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PwC Success Formulas: What needs to be done first?

In the consolidated and internationalized business environment scale-based competition has become a must. Competitive advantage grows from the power of enterprises that have managed to create scale effects by producing and offering more and more volume of a given product. The easiest way to realize this scale is through M&A activities, preferably mergers with former competitors. Stimulated by the EU's cohesion plans for increased foreign investments, Central and Eastern European markets provide the industry with additional growth potential. However, scale alone does not automatically lead to success in the market, but companies are in turn forced to participate in the consolidation race and change their product and innovation strategy to fit with the particular stage they are in. It is that easy: A company has to improve business continuously to stay on top of the industry.

The new strategic framework formed by the consolidation of an industry has to be understood by management, and suitable action has to follow. The determination of growth and marketing strategy for clearly defined markets and customer groups plays a significant role in gaining and sustaining competitive advantage and long-term profitability. This is the most important strategic challenge for managers these days.[1] Management has to set their direction and decide whether it is possible to become one of the only three remaining global leaders or a top performer in a niche. Both are only possible with innovative power. Smaller smart acting enterprises can also be catapulted to the top by their innovation strategies. Companies have to have a clear picture of who they are and how they can outperform their competition in the future by innovations; hence, setting its own direction is the first step towards an organization's successful innova-

1 Vizjak, A.: Success Formulas for the New Decade, 2011.

tion management. Therefore, this situation is also the starting point of the PwC Wheel of Innovation Excellence (Figure 1.1).

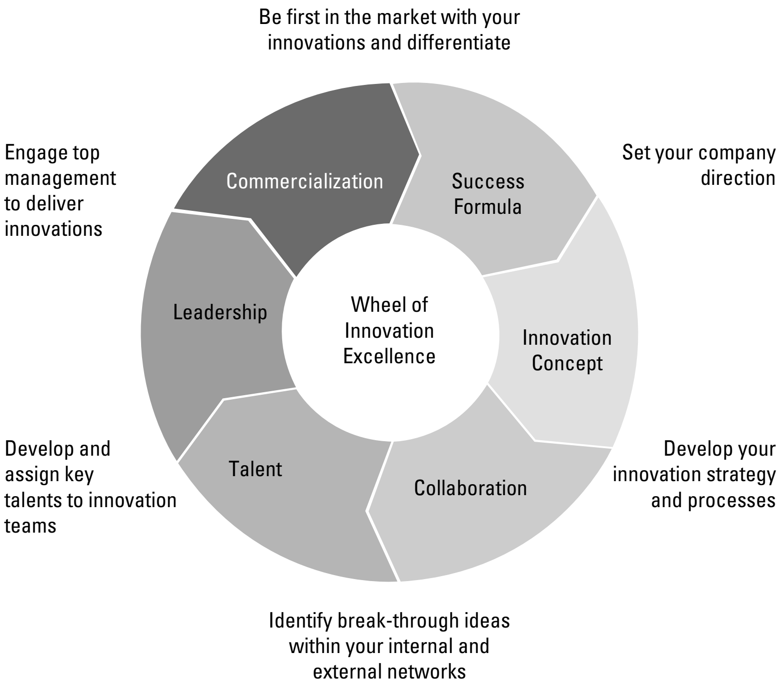

Figure 1.1 Set your company direction

Several theoretical models exist within the literature explaining the patterns of industrial consolidation. However, only a handful of theories are explicitly linking changes at the industrial level with implications for managerial actions. How a corporate strategy should be organized, especially when innovation based, depends on a company's profile.

Based on existing theories, the identification of successful acquisition behaviour of acquiring companies and the analyses of crisis-safe companies from 2000 to 2009, PwC developed clear success formulas of four winner types. Each type needs different innovative power depending on the level of internationalization and product diversification:[2]

2 Product diversification includes all forms of business enhancement (e.g. additional services, brands, channels, vertical integration).

- **Local Specialists** are smaller companies with little internationalization as well as little product diversification. They fulfil customer needs as small and first-rated niche players. Because of their size and related flexibility they can focus on specific product requirements of their regional consumers within their regional industry segment. A high share of revenues in one business segment within one geographical region characterizes a local specialist. Their unique regional product focus offers the opportunity to succeed with new products and services in the home market. This is only possible if they manage to acculturate innovations into a local language and add some local ingredients every few years.
- **Regional Heroes** are medium sized enterprises with little internationalization but numerous product diversifications across several business segments. They are recognized for their unique growth and regional market related capabilities, which support their strategy to be first to locally leverage multiple innovations in different areas every year. They acquire customers in the regional market taking advantage of marketing and sales related synergies. Their significant market power has to be used to develop the market and open up new channels to innovation. In particular, process innovations that influence business access and reduce costs are useful for them.
- **International Champions** are sustainable winners among the small and medium-sized companies with a high degree of internationalization and little product diversification. They do business worldwide within their industry fields. The regular development of new global products and services every few years in their international product niches—usually with unique product or distinct service features—are their path to success. Close networks, developed through the limited product niche, support innovative activities and push them even further.
- **Industry Sharks** are large-scale companies with a high degree of internationalization and product diversification. They are the most recognized drivers of new products and services that push—even if they are not 'born globals'—international presence. Industry Sharks operate across several business segments in global markets and can manage higher investments for R&Ds. Their unique growth path refers to scale, and global market

related capabilities are enabled to be first to globally leverage multiple innovations.

These future winners can be all companies that develop a clear profile for each of their business fields and manage to be innovative. The future losers are those companies that do not come up with new ideas during the concentration phase of their industry.

In the past, only two options, depending on a company's size, specific culture, industry or market position, have been discussed: Either a company becomes a global market leader or a top-performer in a special niche.[3] But, as the consolidation game goes on, there is also space for smaller companies oriented towards specific local activities, where size is not the main competitive advantage and economies of scale are difficult to realize. Other small companies will survive the industry consolidation process because they have managed to develop a sustainable global niche. Market leadership and operating in a niche do not represent the only two strategies a company can choose to implement. Nonetheless, these are the two extremes of a portfolio of successful strategies.

