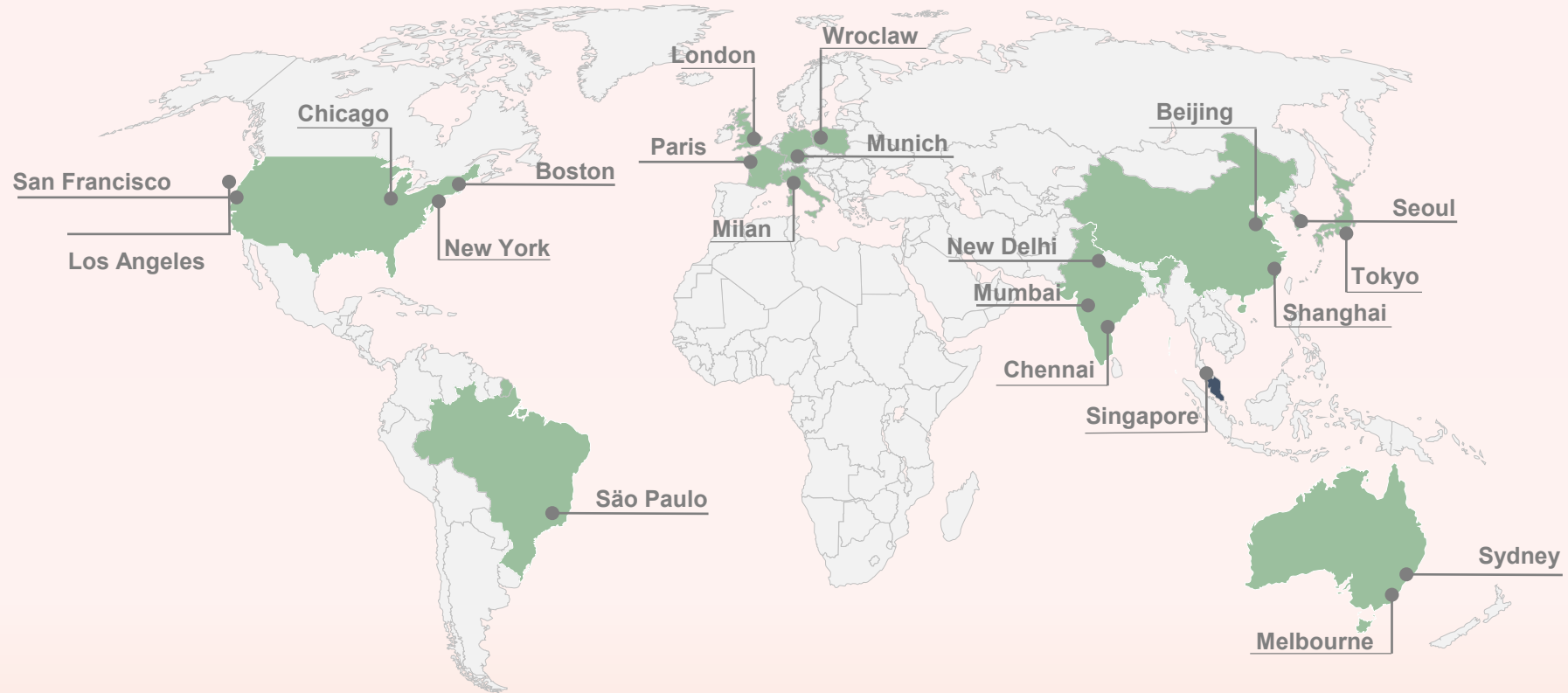


Edge Strategy: *A New Mindset for Profitable Growth*

Association for Corporate Growth Webinar
March 3rd 2016

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21 Offices

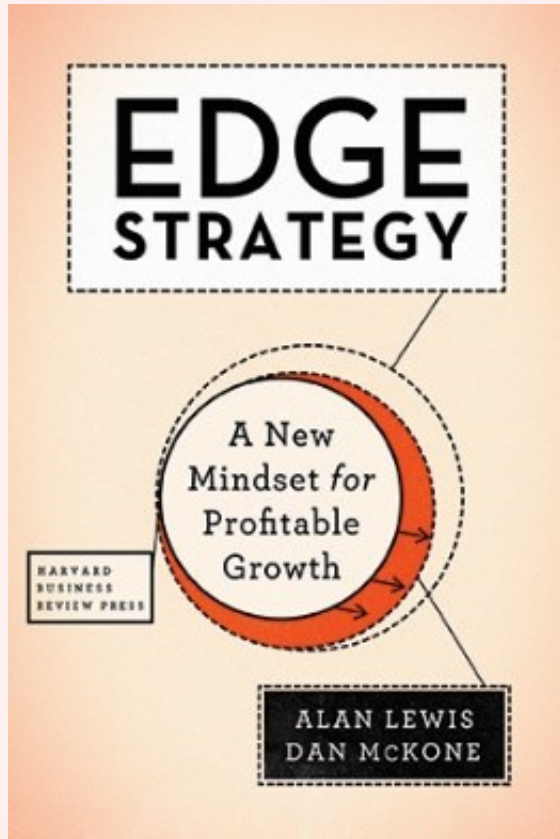


~100 Partners



~1000 Staff

L.E.K. is a thought leader in growth strategy



- *Edge Strategy: A New Mindset for Profitable Growth* is a new business book by Alan Lewis & Dan McKone, published by Harvard Business Press in 2016

John Tague, President and CEO, Hertz Corporation

“Alan Lewis and Dan McKone offer an alternate path to growth and show how implementing an ‘edge strategy’ creates value in a sustainable way. To presume it doesn’t apply to your industry or situation would be missing a great opportunity.”

Kevin Mayer, Senior Executive Vice President and Chief Strategy Officer, The Walt Disney Company

“We all need peripheral vision. *Edge Strategy* offers a clear and powerful framework for identifying and leveraging opportunities for growth that can sometimes be hard to see—at the edges of your core business. A must-read.”

Darrell Webb, President and CEO, Guitar Center

“Refreshingly pragmatic advice for driving growth, with a strong ROI, in any business.”

John Rainey, CFO, PayPal

“*Edge Strategy* flips the conventional notion of strategy on its head and provides an insightful take on where some of the best value-creating innovations come from.”

