customers. Their corporate mantra was "Whatever it takes." The founders even trained store employees in customer service themselves. Employees, in turn, offered clinics on home improvement projects for customers and were always available in stores to provide knowledgeable advice. The strategy set the company apart and generated powerful customer loyalty, and for years The Home Depot was a major success story. From its founding, in 1978, until 2000, it consistently eclipsed its 20% annual earnings growth targets. But in December 2000, after missing an earnings target and having become increasingly concerned about antiquated systems—especially IT—in a company that was approaching $50 billion in revenue, the board of directors hired Robert Nardelli, a senior executive from GE, to introduce some big-company discipline as CEO.

The owner's mindset focuses on the long term and has a strong bias toward speed and action.

Nardelli created a command-and-control environment. By early 2006, 98% of the company's top 170 executives were new to their jobs, and 56% of the new managers at headquarters had come from the outside. Fresh leadership, especially in the area of systems, was probably needed, but this changing of the guard failed to build on the deep strengths that had once made the company special and beloved by its customers. Nardelli and his team neglected customer relationships and frontline enthusiasm in favor of boosting quarterly profits. Many long-serving full-time employees were replaced by lower-paid part-time workers, and customer service collapsed. "Do it yourself," some people joked, was now "Find it yourself." When the University of Michigan released its 2006 American Customer Satisfaction Index, The Home Depot had slipped to last among major U.S. retailers. The board held meetings in the field and found a consistent pattern: concern for the future, disempowerment of longtime store employees, and a feeling that the social contract between the company, its employees, and its customers was being breached.

Greg Brenneman, the longest-serving board member and a global turnaround expert, told us, "You could see the serious trouble bubbling up under the surface. Store managers were feeling shackled by dozens of financial templates and metrics that took time away from customers and running the stores. The most experienced store employees, the real experts on plumbing or electricity, had been let go and replaced with less experienced and cheaper part-time store workers. Foot traffic, the lifeblood of any retailer, was dropping. New stores were not generating good returns, leading to further staff cuts. We were stalling out and needed to change course."

The deterioration of the customer experience was at the root of the company's woes, and thus it illuminated a path back to sustainable growth. In 2007 the board replaced Nardelli with Frank Blake.

On his very first day on the job, Blake spoke to all employees using The Home Depot's internal television station and quoted extensively from Marcus and Blank's book, *Built from Scratch*. In particular, he highlighted two of their charts. One listed their core values, and the other gave pride of place, at the top of an inverted triangle, to the company's front line: its stores, where customers and employees interact.

Many of Blake's first initiatives focused on restoring the "orange-apron cult": knowledgeable store employees, easily identifiable by their aprons, who focused on high levels of customer service. Taking advice from Marcus, Blake also began anonymously visiting stores on "undercover missions," as he called them. These proved so valuable that he instructed his senior executives to adopt a "management by walking about" approach, something most had never done before.

Like Lloyd at Perpetual, Blake then set out to reduce complexity, restructuring the businesses and closing money-losing stores—essentially, shrinking to grow. He also increased the employee bonus pool by a factor of seven, rehired some veterans, and asked store managers to return to the pre-Nardelli policy of giving out honor badges to employees who had been exceptionally attentive to customers.

Eight years ago The Home Depot had stalled out and was facing the prospect of free fall. But as of the end of 2015, thanks to Blake's renewal of the founders' mentality, the company has reenergized its employees and repersonalized its customer experience—a return to core principles that has driven the company's stock from about $25 a share in 2009 to more than $130 by December 2015.

3 Instill an Owner's Mindset

The third factor in reversing stall-out involves a management idea that first came into vogue 40 years ago: the owner's mindset. Designed to instill balance-sheet discipline and accountability by aligning employees and shareholders, this concept is frequently misunderstood. Too often, it implies an incumbent's mindset: a concern with hunkering down and extracting value from the existing business, and a loss of interest in innovating, serving customers uniquely, and fully valuing frontline employees.

At its best, the owner's mindset focuses on the long term, has a strong bias toward speed and action, and embraces personal responsibility for employees' actions and for how resources are used. The power of the owner's mindset is central to the rise of the private equity industry—a reaction against the bureaucracy, poor cost management, and complexity that beset many large companies. When we analyzed the returns of deals within several private equity funds, we found that businesses sold by large public companies in which management had seemingly lost the incentives of ownership subsequently earned nearly 50% more than the others. After private equity firms had restored the owner's mindset, these companies benefited from increased speed, reduced bureaucracy, a more critical evaluation of noncore businesses, and an improved management of costs.

A case in point is Dell, the best-performing large company of the 1990s. It began to stall out a decade later, when some of the advantages of its legendary direct sales model began to narrow, and the company saw its market value decline from $107 billion in 1999 to just under $25 billion in 2013—a 77% drop. When Michael Dell returned as CEO to renew the company he'd founded, he concluded that he could more effectively make the changes he wanted if he took the company private, which he did in partnership with Silver Lake in 2013.

