
2. THE ART OF GUIDING A COMPANY THROUGH ITS LIFECYCLE

2.1

CHANGE OR DIE

Sounds like a typical example of consultant-speak? Consultants are naturally keen to find compelling arguments for the biggest projects possible. Yet there is more to it than that. We can all think of high-profile examples. In Germany, Schlecker is undoubtedly the year's top corporate swan song. But there are also the Neckermanns and the Q-Cells, not to mention Kodak, Saab, Quelle, Hertie, Agfa and Grundig – as well as Kirch and Holzmann, who went to the wall almost exactly ten years ago.

The briefest glance at the history of a few well-known share indices and rankings shows that these cases are by no means exceptions. Change is constant, causing positions to shift and companies to disappear from view or go under completely. This has always happened, and it has done so on a far greater scale than we realize in the course of our day-to-day business.

- ◆ Of the 100 biggest US companies that constituted the first Forbes 100 in 1917, 61 no longer existed in 1987, just 70 years later. Of the 39 that had survived, only 18 were still on the list.¹⁵
- ◆ Of the companies listed as the Fortune 500 in 1970, only two-thirds were still defending their turf in 1993. In the space of just over 20 years, fully one-third had dropped off the list.¹⁶
- ◆ Of the 500 companies that made up the Standard & Poor's 500 in 1957, only 57 still figure on the list today. To put it another way, nearly 90% have failed to maintain their standing.
- ◆ Statistically, a company in the 1920s could expect to stay on the S&P index for 65 years; today, the figure is just ten years.
- ◆ If ten years doesn't seem very long to you, consider this: The average age of all Western European companies today is just 12.3 years.¹⁷

Births and deaths – to speak the language of the lifecycle model – are thus business as usual. Change happens. Not somewhere at the back of beyond, but right on our doorstep. A mere 18 of the first DAX 30 companies at its launch in 1988 are still listed on the index.¹⁸ Similarly just 11 of today's 50 MDAX companies have

been there since its launch in 1996, 12 of the 30 TecDAX companies (since 2003) and 8 of the original 100 SDAX companies (since 2001).

Not all the companies that drop out of this or that index have disappeared altogether. Some have merged. Others have simply been relegated to a lower division. Many, however, have indeed shuffled off their mortal coil. Recent studies show that roughly 10% of all companies go belly-up every year.¹⁹ That is an alarming figure. So it is perhaps not surprising that entire libraries have been filled with analyses of corporate failure or – to take a more positive angle – ideas about how to prevent it.

The explanations given vary as a function of the period in which they were written and the zeitgeist. On occasion they are also influenced by the consulting concepts that were then in vogue. It is scarcely possible to classify them systematically. Even so, reduced to their common denominator, they ultimately point to three principal reasons for why companies fail.

First: Companies fail because of changes in the market and the environment. Because their products no longer scratch where the market itches. Because their core competencies have become obsolete. Because new legislation has been introduced – in the finance industry, for example, and possibly for auditors too in the future. Because new technology has radically shaken up processes, as the Internet did with retail and the media. Because materials have become too expensive. Or because of a significant shift in factor costs, as in shipbuilding, shoe production, textiles and the steel industry.

It would be easy to add more reasons and examples. The other side of the coin, however, is that not all companies fail. Some do indeed manage to translate change into fresh growth. They do so by making new products or adapting their offerings, improving their marketing, deploying new technology, relocating at the right time and/or globalizing their activities.

Second: Companies are often the cause of their own downfall. Because they (or rather their managers) rest on their laurels. Because they come up with the

wrong strategies, are guilty of overconfidence or even arrogance. Because they have the wrong people on board at the wrong time. Because they fail to spot change in time. Because they lack the courage and sometimes the creativity to change swiftly and thoroughly. Because they are unable to break free of inherited ways of thinking. We have already encountered these reasons – in practice, so to speak – in the survey I conducted among Roland Berger's Partners, summarized in Chapter 1. Once again, this confirms our theory: It is not change that leads to failure but the inability to see it in time and respond resolutely.

Third: Companies fail to achieve critical mass or do so too slowly. Let's look at how many companies have managed to defend their position in the various German share indices:

- ◆ DAX 30: At least 18 out of 30 companies – a good 60% – have managed to stay on the index for close to 25 years.
- ◆ MDAX: Only 11 of the original 50 companies are still listed on the index today – just 22% over a period of about 15 years.
- ◆ SDAX: A mere 8 of the original 50 companies are still there. In other words, only 16% have been able to stand their ground for roughly 12 years.