Innovations and consolidation influence each other

Innovation is one of those underlying processes leading to increasing industrial consolidation. The better a new product, the less will be sold by the competition offering older versions. Time-to-market is most often the key to innovation success; it does not matter if you are first in adapting to local regions, as local specialists and regional heroes do, or to the world, like international champions and industry sharks. In this way, former competitors can become acquisition targets sooner or later and vice versa, the industry structure affects the way of innovating. If the market becomes more and more saturated with many competitors, innovations are the only way of differentiation either in a single product or in a multi-business niche. With a new segment new sales chances develop and new revenue streams are started. The remaining competitors at the same time will become subject to an industry shake-out that leads to a consolidated industry that is more innovation minded than a couple of years before.

3 Vizjak, A.: Competing against Scale, 2008.

At the beginning of an industry, companies do business in a fragmented field starting with experiments and innovations towards dominant product design. First movers will ask premium prices, later those companies that can afford it, will start pricing at more competitive rates to outpace the first mover. This will eventually force the smaller players out of the market. Especially regional heroes, international champions or industry sharks have the chance to accept losses for one product niche for a limited time or region—if others do well—to drain competitors. Local specialists can survive, if they add their unique local knowledge first to breakthrough innovations.

In a more consolidated industry structure, process innovations are essential to cut prices and improve quality. To serve mass market standards, procedures and administration are required, but this can also be nothing less than the kiss of death to further product innovation. Process innovation puts the whole company in an inflexible efficiency mode, with little energy, time or inclination to look outside the box to new approaches.[4]

Development of new products, changes in design of established products or use of new materials or components in manufacturing established products most often lead to competitive advantages in fragmented industries. Creation of a better product or service generates value for the customer, the company or both. This is a major factor of economic success.

Further on, in a fragmented industry, competition is shifting from unique product characteristics and increased product quality towards price cuts and process innovations in the already more consolidated segments. Cost savings are often starting points for process innovation initiatives.[5] Process innovation means 'the implementation of a new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software' (OECD, 2005).[6] Technological advantages change the competitive nature of companies. Scale advantages emphasized by larger market shares lead to higher improvement effects in production pro-

4 Utterback, J. M.: Mastering the Dynamics of Innovation, 1994.

5 Davenport, T. H.: Process Innovation: reengineering work through information technology, 1993.

6 OECD: The Measurement of Scientific and Technological Activities: Guidelines for Collecting and Interpreting Innovation Data, 2005.

cesses.[7] Economies of scale and their cost advantages are more important for consolidated industries. Regional heroes have the chance to become price leaders due to their more effective use of distribution channels while international champions strengthen their leading position through lower production costs. Industry sharks have the opportunity to use both possibilities while local specialists are better off due to less complexity in their businesses. Furthermore, if companies benefit from increased economies of scale or expect scale to enhance innovations in the near future, this means taking part in the consolidation process.

The other way around, innovations can fragment a well-consolidated market, if these innovations lead to developing former niche players. Companies' success depends on flexibility. If a company recognizes new situations, e.g. technological change, faster and can react accordingly, then they will achieve temporary competitive advantages—no matter if the company is first with breakthrough innovations every few years or annually in different markets. In particular, first mover advantages—when it comes to the last part of the PwC Innovation Wheel, 'commercialization'—can split up the market again.

Companies doing business in a single niche can also defend their position by innovations. The remaining 20% of market shares not served by global industry leaders might still be an attractive potential depending on the size of the industry in general. A niche in a lucrative but not highly segmented market can be served by focusing on a specific customer group, with specific product features or by serving a limited region.[8] The advantage of niche-leaders can be one of individualization, specialization or concentration.

7 Utterback, J. and Abernathy, W.: A Dynamic Model of Process and Product Innovation, vol. 3, No. 6, 1975; Utterback, J.and Suarez, F.: Innovation, Competition and Industry Structure, 1993; Klepper, S.: Industry Life Cycle, Industrial and Corporate Change, vol. 6, No. 1, 1997.

8 Danner, M.: Strategisches Nischenmanagement: Entstehung und Bearbeitung von Marktnischen, 2002; Kröger, F., Vizjak, A. and Ringlstetter, M.: Wachsen in Nischen—9 Strategien in der globalen Konsolidierung, 2006; Nickel, S.: Erfolgreich in der Nische; Wie Sie als schlanker Anbieter die Konkurrenz schlagen, 2005.

Advantage of individualization vs. differentiation

A provider that focuses on a niche market is addressing a specific need for a product or service, which is overlooked or untended by mainstream providers.[9] Local specialists can better address customer requirements, which are not served satisfactorily by larger companies in the market, with quick adaptations to local tastes.[10] Small, nimble companies and start-ups can think out of the box and take over monstrous organizations. They move faster and are willing to take higher risks for their success, sometimes because there is not too much to lose.

For example, CPCR Express in Russia[11] operates in a region where there is no competition for them. The independent express operator recognized that Russia's smaller cities and rural areas have no courier service because transnational companies like DHL, FedEx and so on do not want to take the risk of expanding their distribution network in Russia. Under a Russian perspective, foreign companies estimate the unpredictability of Russia's economic development simply to be too high.

For the local specialist, CPCR Express, the risk was smaller. They know the local market and the country risk is part of their day-to-day business conditions. CPCR now offers delivery services to leading international express operators assisting them in providing delivery to rural areas. In addition to this service they provide clients with a range of national and international services, e.g. an export service for Russian companies. CPCR Express has one of the largest delivery networks in Russia now and delivers to virtually all cities and district centres, with the exception of Ingushetia and Chechnya. Every year, the company establishes up to ten new routes for express delivery within Russia, offering a service that was not available before.

