CoBank

OUTLOOK Economic Data and Commentary

March 2010 Volume 7 Number 3

Double-Digit Growth – No Matter What

All good business managers recognize that they must deliver top-line growth to be successful in the long term. But what is a reasonable growth rate, especially during tough economic times?

Some experts insist that growth depends in large part on where a business falls in its lifecycle. Small, start-up companies often grow very quickly, while larger, mature companies tend to see their growth rates plateau or even decline over time. Conventional wisdom also dictates that a company's growth rate is influenced heavily by external economic forces and conditions.

Business strategy consultant and entrepreneur Michael Treacy, however, contends that the conventional wisdom is wrong. Treacy, a former MIT business professor and successful entrepreneur, argues that any company should be able to achieve double-digit growth in any industry segment – regardless of market conditions at any given time.

Treacy, the author of the best-selling book on the subject, recently sat down with Outlook to talk about what strategies companies must employ to realize double-digit growth consistently.

OUTLOOK: The nation just experienced the worst economic downturn since the Great Depression, and many companies suffered in market sectors that were hard hit, including housing, the auto industry, consumer goods and more. Is it really realistic to expect double-digit growth in that kind of market environment?

MT: The fact is many companies are growing 10 percent or better in this economy. The seven businesses I'm involved with have all grown during this tumultuous time. All of these companies understand very clearly why their customers do business with them and have taken a disciplined management approach to growing.

OUTLOOK: What about companies that face stiffer headwinds in their market sector?

MT: There's a whole industry of excuses why companies didn't grow. Most companies see only barriers to growth, things such as lack of market opportunity, competitor resistance, operational capacity and financial capacity. The real reason most companies don't grow is they don't know how.

It reminds me of how American companies learned about the discipline of cost control. When the Japanese came ashore 20 years ago with products priced at points U.S. manufacturers couldn't match – whether it was automobiles, electronics or whatever – the conclusion was that the Japanese were simply cheating. In fact, the Japanese had built a disciplined, structured way of attacking costs. Today, it's table stakes for being in a business to know how to control costs and get productivity improvements year-over-year. We've built a discipline.

One reason companies have put up solid bottom line growth numbers in this recession, even while their top lines have taken huge hits, is because they have a deeply-rooted discipline around managing costs. But firms struggle to grow because they don't have that same discipline for managing the top line and growing the business. But the fact is you can control growth the same way you control cost, by having a plan and executing the plan.

If company growth is not reaching expectations, it's not a market problem, it's a management problem. Most organizations should be able to grow at any reasonable level of ambition. But doing it requires a very thorough discipline.

OUTLOOK: Not everyone would agree that any company can achieve 10 percent or better growth in any industry or economy. What kind of research supports that notion?

MT: A few years ago, I did a five-year study of the 1,000 largest publicly traded companies in the U.S. to see who could grow their top, middle and bottom lines – revenue, gross profit and net income – 10 percent or better for five years in a row. In the S&P 1000, 78 companies could do that. I looked at those in great detail and matched them up against about 50 companies that looked like growth firms on the surface, but when I took a closer look at them, they weren't at all.

Four basic findings dropped out of this study: First, and most importantly, businesses can achieve and sustain double-digit growth if they have management discipline. Second, companies need to focus their growth strategy on sources of revenue growth and a portfolio of growth opportunities. Third, a critical foundation for growth is customer value, meaning they have to answer the question: "Why should people do business with me?" Finally, the stronger that foundation, the steadier and longer the business can achieve desired levels of growth.

OUTLOOK: What exactly is "customer value," and why is it so important?

MT: Customer value is both what you sell and how you do business. On the cost side, it's the price your client pays. On the benefit side, it's what they get that's special, new or different. Companies can optimize value leadership

About this article

Dr. Michael Treacy, recognized expert in the area of corporate growth strategies, is a former MIT professor, a best-selling author and a business consultant. Dr. Treacy holds an engineering degree from the University of Toronto and a doctorate from MIT; he served as a professor at MIT's Sloan School of Management in the 1980's. A co-founder of Gen 3 Partners, a Boston-based consulting firm specializing in product innovation, Dr. Treacy currently serves as a member of that firm's Board of Directors. He is a popular lecturer and best-selling author of business books, including *The Discipline of Market Leaders* and *Double-Digit Growth, How Companies Achieve It, No Matter What.*

Dr. Michael Treacy, a recognized expert in the area of corporate growth strategies, is a former MIT professor, a best-selling author and a business consultant.

"There's a whole industry of excuses why companies didn't grow. Most companies see only barriers to growth, things such as lack of market opportunity, competitor resistance and operational capacity. The real reason most companies don't grow is they don't know how.

on one of four dimensions: low price, being hassle free, offering a uniquely better product or providing value-added results expertise.