Without reading too much into this simple arithmetic, one trend does suggest itself: Companies that have become big enough to join the DAX have a significantly better chance of not disappearing altogether – a view that, incidentally, is also factored into ratings and credit facilities. Financing almost always becomes more expensive for companies that are demoted from the DAX. Conversely, those firms promoted to the DAX find financing cheaper and easier to come by.

The suspicion that there is a correlation between companies' size and their age is confirmed by a study by Christian Stadler and Philip Wältermann.²⁰ I have already mentioned that the average age of Western European companies is currently just 12.3 years. That figure should be qualified:

- ◆ Publicly traded (and hence normally larger) companies have an average age of 28 years.
- ◆ The average age of companies that post annual sales in excess of USD 5 billion is 48 years.

Size clearly matters. Companies that take the first hurdle, expanding rapidly and becoming "big boys", have a better chance of a longer life. The same principle is also observable at the smaller end of the scale when we look at the embryonic phase of a company's life. The supposed fact that only one out of two startup companies survives the first two years – and that only one in five is still in existence after five years – is the subject of heated debate in many American startup blogs. While proper studies show this failure rate to be greatly exaggerated, the general pattern can indeed be confirmed. A recent study by the Centre for European Economic Research, for example, found that:

- ◆ Between 10% and 20% of all startups fail after the first year, between 20% and 40% after the second year and around 50% after five years.
- ◆ The probability that a company will fail increases sharply up to the third year after its inception, but decreases again significantly after that.²¹

Incidentally, international comparisons reveal very similar survival rates. Nor has there been any significant change over time.²² Quite obviously, it is difficult to lead a company to growth (and hence achieve critical mass) and then sustain that growth anywhere in the world. It is an interesting exercise to turn that formulation around, however: Companies do not fail – or, at least, they fail more rarely – if they grow quickly at the start and constantly thereafter.

2.2 THE LIFECYCLE CONCEPT AND ITS HISTORY

Whenever we talk about companies surviving or failing, growing or growing up and having to change, we use examples and terminology from human life. We speak of birth (the inception or launch), puberty (the rapid growth phase), coming of age (when companies mature or reach "middle age") and death (when companies disappear completely).

The idea of describing a company's development in terms of a natural life-cycle is nothing new. As far back as 1914, S.J. Chapman and T. S. Ashton used a similar analogy to nature in their study of the size of companies based on the example

of England's textile industry.²³ In the decades that followed, lifecycle concepts became more widespread, initially describing the typical sales curve for products and later as a metaphor for whole industries. Essentially, the concepts used are all very similar:

- ◆ Product innovation is the focal issue during the introductory or startup phase: A new product or solution is launched on the market. Average prices are high because of the innovative nature of the product, but then – depending on the intensity of competition – drop off again fairly quickly. Dominant designs and configurations then emerge and an initial transition from product to process innovation becomes apparent.
- ◆ The growth phase focuses on quickly ramping up resources, capacity and distribution channels in order to increase market share and realize economies of scale.
- ◆ During the maturity phase, growth in demand slows at an increasing rate. Companies that have realized economies of scale can leverage attractive prices to raise their market share and add to their lead.
- ◆ In the degeneration phase, products become less clearly differentiated, surplus capacity arises, competition for market share intensifies (causing market share to become more and more expensive) and the product or industry goes into visible decline.

The above description of the various phases makes it clear that more is at stake here than simply the trajectory of sales curves or sales and marketing considerations. Since the volume and speed of sales – i.e. growth – also triggers changes in production and financing, lifecycle concepts remain the cornerstone of many portfolio strategies to this day. The "cash cow" strategy that we know from market growth/market share portfolios, for example, can be explained by the fact that a company, business or product has reached the maturity phase of its lifecycle and therefore only needs to finance slow market growth. However, at the same time it has achieved a substantial market share (usually a market-leading position), allowing it to fully exploit economies of scale and generate cashflows to finance new business.