Another example is the company Ural Press, which adapts to the need of a very specific customer group. Russian Post, their main competitor, is the unitary enterprise postal operator of Russia. Their

9 Niche markets are submarkets, in which niche-leaders develop a specific competitive advantage, but do not compete with the biggest companies.

10 Vizjak, A.: Success Formulas for the New Decade, 2011.

11 http://www.spsr.ru/

company policy includes cross-subsidization, which leads to higher prices for the delivery of newspapers and magazines to firms compared to private households. Ural Press decided to put all efforts into the business market segment but without higher prices. Unlike for Russian Post, this was no problem for Ural Press as cross-subsidization was not an issue. Lower prices and better service enabled Ural Press to push the giant Russian Post out of an important business. The state post no longer delivers magazines and newspapers to companies.[12]

The unique capability to offer individualized products and services to an extreme extent is most often associated with more flexible small or medium sized local specialists. Creating an advantage of individualization fosters customer loyalty and results in high entry barriers for potential competitors. Single innovations every few years and being first to respond to local demand is their key to success. For companies that offer a large range of different products and services in their portfolio, like regional heroes and industry sharks, innovations are a must on a more regular basis in all of the different markets they operate in. The objective is not to lose the market connection despite the more individualized offerings.

Advantage of specialization

The focus of niche players on target customer groups, regions or products can result in the acquisition of special knowledge and expertise that is not possible for major competitors who focus on mass markets with high volumes. The more sophisticated the knowledge achieved, the higher the profitability, because core capabilities safeguard the niche against other companies by preventing imitation or adaptation of a competence.

The success story of Kaspersky Lab[13]—who started out with antivirus software—provides a good example. Through their attention to the Russian market, the company recognized the high potential of the

12 Yudanov, A.: Russische Gazellen—Schnell wachsende mittelgroße Unternehmen als neue Träger wirtschaftlicher Entwicklung in Russland, 2009.

13 www.kaspersky.com/de

Russian software programmer and was able to support their strengths with Western marketing strategies. The company turned hackers into an army of virus fighters and has proven to be a magnet for Russia's young computer geniuses, luring them away from their usual focus towards viral analysis. When Kaspersky Lab launched in 1997 'with zero investment and external funding', recalls founder and CEO Eugene Kaspersky, 'we knew that innovation and quality were the only feasible way to achieve international success.' The firm now supplies antivirus solutions for Microsoft, IBM and Cisco, and it has expanded into mobile communications as well. The company is the world's fourth biggest supplier of secure content management systems, competing with Symantec, McAfee Inc and Trend Micro. Currently, ninety patent applications filed by Kaspersky Lab are being processed by the patent authorities in the USA, Russia, China and Europe.

Similar effects of standardization can be achieved by offering services or products that are otherwise only offered on large-scale markets by big players locally.

A good example is the shoe producer Ralf Ringer[14]. In present times Russia's shoe industry is almost ruined. Even during the period of extraordinary economic growth, between 1999 and 2007, Russian shoe production stagnated at only 23 to 25% of production volume during the Soviet era. In the year 2000, only 23% of the shoe industry's production capacity was used. On the other hand, imported goods account for 70 to 80% of the Russian shoe market. The biggest volume comes from South-East Asia and Turkey. A considerable portion of products from those countries is low quality and must be offered at discounted prices. With the advantage of superior quality, German and Italian producers serve the high price segment. But is there really no customer group for national shoe producers to serve? There definitely are opportunities and Ralf Ringer is taking them. This company have managed to remain in the market and even grow with an exact yet creative positioning. Their 'High comfort and quality at suitable prices' recipe for success works. Their most loyal customers are Russians whose incomes are high enough to buy quality products but who are not willing to pay for exclusive brands and

14 http://www.ralf.ru/

design. The result is that, while the whole Russian shoe industry increased by a moderate 1.5% annually, Ralf Ringer's production volume increased in only fifteen years from 20 000 to 2.15 million pairs of shoes. Today, Ralf Ringer is the largest manufacturer of male footwear in Russia. The company has been developing successfully since 1995, increasing their manufacturing volume at a rate of 30% each year. Ralf Ringer has even expanded the business geographically. The first Ralf Ringer store in Russia was opened in 2005 and, at the beginning of 2010 the chain comprised seventy stores located in ten major Russian cities. Here the advantage Ralf Ringer has as a local specialist is that as a small company they have superior knowledge of customers' needs, requirements and expectations and of the right customer approaches, which global companies do not have or cannot afford to research for all the customers they serve.

Advantage of concentration

A small company can also achieve a direct advantage from consolidation because smaller companies avoid the costs of complexity and coordination that can make up 15 to 20% of total costs in large companies. A limited and focused product portfolio with just a few items, customer groups and/or regions requires less resources and generates lower complexity costs. Often it is exactly the advantage of a concentrated industry that allows a company to succeed in a niche not profitable for companies that operate on a larger scale.

Being alone in a niche market, because other smaller businesses may not be aware of the particular niche and industry sharks will not want to serve it, is a unique competitive advantage that gives companies the power to determine prices. In general it is important that those wishing to capitalize on a niche market find or develop a market with customers who are accessible. This market must be fast growing, not susceptible to being overtaken by swift innovation and not already owned by another player.

'Grow or go' refers to niche leaders as well as industry leaders. However, the more successful you are in your niche the more attractive it becomes for competitors as well. Like any other, this exceptional niche position must be defended by ongoing first-to-market innovation activities, which shift the limitations of the industry permanently. Finally, even market leaders have to monitor market development and watch out for radical innovations that have the potential to change the competitive landscape for good. Firms that lag behind in the consolidation race still have a chance to compete through single breakthrough innovations and building unique customer loyalty. Several top performing smaller players have managed to differentiate themselves with innovative products or achieve cost leadership. In the Chapter 2, hidden frontrunners from CEE countries are introduced and their activities in terms of innovation are characterized based on innovation targets that follow the defined growth strategy. These growth strategies follow the pattern of the PwC Success Formulas which will be described in the following section.