Companies that choose to optimize on price sell things less expensively than everybody else. Then there are those that have optimized their businesses around being hassle free – which can include streamlined ordering, shipping, billing and so forth. Product leaders focus on delivering a uniquely better product. The fourth dimension of customer value is results expertise. That means leveraging your expertise to take on processes customers would traditionally have done for themselves, delivering value-added services like inventory management.

Which dimension a company chooses depends on a combination of customers, competitors and competencies. What do your clients need? Who's the competition and what are they doing? And what are your company's core competencies; what is the firm is naturally good at compared to the competition? The answers to those questions will determine each firm's value proposition and which dimension of customer value they choose to build their business around.

OUTLOOK: Can you give examples of companies that have successfully achieved consistent double-digit growth?

MT: In my book, I profiled Johnson Controls, Mohawk Industries, Paychex and Oshkosh Truck. These organizations demonstrated that with disciplined, one-step-at-a-time progress, growth can come from a variety of fields simultaneously. It's no accident that these companies adopted a portfolio approach to growth, closely managing both current sources of revenue and potential growth opportunities. And they kept an eye on customer value, never abandoning the core businesses that accounted for their original success.

All of these companies grew by managing a growth portfolio that allowed them to recognize and seize opportunities. For example, Johnson Controls' relentless product and service innovations helped it retain its customer base and build market share. By focusing on serving smaller businesses, Paychex essentially created a market, with expanded offerings driving more revenue from existing customers and capturing new ones. Oshkosh Truck leveraged acquisitions to penetrate new markets, where it made the most of its technology, manufacturing know-how and distribution system. Mohawk produces an extraordinarily broad line of products that help it continuously enhance its position in every segment of the flooring market. The company is also famous for helping its distributors succeed.

Johnson Controls is really one of the strongest examples. Between 1995 and 2002, the company lifted revenues by an average of 14 percent, gross profits 13.5 percent and net profits by a whopping 18.6 percent per year. Today, even with the economic downturn, Johnson has continued to deliver double-digit growth.

OUTLOOK: How can organizations begin to develop the kind of discipline needed to achieve consistent double-digit growth?

MT: The most important step is to develop the organizational capability to grow. It's one thing to build a growth plan – it's quite another to make it so automatic that the plan isn't just executed, but improved and adjusted on the fly while being executed.

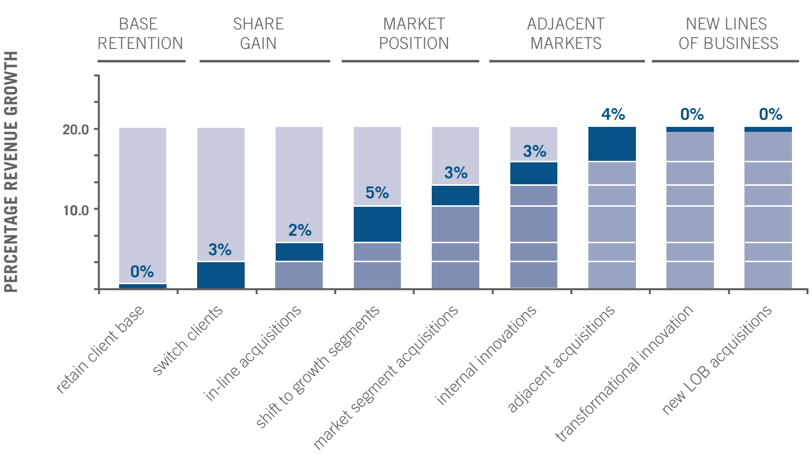
How this approach is different from what most American businesses are doing can be defined by one word – granularity. It's not about a big, macro growth plan; it's about breaking the plan down into small pieces that teams can deploy. For example, instead of trying to grow 15 percent by expanding the sales force, break the plan down into discrete components and distribute the responsibility so that the individual pieces add up to 15 percent.

OUTLOOK: Where does a business start building a growth strategy?

MT: There are five places to look for growth: base retention, share gain, market positioning, adjacent markets and new lines of business. These are common-sense, but most management teams are not measuring and managing these components of growth.

Base retention, reducing your rate of customer churn every single year, is often overlooked as a revenue opportunity. Measure it – establish a baseline and determine the current churn rate – and plan how to reduce churn every year. The next source of new revenue is share gain, or taking business from the competition. Only two things drive share gain – a better value proposition or a better market coverage model. Market positioning is showing up where growth is going to happen. The positioning game is about weighing your portfolio to target growth segments – product, customer, geographic – before the other guy.