Robin Hayes, President and CEO, JetBlue

“*Edge Strategy* will help you and your business pull some of the most powerful levers at your disposal. Lewis and McKone outline a clear, smart approach to driving new—and greater—yield from assets you already manage . . . and delighting customers in the process.”



Objectives of the Session

- Introduce the edge strategy framework and how companies can apply it

What is **Edge Strategy**[®]?

Edge Strategy is a way to access high margin new revenue availing of investments already made and risks already taken



Highly profitable because you're leveraging foundational assets you already have in your core (e.g., customers already in your store, tangible / intangible assets)



Lower risk because your ability to operationalize is quicker than launching a new business (which requires high upfront investment)



Higher probability of success because the increase in complexity to execute is marginal relative to further afield opportunities



Some simple illustrations of edge thinking



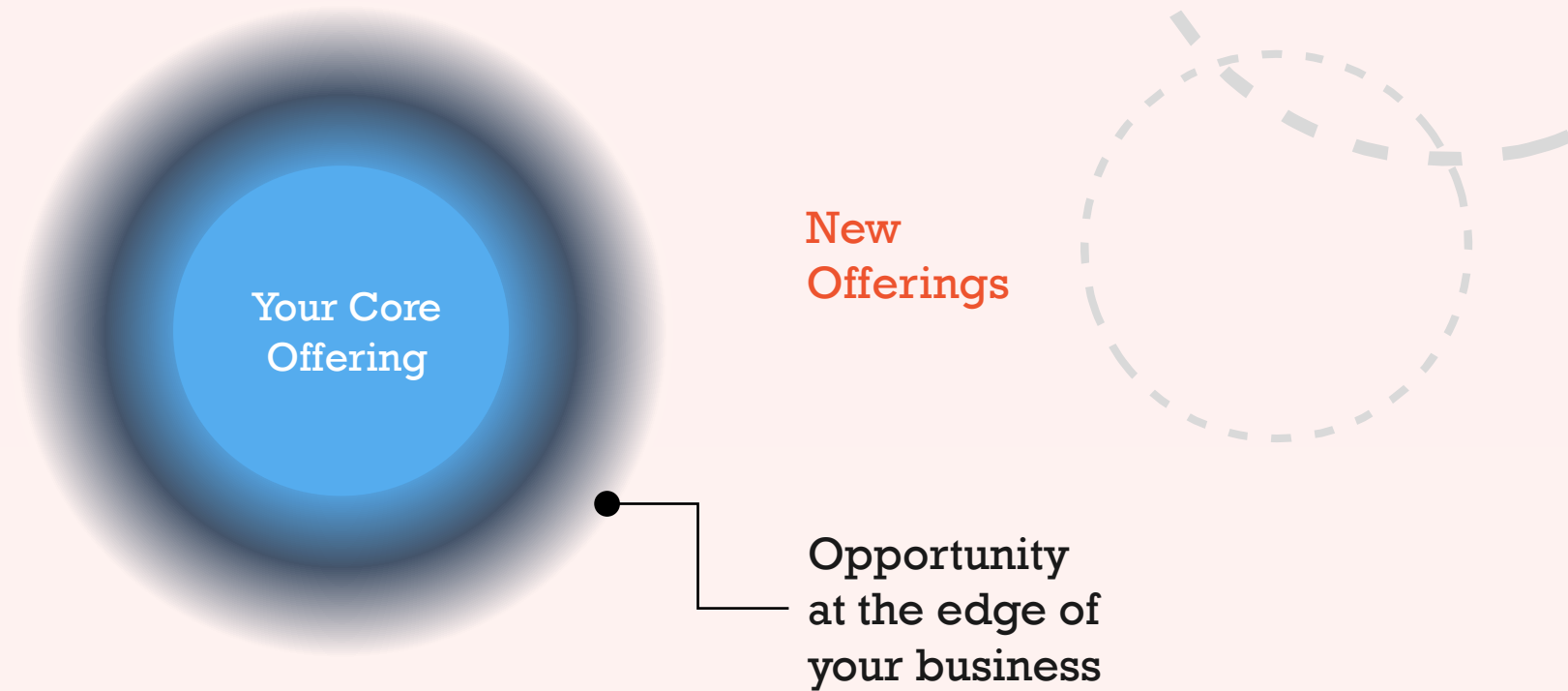
Retailers who add warranties to low margin high ticket items

Grocers make x5 times the profit by chopping and bagging lettuce

Farmers get paid to allow energy companies access their fields


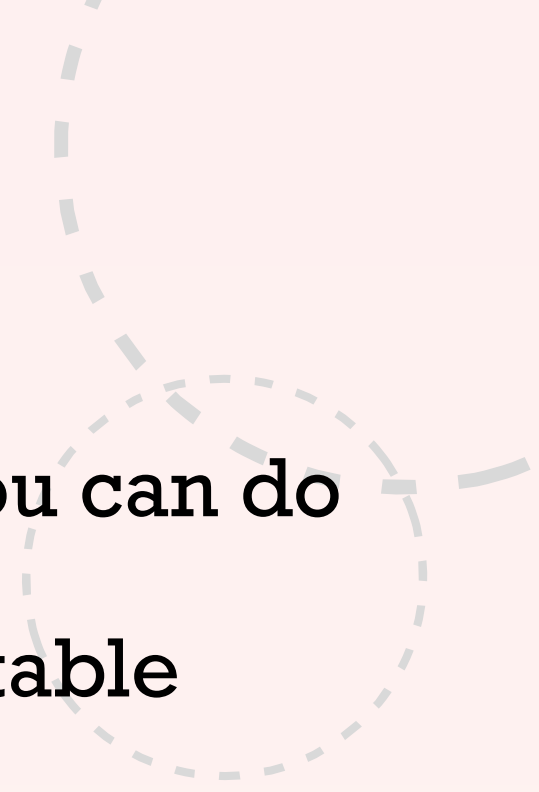
Airlines allow some customers to pay to have more leg room

Why does it work?



The edge of your business is rarely a sharp perimeter but rather a nexus of opportunity

Edge Strategy is

- A Discipline
 - A Pattern
 - A Mindset
- 
- Something you can do
 - That is repeatable
 - And can be internalized
- 

Edge Strategy is

- A Discipline
- A Pattern
- A Mindset

A sustainable and repeatable way to take low, incremental risks and access new growth

But

While the goal is not disruption, the benefits can be transformational

What is **the Discipline?**

- Using your existing business to create new revenue streams that are incremental to your core offering today by:
- Challenging what permissions your customers' give you
... **All your customers...all the time**
- Challenging the value of your assets
... **All of them... to any company**

What is **the Discipline**?