Which winner type are you?

The PwC Success Formulas follow the six success factors of scale-based competition[15]

Position your scale profile

According to the first imperative you need to position the existing and target scale for your company to classify future scale categories and a realistic forecast of your position in relation to the industry leader. Each option allows you a different level of freedom to choose your growth strategy. Whether you are small or big depends on your market capitalization. This is an indicator not only of company size but also of **absolute scale**. Larger companies usually have a market capitalization of US $ ten billion or more. The second dimension refers to the sales rank in the industry you are competing in as an indicator of **relative scale**. Are you among the top three as an industry leader or among the followers?

There are four possible categories to consider: Large industry leaders, smaller industry leaders, large industry followers and smaller

15 Vizjak, A.: Competing against Scale, 2008.

industry followers. *Large industry leaders* are well positioned to compete in consolidated markets. However, in emerging markets like CEE *smaller industry leaders* are more common. They must grow in size as their industry matures by embracing even small innovations in every area and country they operate in. *Large industry followers* must also speed up their growth whether they operate in different regions with one product or in different markets within one geographical zone. In the long run only the top companies will manage to survive the market consolidation. There is a vast array of companies that are *smaller industry followers*. Even though they are often profitable, their lack of economies of scale and acquisition power all too often makes them an easy target for larger industry leaders if they are not first to introduce real innovations every few years in their local region.

Nevertheless, many small and medium size companies managed to emerge stronger from the crisis and even achieved an appreciation in this period. However, the success rate in terms of not becoming a victim of concentration was three times smaller for smaller companies than for the biggest companies during the observed period 2000 to 2009. One and probably the most successful way to survive is defending and even expanding your niche position. Today, still 94% of PwC's sample 8000 companies[16] are small industry followers and four percent are large industry followers. Both categories are threatened by consolidation intentions of the remaining two percent representing industry leaders.

Benchmark your growth profile

As already mentioned, companies that survive the consolidation period, do so partly due to having selected the right growth profiles. You need to benchmark your company according to financial performance in order to respectively self-finance your growth in the long run.

Several governmental programmes and private investors have backed CEE organisations to support innovation and business in the short term. However, those scholarships are limited and companies eventually have to find their own way.

16 Vizjak, A.: Success Formulas for the New Decade, 2011.

This leads to the second success factor defining the PwC Success Formulas in concentrated industries. Your company's past direction must be benchmarked by comparing annual **sales growth** (being larger or smaller than 12% CAGR over ten years) and annual **profit growth** (being larger or smaller than 12% CAGR over ten years).

The following four profiles are possible:

- Top performers,
- Profit growers.
- Sales growers,
- Underperformers,

Top performers improve revenues and profitability at above-average levels. They compound annual growth in profit and in sales larger than the benchmark, which leads to being well positioned to compete against scale in any industry.

Profit growers are successful in terms of profitability but fail when it comes to revenue or sales growth because they only serve a local region. They must find out how to target the market more aggressively and should not rely on profit growth.

Sales growers improve revenues by serving more global zones but lag behind profit growers in profitability. They must cut costs in order to avoid the risk of becoming M&A victims in later phases of industry consolidation.

Underperformers perform weakly in both categories and, hence, do not characterize companies with implemented PwC Success Formulas. They must change their growth strategy immediately or prepare to go.

In the already quoted study of 8000 companies, 36% of smaller industry followers are top performers and only 29% of large companies are top performers. The opposite result for underperformers confirmed this finding, where only 33% of smaller companies but 41% of bigger companies perform poorly in both categories. Following the right growth profile is essential for future growth since it ensures the budget for growth and innovation itself.

Review Your Growth Direction

After positioning your scale profile and benchmarking your growth profile the third and most obvious imperative is to review your growth direction. In order to ensure the most promising future growth direction you should avoid misfits between those three imperatives. Have you added new product lines **(diversification)** or additional geographical regions **(internationalization)** in the past and what occurs when? The key factor is to choose the right growth direction at the right time—but always earlier than the competition.

Usually small companies start with a *regional product niche* and generate single innovations every few years. First diversifications driven by shared sales and distribution channels or capitalization on a regionally well-known brand lead to *regional multi-business niches*, with many innovations in each niche every year. Crossing borders can lead to *international product niche*s, capitalizing on a superior innovative product by selling it in additional regions. Step by step, a former small company can gain international leadership in the *total global market*.

The further analyses of 200 smaller and medium sized top performers showed that internationalization towards the global total market is not the most frequent growth direction for smaller companies.
More than half of the enterprises serve international product niches with their portfolio, which leads to a success rate of 48%. Even higher success rates have been gained by those 41% of companies focusing on regional products and regional multi-business niches. Azbuka Vkusa[17], for example, is one of the most powerful and well-known Russian consumer brands. What makes the company one of the leaders in the Russian retail market are its unique product range, delicate style and high level of service. The company's young history began in 1992 with the opening of their first supermarket offering only those products that best meet customers' requirements. Today the Azbuka Vkusa supermarket chain has forty supermarkets in Moscow and the outlying region. They have become the first Russian company in food retail to introduce a quality management system based on ISO 9001:2000. This has lead to several awards from the Russian busi-

17 http://www.azbukavkusa.ru/

ness community, including 'best service quality', 'best supermarket chain' and for their individual approach to customer service. They have also won several prizes for their innovative trade concept of restaurant zones within their supermarkets. Delis, fresh goods, 24/7 opening hours and a customer hotline all contribute to their niche position in the top price segment. Two Russian supermarket chains, Seventh Continent and Azbuka Vkusa, are among the first movers entering the virtual market, too.[18] Since 2004 Azbuka Vkusa's annual revenue has multiplied by nine. It is the innovation in services as well as products that has led to their success.