HOW MIGHT YOUR BUSINESS GROW 20% PER YEAR?



Source: Michael Treacy

Unlike positioning, growing into adjacent markets is like going into a whole new business. Acquisition is the recommended method for successful growth through adjacency. Lastly, only go into completely unrelated lines of business if your investment skills are up to Warren Buffett's level. Very few people have both the ability to pick wisely and a management structure to manage diverse acquisitions like portfolio investments. The basic insight from a strategy perspective is that businesses need to build detailed strategies in at least the first four areas.

OUTLOOK: Can you give a specific example of a company that's successfully implemented a consistent growth strategy?

MT: Once again, let's consider Johnson Controls, which has a discipline around all five sources of revenue. To begin with, it deployed a powerful base-retention strategy, creating service relationships that entangle customers in complex, hard-to unwind relationships and delivering innovations that maintain market-leading customer value. The company employs a remarkably consistent share-gain strategy across its divisions, targeting value innovations in products and services at ever-expanding definitions of customers' problems. For example, in the building-controls business, Johnson has innovated at the component level, in the design, installation and maintenance of complete HVAC systems; and it has created innovations for complete building control systems that include fire alarms, equipment monitoring and security systems. It has even created innovations for entire real estate portfolios and large campus facilities.

The company also addressed market positioning through a series of acquisitions in Japan and Europe, which provided an immediate boost in global market share while improving its value proposition. Johnson Controls penetrated adjacent markets by innovating. The building control division branched out into facilities management, a natural growth opportunity. And its expertise in temperature-control systems inspired Johnson to penetrate the market for security systems for commercial buildings, which led to providing airport security.

Johnson Controls also is a veteran of expanding into new lines of business. Adding to its original core business of temperature controls, the company entered both the automotive interiors business and automotive battery business via acquisitions, building both into powerful divisions.

OUTLOOK: What strategies and tactics should be employed to create a successful growth portfolio?

MT: Roll out your initiatives for base retention, share gain, market positioning and adjacent markets at the corporate level, by business unit and by geography. Whether you naturally decompose your business by geographies, If company growth is not reaching expectations, it's not a market problem, it's a management problem. Most organizations should be able to grow at any reasonable level of ambition. But doing it requires a very thorough discipline.

customer segments or various businesses with different products and services, have each area build its own growth plan and growth portfolio. To get a smooth effect, you manage all of those growth initiatives as one portfolio.

Consider Wal-Mart, which has a wide variety of growth initiatives. One of those is to increase average "basket size," meaning the amount of goods the average shopper buys on each trip to the store. To achieve that, they have a program to offer new consumer credit, another one to increase demand by strategically lowering prices on products with price elasticity, and a whole list of other initiatives. That's just one item in their growth portfolio. Note the granularity. You don't create a growth portfolio for the business there's a growth portfolio for each part of the business.

But talent is the key to most of what I'm talking about. When it comes to growth, most of us run out of talent long before we run out of money. Imagine that you have 16 growth initiatives. You have tactics to improve base retention and things to drive share gain. You're working on improving your value proposition and looking at moving into some adjacent markets. Do you have the talent base – 16 go-to executives – to lead those growth initiatives?

OUTLOOK: How can companies recruit and retain talent with growth in mind?

MT: Some of the really good firms treat talent like a supply chain. They think consciously about the talent they need to "fund" their growth strategies – adding from the outside and building it up from the inside. Continuing today's rate of growth five years from now will require a steady infusion of talented people and placing them in roles where they can have the biggest impact.

Much of the time our incentive systems are not granular enough to get people focused on the right stuff in a way they can help drive growth. Sometimes we're paying people for growth they didn't contribute to. Other times we're not paying them enough for an enormous effort that helps the firm grow. For example, we typically incent sales the same way for market-positioning and share-gain, even though very different activities and efforts are required. Nobody incents their accounts receivable department around base retention, even though accounts receivable is like the canary in the coal mine. When a client is thinking of leaving, the first thing they do is complain about their invoice and slow their payment cycle.

OUTLOOK: What other shifts in perspective are needed?

MT: Talent is one of three critical areas to consider for steadily growing the firm. You also need to manage innovation and business performance. Innovation means having a steady supply of new ideas for how to grow. Performance management means measuring results against growth objectives and making adjustments. Performance data drives significant conversations about why and how a company is growing, how different geographies are doing with a particular growth strategy, how different business units are doing with diverse market segments and how various service offerings are faring across the business.