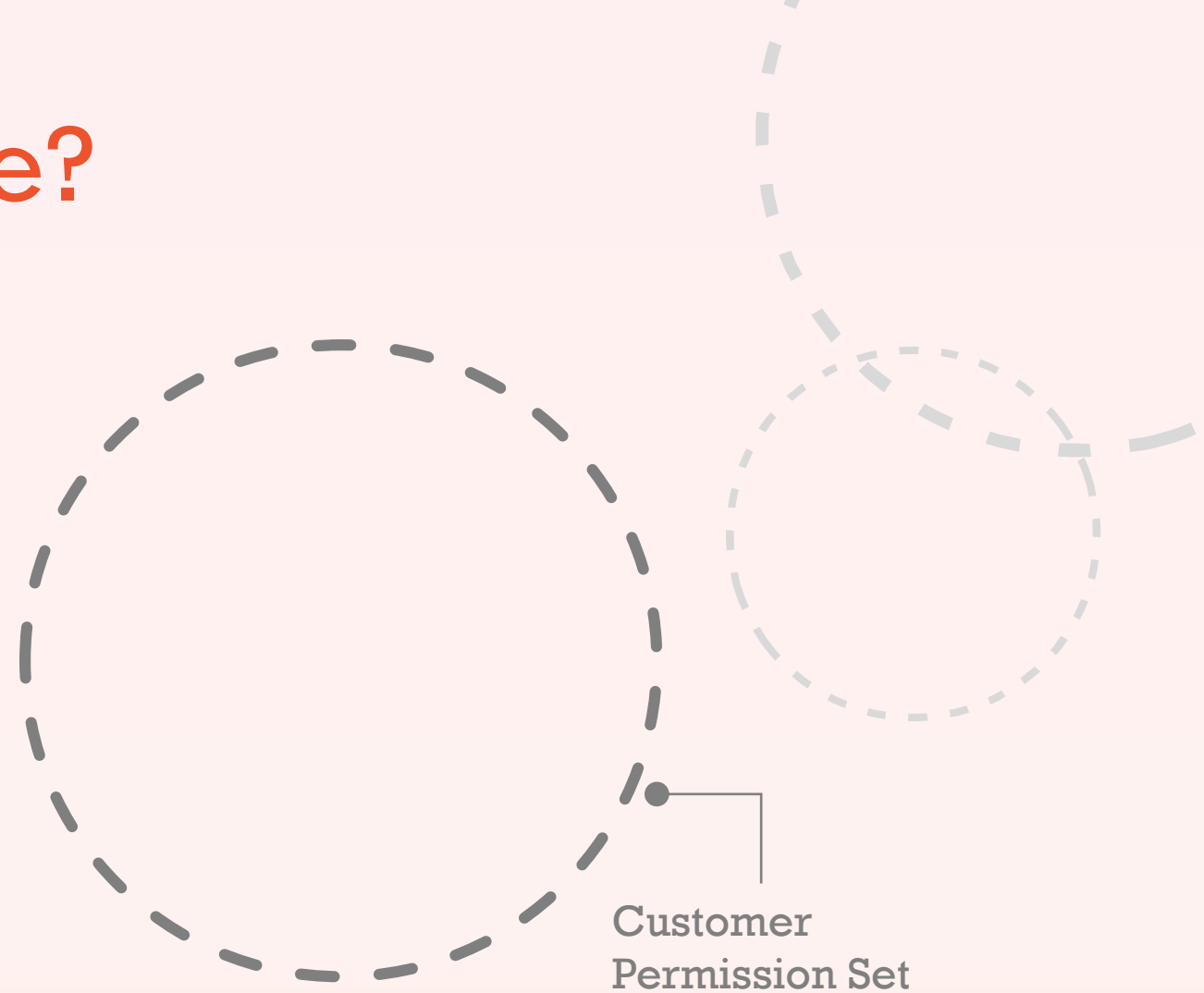
What fully encapsulates the **permission** all your customers give you?

Has your target customer mix evolved?