"In going private," he told us, "it's amazing how we have been able to speed things up. We simplified meeting structures, went to a board of directors with just three members, and increased our appetite for risk. When big committees talk about risk, they talk about risk committees, how risk is bad, the mitigation procedures of risk, and the reaction of the analysts. For us risk is now about innovation and success. It has been very energizing to our 100,000 employees to feel the long-term focus coming back into the company."

Customer satisfaction scores have rebounded, and Dell's employee satisfaction scores are the highest in the company's history. Its core businesses are outgrowing their industry peers again, and Dell is investing heavily to redefine its model for the long term.

Going private is not for all, of course. An owner's mindset can be instilled without taking the business off the market. Companies can generate "mini-founder" experiences by, for example, creating franchises with direct ownership stakes or encouraging employees to create internal start-ups that might later be spun off. They can encourage investors

HOW TO GET STARTED

Here are some ways to prepare your team to reignite growth.

Create a "founder's mentality" scorecard. Manage it as a strategic asset. Does your mission keep you fighting in behalf of your customers? Does your company focus on the front line of the business? Do employees embrace an owner's mindset that eschews bureaucracy, is focused on speed, and demands personal accountability?

Benchmark against your most successful upstart competitors. Are they winning on speed and cost? Commit as a leadership team to closing the gap.

Launch a campaign against bureaucracy. Look for management layers and processes that have outlived their usefulness. Eliminate them.

Get the leadership team out of the office. The front line is where the answer to a growth stall-out is most likely to reside.

Reexamine the precepts and practices of your founders or early leaders. When was the company at its best? What has been lost along the way that needs to be restored?

Look outside for help inside. You might reach out to retired founders or acquire fast-growing, founder-led young companies.

with a more long-term focus and link executive pay more closely to long-term performance measures. They can change the timing of internal meetings to increase the speed of decision making. (Some leadership teams, for instance, hold Monday meetings and Tuesday follow-ups with the aim of removing blockages to important decisions and actions.) They can reach outside the company to partner with insurgents and perhaps eventually acquire them. Or they can bring founders into the company through acquisition and work to retain them and their entrepreneurial energy. This has been the approach of companies such as Cisco, Google, and eBay.

Initially a huge success story, and one of the first dot-coms to radically scale up, eBay stalled out in the late 2000s—a victim of Amazon and other online retail competitors and of its own diversification, which included acquiring Skype. Its aging e-commerce auction model seemed vulnerable to competitors, and its share price had fallen from $59 in 2004 to a low of $10 in 2009.

Some of the biggest stock upturns occur when a company has to return to its core.

When John Donahoe became the CEO at eBay, he recognized that to get the company moving again, he would have to divest noncore businesses, revamp eBay's e-commerce platform, and, most important, shift its focus to a hotbed of innovation: mobile commerce. To successfully enter the mobile space, however, he would have to turbocharge the company's innovation pipeline and capabilities—and the only way he could manage that, he told us, would be "to fill eBay with young entrepreneurs." In doing so, he was guided by a general truth about transforming stalled-out companies: Often, outside forces need to be brought in.

Not long after he took over, Donahoe began to acquire small, founder-led companies at a rate of about one every three months. He wasn't interested solely in acquisitions and technological innovations. He wanted to retain the founders and their teams, frequently so that he could move them into core-business positions. "Many of these founders like our approach," Donahoe told us, "because they can innovate at scale in eBay, and they get to expose their innovations to 130 million customers globally."

One of them was Jack Abraham, the 25-year-old founder of Milo, a shopping engine that searched stores for the best-priced merchandise. At one of the regular Friday meetings that Donahoe held with company leaders under 30, Abraham raised his hand and proposed a major innovation for the home page. Donahoe told him to go figure out what resources he needed to explore the idea. Immediately after the meeting, Abraham found five of the best developers in the company, went out for drinks with them that night, and persuaded them to leave with him the next morning for two weeks in Australia, where they would be as isolated from California headquarters as possible and could work on developing a prototype.

What they came up with blew Donahoe away. "Had we asked a normal product team," he said, "I would have gotten back hundreds of PowerPoint slides and a two-year time frame and a budget of $40 million. Yet these guys went away, worked 24/7, and built a prototype. These guys build. They do no PowerPoint. They just build."

Obviously, Donahoe's approach is best suited to fast-moving markets where incumbents need to constantly add technologies and build new capabilities. Not all these initiatives have been lasting successes. The fivefold increase in eBay's stock price during Donahoe's tenure was driven by many things, including the success and spin-off of PayPal (whose independent status has enhanced its founder's mentality), yet it is a clear example of the power of pulling in business owners from the outside and harnessing their energy and entrepreneurialism.

STALL-OUTS ARE frightening for companies—if ignored or mishandled, they can lead to lasting reversals of fortune. But like any other daunting challenge, they can also be viewed as an opportunity. When we analyzed value swings on the stock market, we found that some of the biggest upturns occur when a company is forced to return to its core and redefine it in the process. Managers need not panic when stall-out occurs. Companies that reignite their mission, renew their obsession with the front line, and instill an owner's mentality throughout the organization can reach new heights. ▽

HBR Reprint R1603F