Their newest idea is to open their own convenience food factory in 2012 with its own logistic centre to serve all supermarkets. In 2011 the grocery retailer increased its revenue to US $ 820 billion, from US $ 52 million in 2004, and increased its number of stores from eight, in 2004, to fifty-eight. Besides expansion in its core Moscow market, the company is interested in entering Yekaterinburg (Urals), Samara and Kiev (Ukraine), and Alma-Ata (Kazakhstan). Investment in the opening of one supermarket is estimated at some US $ 3–3.5 million.

Leverage Unique Growth Capabilities

After analysing what growth direction your company has taken, or should take, the focus has to be on profitable growth. Unique capabilities can be exploited and should be leveraged for further growth either via internationalization or product diversification. There is one main question to answer:

Where do your available **product or market synergies** come from?

Smaller companies often have a *product and/or regional focus*. Their capability is to serve a particular region with suitable products and services. As their competitive advantage is limited to a particular regional product niche it cannot be leveraged across different countries or product segments. If your strengths are *product-related capabilities*, innovative products and services are outstandingly important.

18 PwC: Online retailing in Russia. Social media marketing, 2010.

Unique features open up innovative niches and counter niches by using the disadvantage of mammoth companies. You should invest even more in your production, logistics and R&D to expand the borders of your own industry permanently and serve not only a single region but the international niche. If profitable growth is linked to your *market-related capabilities*, e. g. branding or strengths in sales and marketing, the niche has to be encouraged to grow in a particular region and then that successes has to be transferred to another niche. The company should diversify its product portfolio by developing several products, which can be sold under the same brand or through the same channel on a more frequent basis. Marketing innovations and new distribution channels can increase market-related capabilities even more. If customers have homogeneous needs worldwide the niche player can use its advantage on a global basis even with single innovations every few years.

Gorenje, for example, is a very successful international home appliances manufacturer with a unique sales concept: It uses show rooms to sell household appliances. In January 2011 they opened their eleventh studio showroom in Serbia. This distribution channel generates approximately 17 % of Gorenje's sales in this country with the percentage rising each year.[19]

Yandex's[20] unique branding as their market-related capability is another example. Its name derives from the phrase 'yet another indexer', but the web-search firm Yandex is much more than that. Russia's internet market is booming, it was the second biggest in Europe in 2010 with 60 million users and significant growth potential as only 43 % of the population have net access so far. During 2009 and 2010 the homepage of the leading Russian IT company Yandex was visited by 21.5 million surfers monthly and was rated as the most popular website in Russia, even beating the Goliath Google. In 2010 they generated 64 % of all search traffic in Russia, starting expanding the business to Belarus, Kazakhstan and the Ukraine and offering its services in English as well. Yandex is ranked the eighth-largest internet portal in the world. Their mission 'answering any question internet users may have' seems to work. Utilizing Russia's long-standing

19 Gorenje Homepage Press
20 http://www.company.yandex.com

educational focus on mathematics and engineering Yandex employees a local talent pool. Advanced technology and information retrieval services are developed and provided by maximizing capabilities in applied mathematics and data analyses and knowledge of cultures, preferences of internet users and languages. These services are location-based and available in many formats tailored for mobile and other digital platforms and services.

Nowadays, the company is expanding. They've opened an office in San Francisco to foster innovation and service in advertising technology. Yandex aggregates and organizes local, national and international content and offers a wide range of additional services. 'Read[ing] users minds' (Alexander Amtsmin, spokesman for Yandex) combined with strong branding has enabled 'Yandex.Market' to grow: It is currently hosting 4000 shops. 'Yandex.Images' uses the in-house developed method for search and categorization of duplicate images and 'Yandex.Money' is the second most popular e-commerce payment system in Russia. 'Yandex.Mail', 'Yandex Music' and 'Yandex Traffic' are other user-based services, but Yandex also offers products for companies. 'Yandex.Direct', the first and largest automated, action-based system for the placement of text-based advertising in Russia, makes it easy for the more than 180 000 advertisers to bid for desired key words and to obtain the best price for the ads. 'Yandex.Start' finds new start-ups to work with them professionally from the beginning and 'Yandex.Maps' highlights advertisers' local small businesses on a map of relevant search results. As a regional hero operating in different fast moving areas, Yandex needs many innovations in all business niches every year.

Scale-related capabilities include acquisition power and are directly linked to scale. A large company that can enable product- and market-related capabilities across the entire value chain is already a global player in the consolidated industry. Its only limits are the increasing organization complexity and the corresponding lack of economies of scale. To be first in the world to come up with lots of ideas in different areas annually puts great pressure on those big companies and has to be considered.

Apply the right growth path

After clarifying the right source of growth it is also necessary to determine the right path of growth. According to **investment requirements** and **barriers to implementation** a company has two options: internal or external growth.

Internal or *organic growth* uses internal resources for expansion and is marked by low investment need and low barriers of implementation. It is the typical growth path for smaller companies in regional product niches that succeed with single new ideas every few years and first regional adaptations, start-ups and companies doing business in less consolidated industries. In times of rapid industry consolidation organic growth is too slow to compete with scale. Companies that grow externally acquire capital shares of another company. *Acquisitions* were the most successful growth paths in the past due to the fact that it is usually larger companies that acquire smaller ones. High investment requirements and low barriers of implementation signal this external growth type, which is often used by smaller niche players in order to quickly fill new regional or product and service niches. *Cooperations* or alliances between partners with equal rights require low investment but are tough to implement due to a complicated governance and interest structure. They can be developed with customers, suppliers or competitors, e.g. to generate open innovations in R&D consortia. *Mega mergers* require large investments and are complicated to integrate as two large and self-confident companies merge. Yet, they are the most frequent growth strategies for large-scale companies to achieve global industry leadership.

The region in which a company does business and the level of concentration in that industry often determine the best path or a combination of paths. The company situation also has to be taken into account.

Adapt your organizational design

To get the most out of its capabilities a company finally needs to define the appropriate organizational design. Depending on the level of **product and/or regional complexity** your company has to manage, an enterprise should be organized in *centralized functional units, decentralized product units* and/or *regional units*.