Baby-boomers



Tech-minded
millennials

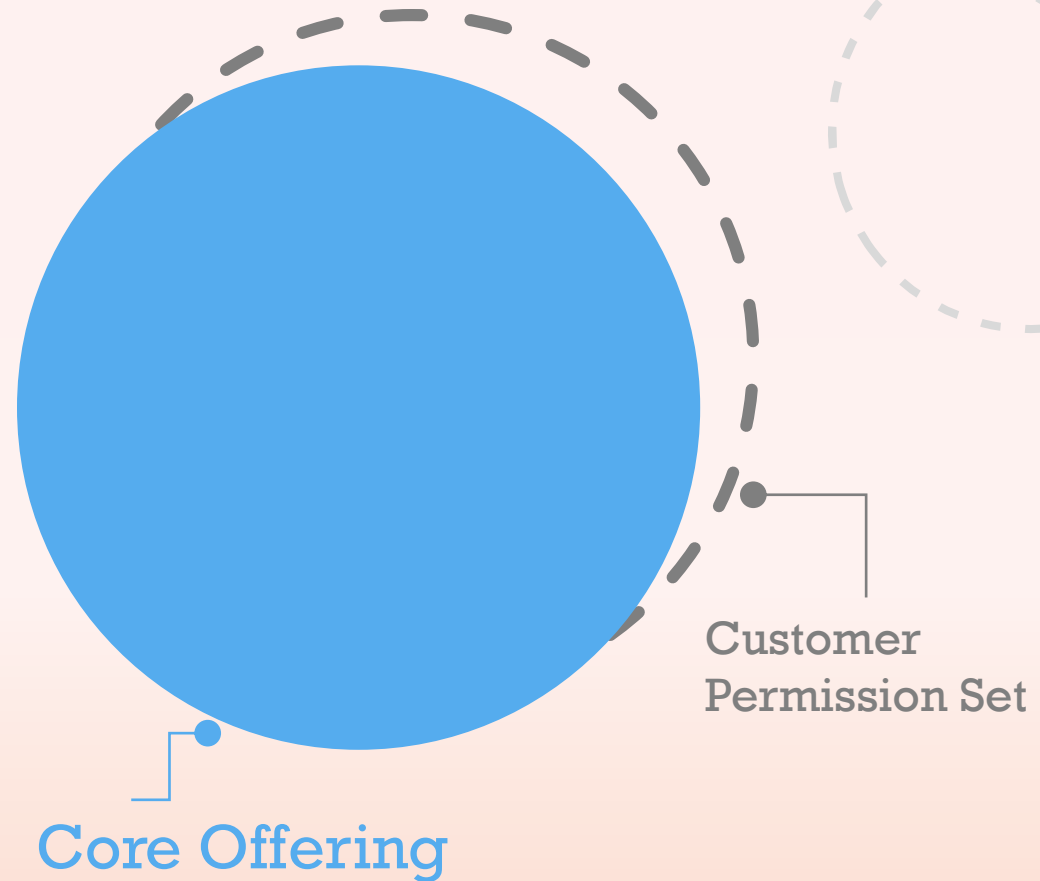


Customer
Permission Set

What is **the Discipline**?

How aligned is your core offering to this **permission set**?

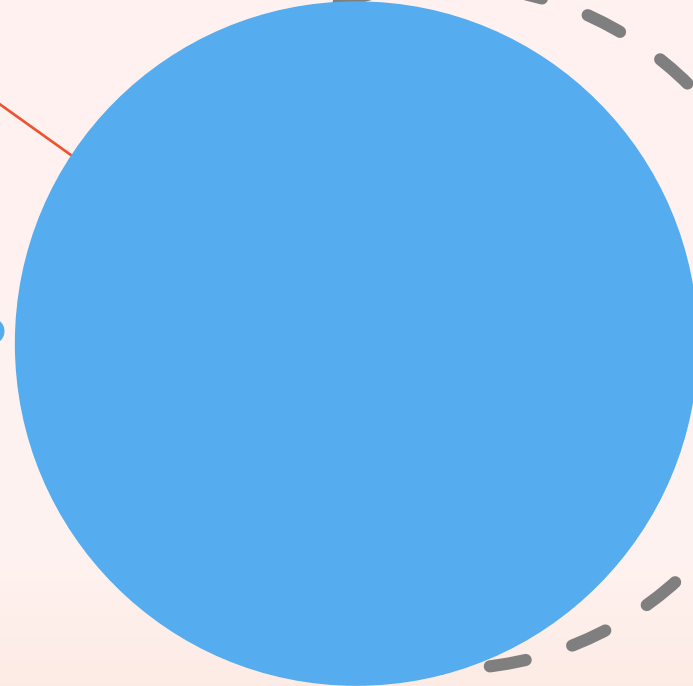
Are there gaps?



What is **the Discipline?**

Elements of the core offering not universally valued are on the 'inside edge'

Core Offering



Opportunities to upsell where you are misaligned to your customer needs: 'outside edge'

Customer Permission Set

What is **the Discipline**?

What is your customers ultimate mission?

What is your role in helping them get there?

Customer
Permission Set

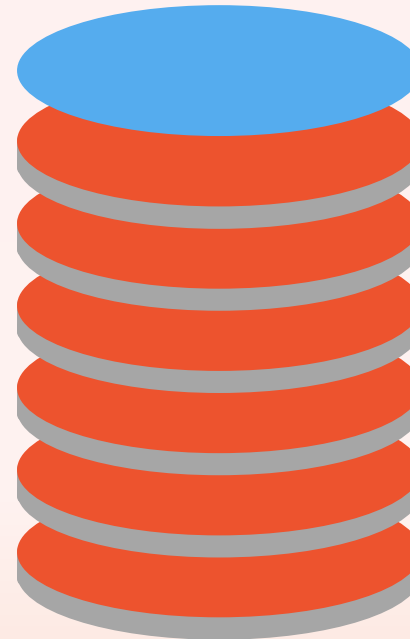
Customer
Mission Set

“sell me a meal not just ingredients”

What is **the Discipline**?

What are the **foundational assets** you use to deliver your core offer?

Do they have value beyond your current purposes?



Core Offering

Culture

People

Data

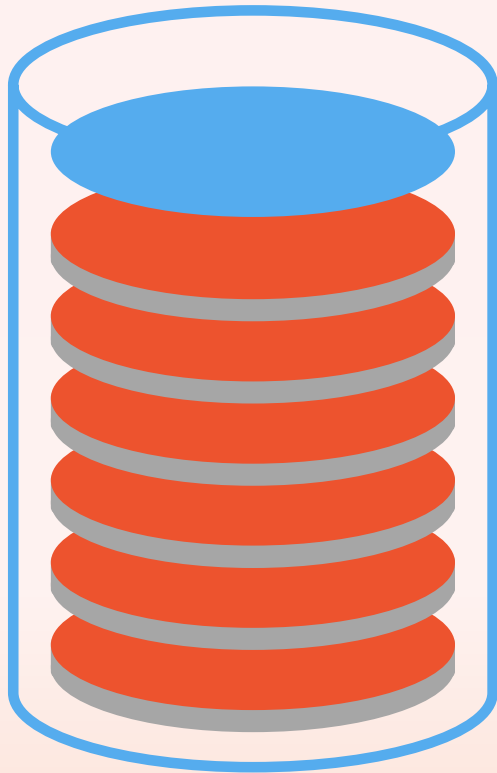
Equipment

Technology

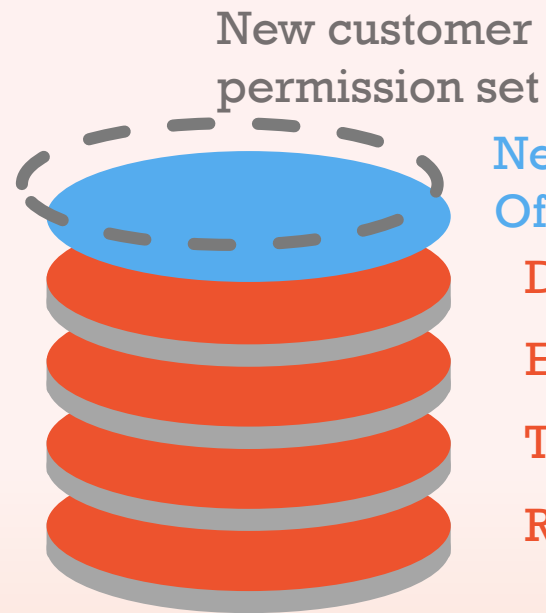
Real Estate

What is the Discipline?