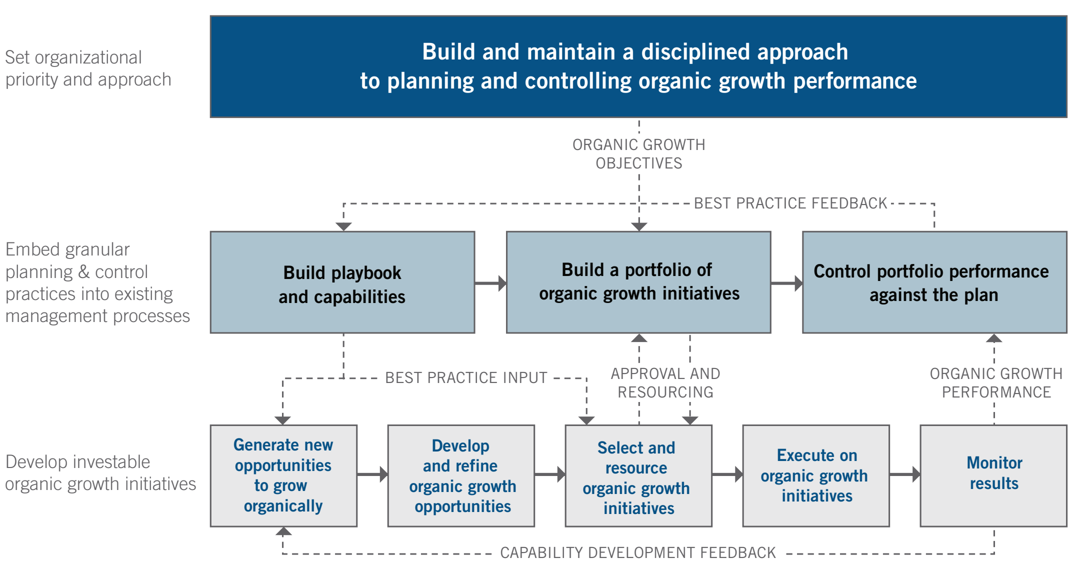
OUTLOOK: How can companies generate innovative growth ideas that work?

MT: You've got to have a system to facilitate conversations throughout the year – not just during the planning season – about better ways to grow the business. What's new and inventive? What can we steal from the competition and what can we borrow from other industries? How can the company boost share gain in a particular segment? How will the business reduce client churn?

These ideas represent potential growth opportunities – but you can't deploy an idea. Develop and refine ideas into something worth investing in by testing them with a few targeted customers, in a sales territory or with a particular product set.

You also need to invest in having a surplus of ideas. Too many firms build their growth plans around the first few ideas they come up with – if they come up with five ideas, then that's the plan. I want you to think of 50 things and pick the five best ones. It's like the concept of deal flow in the venture business. You want to have at least 10 times as many deals crossing your desk as you are prepared to invest in, because that keeps your standards high. When you know there are more deals – or ideas – coming, it makes you picky.

THE STRUCTURE OF AN ORGANIC GROWTH MANAGEMENT DISCIPLINE



Source: Michael Treacy

Often half the initiatives that go onto the plan for a given year will be the continued execution of ideas that were in the plan the previous year.

Ideas that get refined into investable propositions are further evaluated to determine how the idea will support the overall growth plan and the resources required. Proven ideas get rolled into the growth plan with no risk of whether they will work. The only risk is whether the company can deploy the idea across the business quickly enough to get the desired impact.

OUTLOOK: How can an organization accurately measure whether the growth plan is producing the desired results and truly manage business performance to drive growth?

MT: Set organizational priorities and define how the company is going to build and maintain a highly disciplined approach to planning and managing growth performance. Each business unit needs clearly stated stretch objectives for base retention, share gain, market positioning and adjacencies. The business unit growth portfolios and plans are the basis of a control system, which includes regular management meetings, reviews and reports. Then execute the growth initiatives and monitor the results to ensure that goals are being met.

This is not just a control system, it's a learning system. Monitoring results also feeds back into idea development. If an idea that was refined, tested and deployed is not working, what can be learned to help the organization generate better ideas? When senior management and business unit leaders can all see which growth initiatives are working and which aren't, then the organization builds collective knowledge and shared expertise to drive best practices across the business and manage business performance to growth objectives.

OUTLOOK: What advice do you have to help organizations get started?

MT: When a business is super focused on the customer and what they need, a lot of the other stuff gets easy.

Another abiding belief is one I can't fully reconcile with my strategy background. The best team beats the best strategy every time. You may have an A-plus strategy that cost you bazillions of consulting dollars – but if you have a B-plus team, you will get a B-plus result. But, with a D-plus strategy and an A-team, the A-team will fix the strategy in 90 days and give you an A result.