Product diversification leads to a broader product portfolio and a high product complexity connected to differences of operations along the entire value chain with low synergy effects and difficulties in coordinating. As mixed product portfolios apply many innovations in different areas every year, this approach is used by permanent innovation teams divided by product units. On the other hand, a higher degree of internationalization connected to different cultures, languages and geographical distances increases regional complexity, which again leads to lower synergy effects and difficulties in central coordination. Innovation teams should be organized in relation to different regional units with respect to local varieties—most often in a de-central way.

In general, it makes sense that the higher the complexity the more decentralized units either by cultural differences or business units. Growth, either through internationalization or product diversification, most often goes hand in hand with increasing complexity, and the organizational design you choose to manage helps determine how profitable that growth will be.

Above, we have described four strategic options for each of the six success factors. This leads to overall 4096 potential success formulas. But based on the statistical analysis of 8000 companies, only four success formulas were identified as the most frequent for top performing companies during the period 2000 to 2009. They are summarized as PwC Success Formulas in Figure 1.2 and each belongs to one of our four winner types: Local specialist, regional hero, international champion and industry shark.

Knowing which winner type a company belongs to is the first step to defining its profile and following a consistent innovation concept, as all four require different innovation frequencies and competitive scope of innovation.

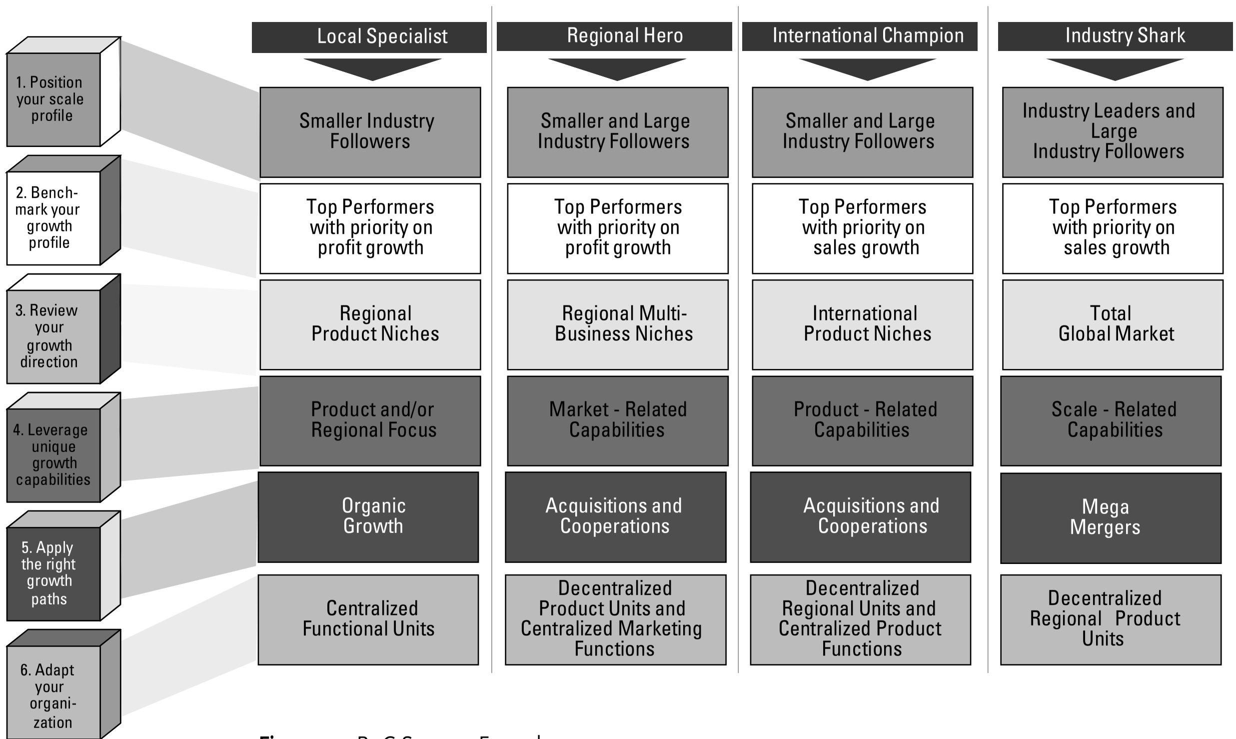

Figure 1.2 PwC Success Formulas

Source: Vizjak, A.: Success Formulas for the Dew Decade, 2011, p 40.

Best practice examples prove the power of innovativeness

Hidden frontrunners lie just around the corner.

Local specialists operate usually in only one region with no or only little product diversification, but, despite their limitations, they are among the most successful companies. If a local specialist has a unique innovation power, the enterprise will grow into a regional hero or international champion sooner or later or just defend its position as a successfully operating local specialist during the whole cycle of industry consolidation.

For example, the Romanian software company Bitdefender[21], founded in 2001, started as a local specialist. Their main strengths were the skills and number of available Romanian IT programmers, who rank number one in Europe, and their innovative IT security software in this dynamic market with an estimated growth rate of more than ten percent in 2011. Bitdefender simply 'takes care of everything' and has created one of the industry's fastest and most effective lines of internationally certified security software. Furthermore, the family-owned company provides security solutions to satisfy the protection requirements of today's computing environment, delivering effective threat management for tens of millions of home and corporate users across the globe. Bitdefender realized that the only way to success against the big players is to develop innovative products that not only meet but exceed consumer's needs. The company developed a new technology that enabled clients' computers to identify many new viruses on their own, even without the need to first receive a signature from a central server. Bitdefender got an extra boost when the Conficker worm was in the news. Bitdefender developed a free Conficker removal tool, and many who used the tool went on to buy the full product. One single innovation and revenues were going through the roof. Now a global network of value-added distribution and reseller partners in more than 100 countries distributes the products across the world. Their profit in 2009 was more than seventeen times higher than 2008, increasing from € 416.000 to € 7.156.000.[21]

21 http://www.doingbusiness.ro/financial/report/541390/bitdefender-srl/, 2011.