The edge of the enterprise



Core Offering
Culture
People
Data
Equipment
Technology
Real Estate



New Data Offering
Data
Equipment
Technology
Real Estate


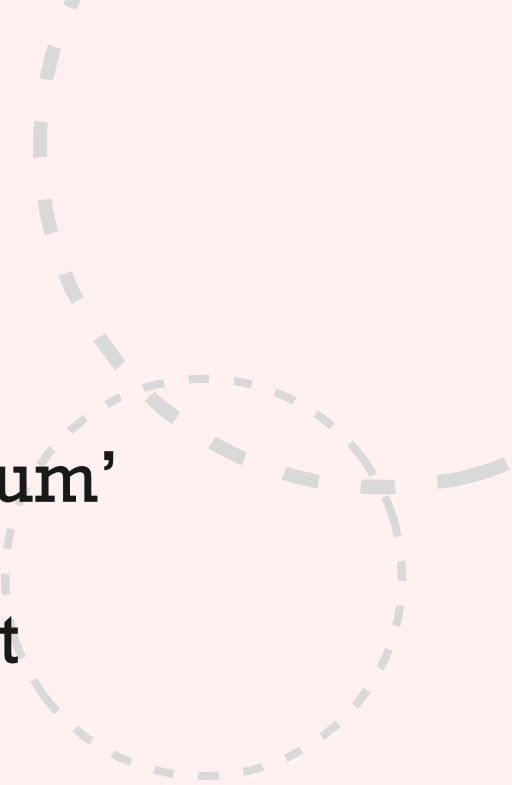
"I would pay you to access your data"



We ask three basic questions

- *Would re-calibrating paid options around my core offering -with my existing resources and capabilities - better unlock value with a sub-set of my customers?*
- *What mission is my customer ultimately hoping to accomplish with my product and would they give me permission to help more toward this end?*
- *Who, besides a direct competitor, would pay for the rights to any of my foundational assets?*

The **benefits** of edge strategy are...

- Incremental revenue
 - Marginal economics
 - Less investment
 - Less learning curve
 - Better product alignment
- 
- Not 'zero sum'
 - More profit
 - Lower risk
 - Lower risk
 - Happier customers
- 

What is **the Pattern**?

Edge
Strategy
is
everywhere

- We studied over 600 companies across 62 industries and found edge examples in every one
- We found examples of edge strategy in the railroads of the 19th century and in the newest technology start-ups today

What is **the Pattern**?

- Companies use **edge strategy** in many situations



- Upsell...
- Sell solutions...
- Monetize Assets...
- Deal with margin pressure...
- Beat commoditization...
- Seed new business...
- Make better deals...



Upselling

■ **Royal Caribbean Lines (RCL)**

- Operating ~50 ships across 6 brands around the world, RCL is a leading global cruise operator
- RCL and its peers have developed complex core offerings for their all-inclusive model: in addition to accommodation, all you can eat dining, and extensive onboard activities, including sports and shows, are all part of the price of a ticket