I've seen companies truly commit to the system, with extraordinary results. There may be a curveball from the economy or a competitor, but these firms are not sweating what their growth performance will be next year, any more than they're sweating what their cost performance will be. They've taken what was a game of chance and turned it into a game of skill.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 2/28/10. They are intended to provide rate or cost indications only and are for notional amounts in excess of $5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC & Blue Chip Economic Indicators

				US Treasury Securities	
2009	**GDP**	**CPI**	**Fed Funds**	**2-year**	**10-year**
Q3	2.20%	3.60%	0.16%	1.00%	3.50%
Q4	5.70%	3.40%	0.12%	0.90%	3.50%
2010	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.80%	2.00%	0.12%	0.90%	3.70%
Q2	2.80%	1.40%	0.14%	0.90%	3.80%
Q3	2.80%	1.90%	0.19%	1.00%	3.80%
Q4	3.00%	1.90%	0.19%	1.10%	3.90%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.25%	0.84%	1.66%	2.60%	3.19%	3.70%
0.25	0.49%	1.04%	1.91%	2.80%	3.35%	3.83%
0.50	1.00%	1.21%	2.17%	3.01%	3.52%	3.96%
0.75	1.53%	1.29%	2.41%	3.20%	3.67%	4.07%
1.00	1.11%	1.25%	2.64%	3.39%	3.82%	4.19%
1.50	1.29%	1.95%	3.13%	3.75%	4.09%	4.41%
2.00	2.37%	2.87%	3.69%	4.14%	4.40%	4.65%
2.50	2.99%	3.57%	4.03%	4.39%	4.60%	4.81%
3.00	3.39%	3.79%	4.33%	4.60%	4.76%	4.93%
4.00	4.07%	4.41%	4.74%	4.89%	5.00%	5.12%
5.00	4.50%	4.79%	4.96%	5.07%	5.17%	5.25%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

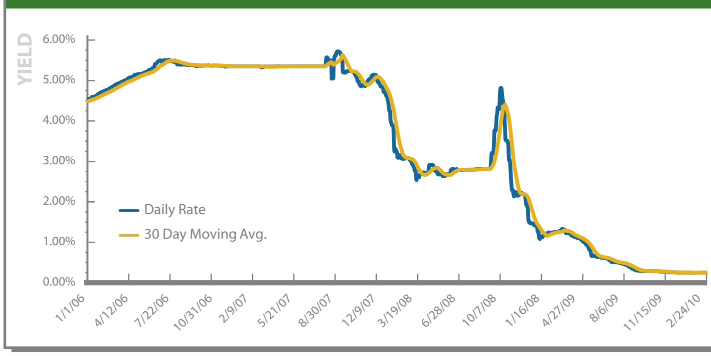
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	11	12	11	7
90	29	30	28	18
180	53	56	52	33
365	106	99	95	60

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

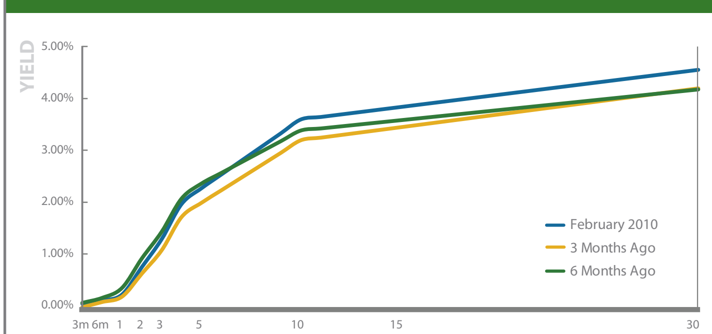
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE



CoBank 2009 Annual Report Now Available

CoBank recently released its 2009 Annual Report, which includes year-end financial information for the bank, customer profiles, and an overview letter from Board Chairman Everett Dobrinski and CoBank President and Chief Executive Officer Bob Engel.

You can download a copy of the 2009 CoBank Annual Report by clicking HERE.

Hardcopies of the 2009 CoBank Annual Report are also available upon request by calling (800) 542-8072 x 45862 or emailing **corp.comm@cobank.com**.

CoBank 2009 Earnings Webcast Available for Download

On February 23, 2010, CoBank hosted a conference call and webcast discussing full-year 2009 financial results. The call featured remarks from CoBank executives and a Q&A session.

You can view a replay of the CoBank earnings webcast by clicking HERE.

About CoBank

CoBank is a $58 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy. In addition to serving its direct borrowers, the bank also provides wholesale loans and other financial services to affiliated Farm Credit associations and other partners across the country.

Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore. For more information about CoBank, visit the bank's web site at www.cobank.com.