What enabled the company to become a successful international champion? On the one hand it is the centralization of product related functions which helps the company to realize product related synergies and to create an innovation friendly environment. The product-related functions like the Human Resource department, online distribution, executive members and R&D centres are still based in the home market of Romania, but to serve customers worldwide regional units in Germany, UK, Spain and USA explore market development trends and identify customer needs and requirements.

Even though Bitdefender has strategic partnerships with different companies in different countries the innovation itself comes mainly from inside, from the employees in Romania. They hold the AI-MAS Winter Olympics, a project at business schools in Romania each year to gain contact to the best students in their home country. Bitdefender also offers higher salaries, € 700 to 800 a month compared to the industry average of € 400, and staff members receive bonuses and higher salaries for high performance. This stagnated salary structure keeps employees loyal. The importance of talent and leadership will be further examined in this book. IT companies especially have a greater chance of selling their products worldwide as market needs are nearly the same everywhere and the main costs are development costs rather than the product itself.

Becoming a regional hero with innovations is a longer and stonier way to glory. Numerous product diversifications across several business segments can only be pushed if the same technology, process or business innovations can be used for several business segments. Usually product innovations alone cannot support other business segments. Petrol[22] is a leading Slovenian oil company and the second largest Slovenian organization in terms of revenues. As a regional hero the company expands on the regional markets and diversifies its business portfolio. This energy supplier sells and distributes natural and LPG gas, electricity and heat, offers environmental services like waste water treatment and drinking water supply, and explores, produces, refines and sells (wholesale and retail) motor fuels. Petrol runs nearly 450 petrol stations in Slovenia, Bosnia, Serbia, Montenegro and Kosovo and has seventy-five gas stations. Petrol's acquisition in 2011 of the innovator in sustainable energy and efficient use of energy and sustainable sources Istrabenz Gorenje makes Petrol the leading energy company in the country. Petrol's own oil laboratory ensures comprehensive and reliable testing services that are fit for its purposes and meet the customer requirements.

Since 2008, the 'Great idea' project supports the establishment of a culture of innovation as global trends and the demand for sustainable development lead to the optimal utilization of all available resources. Employees gain great innovation potential and exchange of knowledge. Innovation, environmental safety and an accessible range of services for managing water resources are becoming a strategic advantage in the selection of energy services offered by the Petrol group. Petrol received more than 300 proposals for improvements in 2010, of which twenty were deemed a 'Great idea'. The realization of 'Great ideas' improves the quality of operations, reduces costs, boosts revenues, increases productivity, enhances safety and provides for better working conditions and employee satisfaction. Pilot projects involve the introduction (blending) of bioethanol in petrol. The project focuses on Petrol's efforts to achieve the required biofuel market share. It is a novelty in its field and warrants innovative solutions. Petrol's employees' creative energy is the assurance of further successful performance. As a result, for a number of years Petrol has been in the prestigious company of the best employers, staying true to its beliefs that promote entrepreneurial innovativeness, good practice examples in employment and quality jobs, even during heightened economic uncertainty. In 2010 Petrol was awarded the Family Friendly Enterprise certificate and committed itself to implementing eighteen measures over the next three years to facilitate a balance between professional and family life.

Petrol empowers its employees to spend their free time in a quality manner. To this end, they have numerous holiday homes in Slovenia and Croatia, where employees and their families can spend their holidays. Each year, the company organizes a Petrol trip, which is always attended by many employees. Ahead of the New Year, Petrol's employees get together at a New Year's party, while 'Petrol's toddlers' are visited by Santa Claus. For more than thirty years, Petrol has been promoting sports, recreation and socializing at events for employees several times a year.[22] Again human beings are the way to success for Petrol.

22 Annual report 2010: http://www.petrol.eu/, 2011.

International champions are the most common winners, because it is easier to spread an innovative idea over more countries than diversify the product range. Small and medium sized companies in particular have a great chance of becoming international champions.

Gorenje[23] is an international champion on the path to becoming the most innovative, design minded creator of home appliances in the world. The company's beginning dates back to 1950 when the first manufacturing started in a tiny village that bears the same name. Since then Gorenje has expanded into a multinational corporation, where three out of four companies are located outside their home country. As mentioned earlier, Gorenje is the largest Slovenian manufacturer of white goods. In addition to larger home appliances, Gorenje's product range includes ceramics, kitchen and bathroom furniture, and the company even provides services in the fields of energy, ecology and trade. Its products for home, services and companies are present in over seventy countries, mostly in Europe. The continent-wide market share of 4% makes Gorenje the sixth largest manufacturer of home appliances in Europe, with the annual revenue of the company jumping to € 1.38 billion in 2010.

But how could Gorenje reach this significant position? Simply, the company strives for innovation continuously in every part of their value chain. Cooperations with designers and companies like Swarovski have led to numerous design awards and underline the fruitful style innovations. The Gorenje Karim Rashid collection of high-design kitchen appliances recently brought home the gold Product Innovation Award at the Design Awards 2010 in London. The central decorative element of this collection is the innovative vertical LED stripe along the hood and oven door. Employing the innovative Mood-Lite technology, a result of Gorenje's in-house R&D, they have become the first to offer a solution that allows the user to freely change the colour of the oven or kitchen hood exterior with a single touch.

Gorenje's innovative fridge freezer 'Made for iPod' captures the essence of our age. Resulting from a license agreement with Apple, the Gorenje fridge features a docking station that enables charging of the iPod, playing back music and video through built-in speakers, and

23 www.gorenje.com

connecting to the world-wide-web, if wireless connection is available in the kitchen.