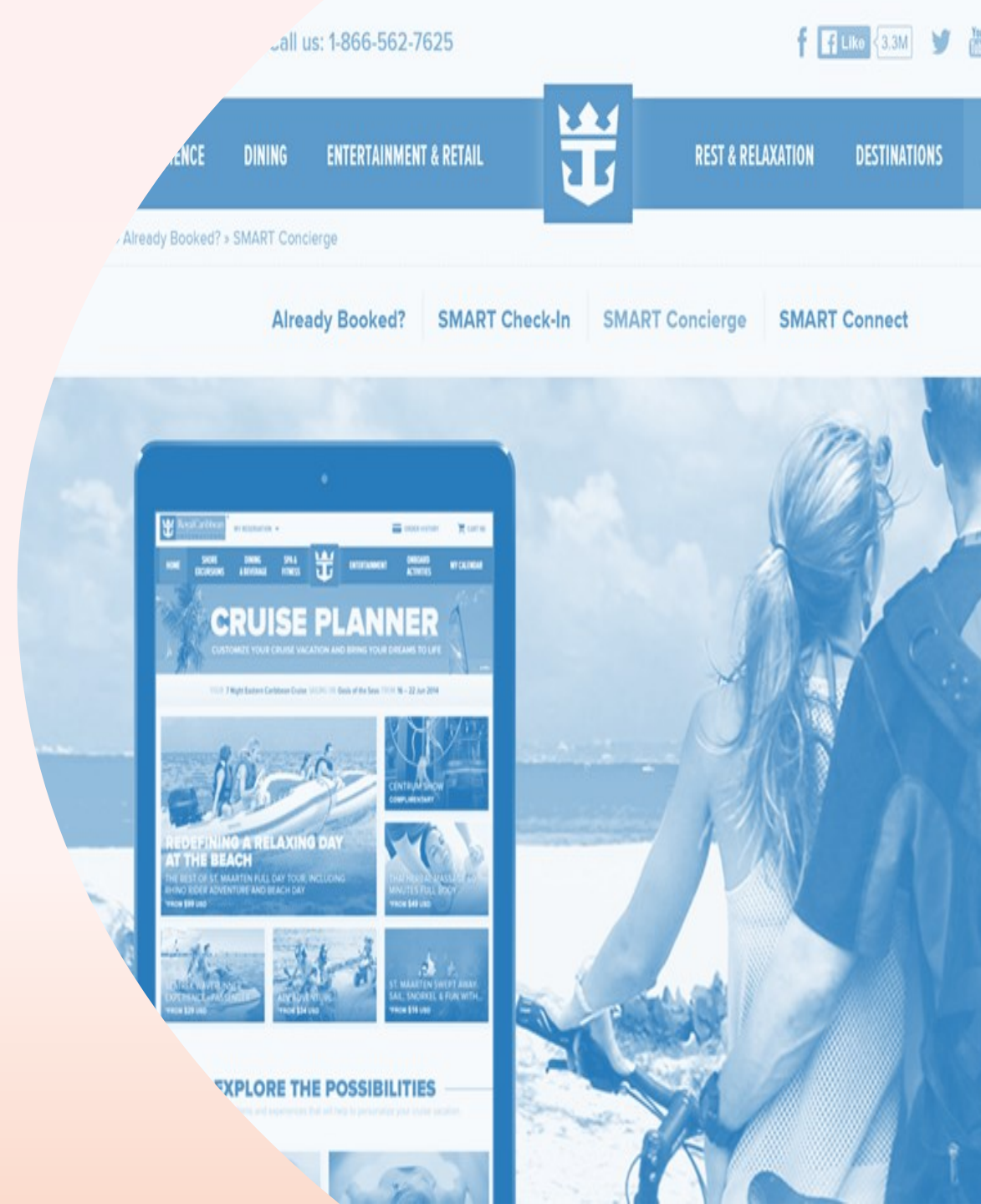
■ **The Insight**

- Recognizing that not only are all customers not the same but their unmet needs vary widely



Upselling

- RCLs Edge move:
 - Rather than a 'good-better-best' upsell, RCL offers a range of add on and expansion packages (shore excursions, onboard services, premium beverage programs) that guests can purchase to tailor their experience
- The Outcome
 - RCL's edge based approach allows for individual based upselling, driving greater overall revenue per guest



Selling Solutions

- **Best Buy**

- A multinational consumer electronics retailer
- Core business has traditionally been consumer electronics sales through both store and online

- **The Insight**

- Best Buy recognized their customers' journeys didn't stop after they checked out
- Customers had many further needs and Best Buy were even providing troubleshooting services at no extra cost



Selling Solutions

- Best Buy's Edge Move:
 - Best Buy made a small acquisition of Geek Squad in 2002, rather than seed this into a service business they used their existing stores to offer services to customers as they shop
- The Outcome
 - Best Buy accessed new revenue from activities that were already occurring and built a process to deliver them more consistently, which also improved customer service
 - By leveraging existing assets, they reduced risk and upfront investment



Selling Solutions

- **Whole Foods**

- Began as a classic grocery business specialized in organic products

- **The Insight**

- Recognized that customers were on different missions when they came to the store, some were filling their pantry but some were buying the ingredients of a single meal



Selling Solutions

- Whole Foods' Edge move
 - Completing the customers' journey with in-store prepared foods
 - Whole Foods leveraged many foundational assets (e.g., stores, foot traffic, supply chain)
 - Resisted the temptation to roll out new business
- The Outcome
 - Prepared foods has seen staggering results with sales of \$2.7B in 2014, 20% of the company revenue



Monetizing Assets

■ Walmart.com

- Global leading mass merchandiser
- Core business through supercenters around the world; 2nd largest U.S. retail website after Amazon.com

■ The Insight

- Walmart recognized that as a leading ecommerce site, it had traffic equivalent to a media site, and was not monetizing over 95% of traffic
- A-B testing showed that modest advertising on the site would be tolerated by consumers and not impact conversion



Monetizing Assets

- Walmart's Edge Move:
 - Walmart partners with a 3rd party in the mid-2000s to leverage the Enterprise asset of their high website and mobile traffic to build a business as a media publisher
- The Outcome
 - Walmart has tapped into media spending budgets to build a new high margin revenue stream
 - Similarly, Amazon.com use their \$1B advertising revenue to subsidize product prices



Margin Pressure

■ **Smith & Nephew**

- S&N is a medical device company focused on hip and knee implants
- As part of its core product offering, sales reps advise surgeons in the selection and use of tools and devices
- Health care reform has led to increasing margin pressure for S&N

■ **The Insight**

- Providing a rep as part of the core offering was expensive (40% of total)
- Not all customers needed the support of an expert rep



at our state-of-the-art training
smithnephew.com/education/york



Margin Pressure

- S&N's Edge Move
 - Rather than cede margin under the new price pressure, Smith & Nephew de-contented its core offering, launching a parallel “rep-less” program
 - This involved selling past-generation products at 30-40% discounts
- The Outcome
 - S&N is better able to maintain its original core offer and still profitably serve customers with reduced budgets
 - S&N estimated only 10% of customers would go “rep-less”, thus the program avoided margin compression across the board



Beat Commoditization

■ Air Products

- Air Products is a supplier of industrial gases, performance materials, equipment, and technology with more than \$10B in revenue
- Many of their products are prone to commoditization pressures

■ The Insight

- They focused on the customer and learned about the needs their customers had around their commodity products
- They recognized their expertise in handling and managing these products was valuable



Beat Commoditization

■ Air Products' Edge Move

- Air Products wrapped services around its core business to focus on complete solutions for clients
- The company offers plant assessment, operations and maintenance, inventory control, advisory, and safety training

■ The Outcome

- By focusing on selling solutions, Air Products accessed incremental revenue streams and was also able to drive more core products sales by establishing itself as a expert partner



Seed New Business

- **UnitedHealth**

- United Health is the largest health insurer in the United States, with revenue of \$113.9B in 2014

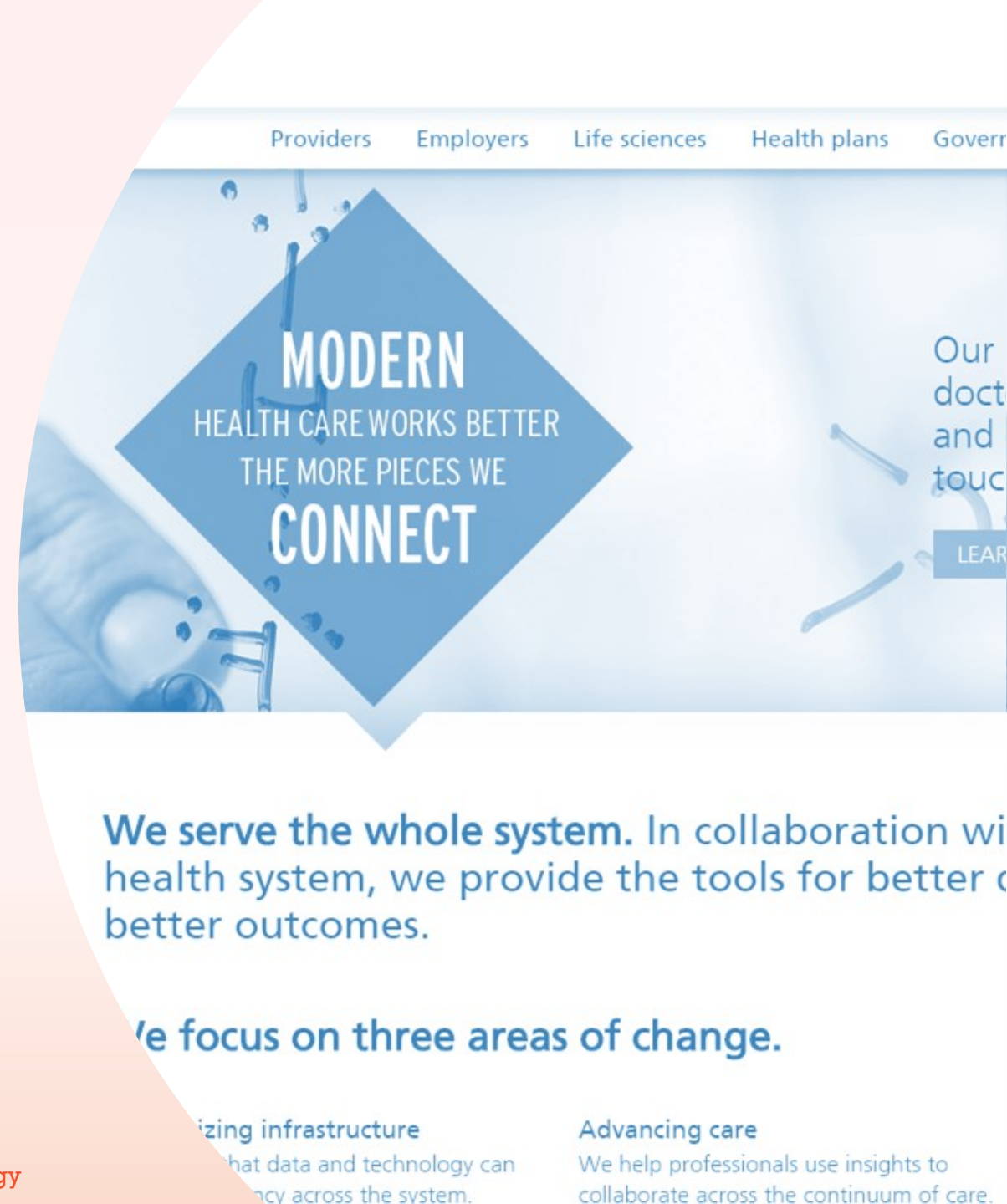
- **The Insight**

- Through its core business of selling and managing health insurance, UnitedHealth has compiled a database of patient information on 114 million people dating back to 1993
- They recognized that their data had unique value for drug companies in how view of patient's use and response to drugs



Seed New Business

- **UnitedHealth's Edge Move**
 - They created a suite of products to allow drug companies to access and use this data, outside of UnitedHealth's core business, called OptumInsight
 - The risk in the new venture was heavily mitigated as most of the offering (i.e., data) already existed
- **The Outcome**
 - OptumInsight has evolved from an edge strategy to a core business today generating billions of dollars for UnitedHealth



Make Better Deals

- **Gilead Sciences**

- Gilead Sciences is a major biotech focused primarily on infectious diseases that built a highly successful franchise in HIV therapies

- **The Insight**

- While in the past big pharma companies acquired outside of their core areas in pursuit of growth, many stumbled and failed to create value buying assets in areas they didn't have prior expertise or executing large deals that brought with them unwanted assets costly to dispose of



Make Better Deals

- **Gilead's Edge Moves**
 - When the company decided to acquire, it stayed within their area of expertise, infectious disease, entering the hepatitis B market with an acquisition of Triangle Pharmaceuticals in 2002
- **The Outcome**
 - Gilead leveraged its knowledge (e.g. regulatory perspective, knowledge of how to produce combination therapies, and effective tiered-pricing model) to increase the speed and probability of success in gaining approval and commercializing their new hepatitis therapies

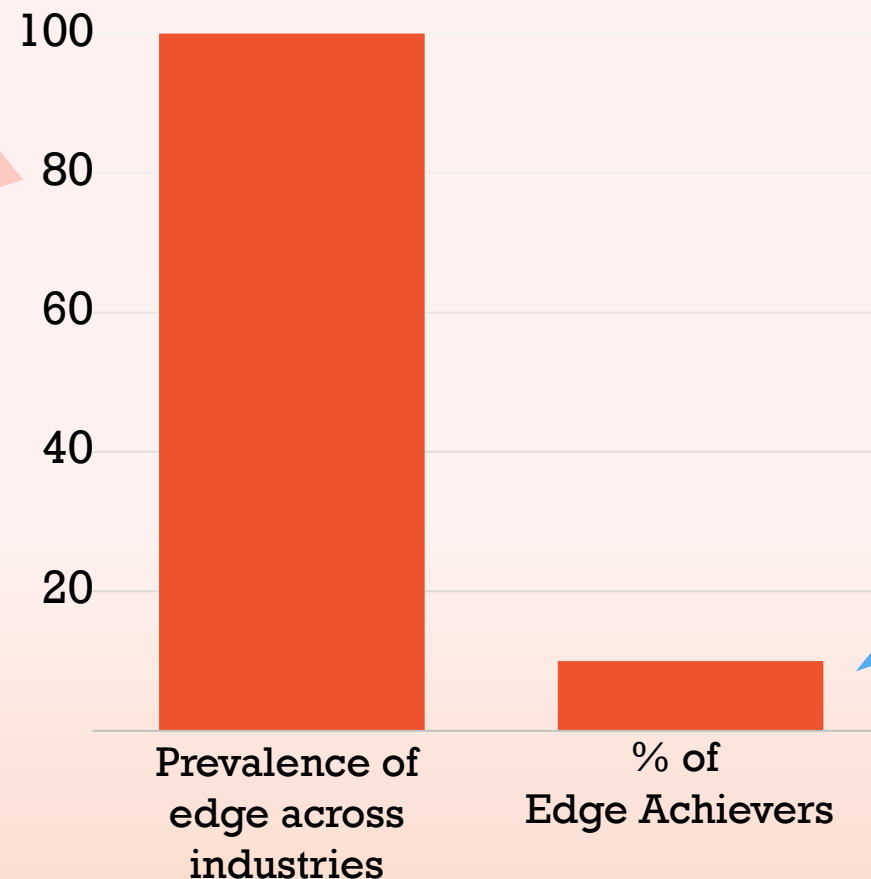


What is **the Mindset**?