Gorenje has also won prizes for ease-of-use and environmental sensitivity. Next to highly efficient power consumption, thanks to remarkable technical improvements additional savings are made possible by numerous functions like the economy programme, holiday programme and the rapid cooling programme, recommended after major shopping trips. There is even the capacity to regulate your home appliances via the internet while you are on holiday.

The company is also very innovative in Eastern Europe with their distribution channels. They sell their goods in their own kitchen studios and via the internet…[24] Gorenje's own sales force knows the products best and promotes them very well as an additional customer service.

Another example of a hidden frontrunner is Automobile Dacia S.A.[24], the main automotive exporter from Romania with a ten percent market share of total exports of the country. The main factory was built in 1968. Nowadays Dacia is a subsidiary of the French carmaker Renault, using the cheaper, standard technologies of the French mother as their competitive advantage. The success of 348 723 sold units in 2010 is surely proof that this strategy works. Their sales grew by 12% worldwide within just one year. The market share in Romania exceeds 30%. In Dacia's main markets after Romania, 110 000 cars were sold in France, 40 500 in Germany and 22 000 in Italy.

The unique selling proposition of the company is their stringent design-to-cost approach, which outputs low-cost but spacious and reliable cars. The customer group that this international champion's main focus is on is families whose only alternative to a Dacia model would be a used car, a cheap, Asian import or a very small European car. Compared to other low cost producers Dacia's customers do not have to compromise on reliability or space and value Dacia's price. The company's marketing also emphasizes the fact that it is able to offer low prices without sacrificing quality and safety. In addition their funny marketing campaign, 'Do you suffer status symptoms', is uncommon and new as a marketing innovation in Eastern Europe.

24 www.dacia.ro

Dacia believes that special principles like ‘focus on building platforms, not products’ are necessary to capture a developed market with emerging market products. The main advantage is that platforms can be scaled up or down for global markets. For the German market Dacia scaled up the product platform with increased safety features and more appealing exterior characteristics, such as metallic varnish. This allowed the automaker to charge higher prices and, in turn, reap higher profit margins.

Maybe the global market is on the brink of a new era where breakthrough innovations happen first in emerging poorer countries and those innovations subsequently are taken to more developed, richer countries. Dacia’s products are a powerful example of such reverse innovation.

These two examples of international champions point out that even if Eastern European companies had to catch up economically compared to Western European companies in the past. Their innovation performance is improving rapidly in nearly all CEE countries and selected companies like Gorenje or Dacia even reach frontrunner positions in their international product niches.

Industry sharks are very rare and not easy to find in CEE countries yet since the countries were closed because of communism and have only just started to serve global markets with a diversified product range. With a few exceptions such as Gazprom, Lukoil or PKN-Orlen, the domestic CEE companies are still too small to achieve the critical mass of industry sharks due to their late starting point. But also globally established industry sharks have to prove their leadership position in the emerging CEE markets. Many industry sharks such as for example Walmart have not yet achieved industry leadership positions in CEE.

PwC is different. Similar to Walmart PwC is the largest company in its industry. However, PwC understands, that each market requires specific adaptation and continuous local innovativeness to leverage product and market synergies locally. We are organized in multiple territories with sufficient critical mass to play the industry shark in each territory. This enables us to develop unique market related capabilities by leveraging our brand and client relationships across our lines of service in each territory. Simultaneously, we are leveraging innovative service solutions from other territories and offering them—locally adapted—in each of our territories. Nevertheless, we as the industry leader offer unique scale related capabilities. With our global acquisition power we can afford strategic investments in innovative companies and individual talents year by year.

We like to compare ourselves with the fastest man in the world Ursain Bolt – next to Francis Obikwelu, the tallest 100 m runner in Olympic history – to prove, that size does not have to be a disadvantage and can even be turned into a sustainable competitive edge.

The financial results prove that we are the industry shark of the consulting industry. In 2011, we have achieved total revenues of US $ 29.2 billion with 169,000 people and 771 offices in 158 countries.[25]

Despite our size we were able to grow by ten percent with this result compared to the previous year. A special highlight was our 20% growth of our advisory business segment, achieving US $ 7.6 billion advisory revenues in 2011 which makes us a larger advisor than the traditional international consulting champions McKinsey (US $ 7.0 billion revenues and seven percent growth in 2011), Booz Allen & Hamilton (US $ 5.6 billion revenues and nine percent growth in 2011) and Boston Consulting Group (US $ 3.4 billion revenues and ten percent growth in 2011).[26] This advisory growth was enabled by acquisitions such as the acquisition of PRTM, a very innovative consulting company and a global thought leader in supply chain management or hiring of partners or groups of consultants from leading competitors. Simultaneously we were very successful in organic growth by attracting new consultants and clients with our brand perception. In 2011, PwC was the only professional services organization to be seen as one of the most highly rated brands in the world.[27]

With US $ million 778 our PwC territory Central and Eastern Europe still represents one of the smallest within the global PwC map. However, we are with this size and our 7500 people in this territory already one of the industry leaders with high potential for further growth and are consistently implementing our success formulas of the Industry Shark. And, just as it seems that Usain Bolt has not actually reached his limit, we are also investing and innovating to grow further. For example, we offer our clients an innovative one-stop shop

25 PwC: Talent to succeed: Global Annual Review, 2011.
26 Kennedy Research and Annual reports 2011.
27 Brand Finance 250.

for M&A consulting. There are very few other PSF firms that can help clients all the way through large-scale transformational change. Sector skills, deep financial know-how and a solid understanding of the broader risk picture help our clients make the right choice. Our capabilities to help clients sell or buy businesses or parts of businesses at the right price, combined with the technology, operational people and change skills to derive sustainable value after the transaction, are critical especially in CEE where the M&A wave is still rolling at full speed. Also, our tax expertise is required by clients to set up compliant new structures and business models to enable change. This makes our services unique and innovative. We are also uniquely positioned at the centre of regulatory bodies, government agencies and financial institutions. This helps our clients in the current financial crisis and enables us to bring our expertise into effect to achieve innovative industry reforms.