Virtually all companies have the potential to access edge opportunities

Prevalence of edge “achievers” that embody the “edge mindset”

Percent of companies screened (N=585*)

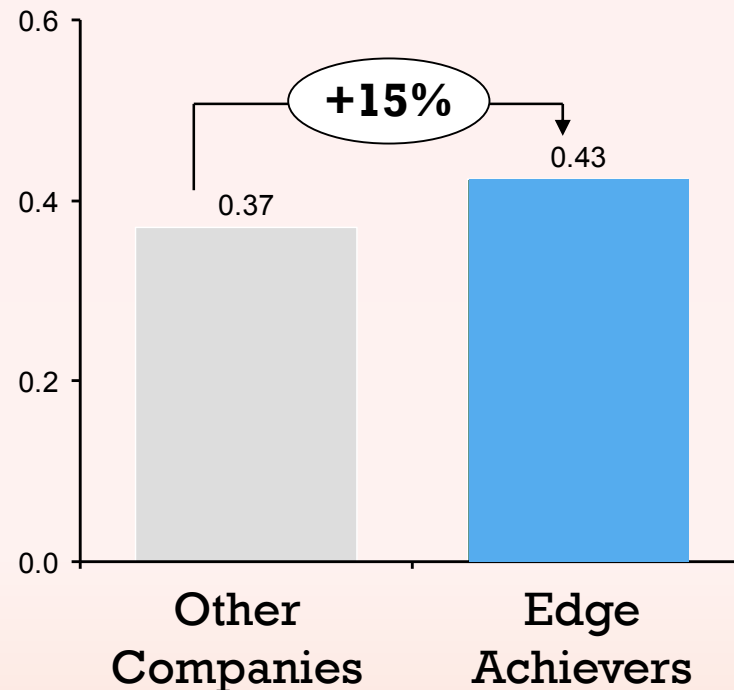


Some companies make repeatable use of an edge **mindset** central to their strategy

It's a **habit** of highly successful companies

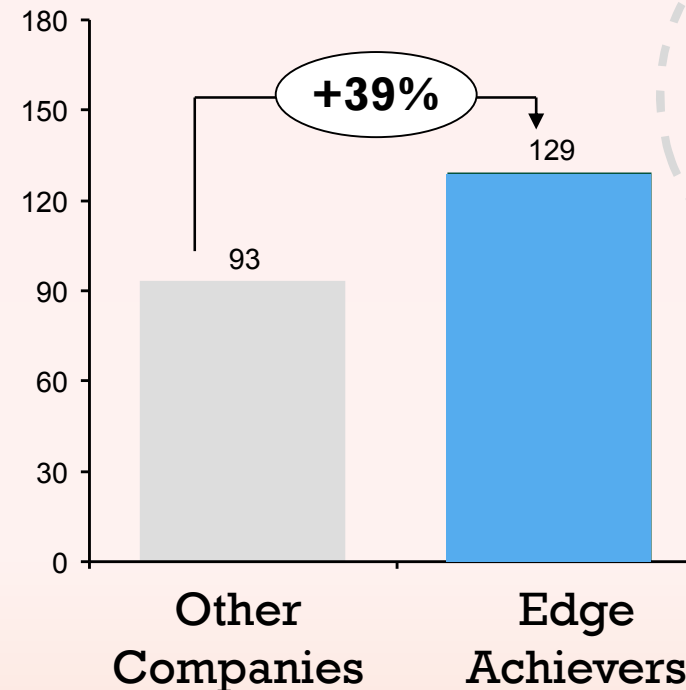
Risk-adjusted shareholder return

3-year Sharpe Ratio* (S&P 500 only)



Three-year revenue growth

Indexed revenue growth rate^ (base = 100; S&P 500 only)



*Note: Sharpe ratio calculated using monthly returns from 01/01/09-01/01/14. The Sharpe Ratio is calculated as ((Average Portfolio Return - risk-free rate) / Portfolio Standard Deviation)

^ Relative performance calculated as the unweighted average of (company performance / industry performance). Industry performance is unweighted. Only includes industries which contain Edge Achiever companies. This measure normalizes for inter-industry differences in revenue growth rates. **Industries experiencing negative average growth during this time period were excluded from the CAGR analysis

Excludes: General Electric, Honeywell, Berkshire Hathaway, Leucadia, Dow Chemicals, Du Pont Chemicals, 3M, Danaher, and Roper Industries.

Source: Company websites and financials, S&P Capital IQ, L.E.K. analysis

Apple has an **edge achiever mindset**

- Apple's core business is primarily a hardware company, with 90% of revenue generated from its devices
- Unlike historical peers like Sony, Apple captures outside product edges to address consumer needs in everything it does



"... Our belief was that if we kept putting great products in front of customers, they would continue to open their wallets ..."

Steve Jobs, cofounder and CEO of Apple

Apple took ownership of the ecosystem of **accessories**

- Purchasing a device is just the beginning of a relationship with Apple
- Accessories (case, speakers, headphones etc.) provide incremental utility to consumers and incremental revenue to Apple
- Licensing additional accessories to be “brand compatible” is a high margin, low risk and low investment revenue stream



What is your **Edge Strategy**?



Have a question about Edge Strategy? Contact us at strategy@lek.com

Authors



Dan McKone and Alan Lewis have extensive experience helping clients drive shareholder value and growth through effective corporate strategies, including Edge Strategy. They have led numerous client engagements that enabled leading companies to unlock the value that exists at the edge of their business.

Lewis is a Managing Director and Partner in L.E.K. Consulting's Boston office. He has spent the last twelve years helping companies large and small to identify new growth opportunities and realize the benefits. He started his career as a professional engineer, commercializing new technologies in the chemicals sector.

McKone is a Managing Director and Partner at L.E.K. Consulting and a member of L.E.K.'s Global Leadership Team. He has led hundreds of client engagements across many industries and has spent the last two decades advising on corporate strategy and growth, business model evolution, and value-based decision making.