Borrowing lifecycle concepts and mapping them onto strategic issues seemed the obvious thing to do. The same concepts also found themselves being grafted into organizational and management doctrines²⁴: Typical structural and procedural

organization patterns likewise change as different phases unfold, as does the style of management, which, again, must align with the varying demands of each phase. The questions that must be asked are self-evident: What constitutes good management in the various phases? Which management skills are of particular importance in which phase? Do a company's values change across the different phases? And are different management personalities needed to optimize management in each phase?

One of the best known lifecycle concepts to examine these issues is that of Danny Miller and Peter Friesen²⁵, which broadens the familiar four-phase logic into five stages:

1. BIRTH
2. GROWTH
3. MATURITY
4. REVIVAL
5. DECLINE

In his "Leadership Lifecycle" approach, Andrew Ward points to five similar phases²⁶ and assigns dominant management attributes to each:

1. CREATION (the Creator)
2. GROWTH (the Accelerator)
3. MATURITY (the Sustainer)
4. TURNAROUND (the Transformer)
5. DECLINE (the Terminator)

In our book "Management between Strategy and Finance"²⁷, Klaus Spreman and I likewise pick up the theme of lifecycles, hence its subtitle: "The Four Seasons of Business". Our primary focus in this work is the constant tug-of-war between management forms dominated alternately by strategic and financial considerations. Even before the financial crisis broke out, our feeling was that the constantly growing power of the capital markets was leading corporate management to focus excessively on financial considerations. Here again, however, the idea of natural lifecycles lent itself as a way to explain our hypothesis. We identified four distinct phases:

- ◆ Finding and occupying the company's proper position: This phase is all about laying the foundation and developing ideas for future business. It involves becoming convinced of an idea and persuading others too. The focus is thus on strategic considerations and charismatic personalities who know how to win others over.
- ◆ Building and developing: Ideas now have to take on a more concrete form. Prototypes must be developed and fine-tuned, customer segments identified. All this again necessitates strategic considerations, although these must now be flanked by financial feasibility deliberations. In this phase, the entrepreneur primarily assumes the role of coach and team leader.
- ◆ Managing growth: The key issue here is to coordinate and plan the conditions to allow the company to scale up. The risks in this phase are particularly high, so risk management takes pride of place and financial considerations gain in importance. The top management acts first and foremost as resource manager.
- ◆ Harvesting and starting over: Earnings – and hence financial considerations – are top of the bill in this phase. As growth slows, cost calculations can determine success or failure. At the same time, either resources for new businesses must be built up or a healthy exit for the shareholder must be prepared and implemented.

When we wrote the book, back in 2007, the general feeling was that the entrepreneurial world was still in order. In light of the recent crises, however, I would now attach much greater importance to the aspect of strategic management. I would also redraw the lines between the phases in the lifecycle – as I show below.

2.3 A NEW LIFECYCLE CONCEPT

Our fascination with lifecycle concepts is rooted in the fact that they allow us to make forecasts. The assumption is that the life of a product, an industry or a company will unfold in a series of phases. Accordingly, if you know which phase you are in, you can reasonably predict the next phase, the expected developments it will bring and the actions it will necessitate. Which is precisely the point at which I start to worry.

If you know the phases, surely it must be possible to shape them rather than almost inevitably sliding toward death and decay. Companies are not living beings

whose death is biologically predestined: They are structures, entities that can be fashioned and molded. Death is not unavoidable. Good management must therefore strive to prevent the company's demise, or to put it to productive use. That is why, in our lifecycle model, Klaus Spreman and I redefined the final phase in particular: The focus is not on dying but on harvesting – on using astute management to reap a rich harvest from the seeds sown in earlier phases.

Staying with this line of thought, I see five reasons why the traditional lifecycle concept needs to be modernized.

First: The familiar charts and figures tend to suggest that the individual phases are all of equal length. Empirically, that is clearly not true. We have already seen that the success of a startup company is decided after three to five years, but that the average age of large companies is 48 years. This alone is an immediate indication that the growth and maturity phases must be many times longer than the startup phase. Logically, therefore, they must also throw out far more opportunities to be seized and risks to be mastered.

Second: The transitions between phases are critical to a company's ability to survive. Can a company translate its business idea into rapid growth soon after its inception, for example? Or can it successfully weather the transition from rapid growth to a more steady upward trajectory? While all concepts accept that these transitions have a part to play, the transitions themselves do not occur at a specific point in time (at best, they can be regarded as mathematical turning points in the lifecycle function). In reality, transitions take place over a period of time that cannot be precisely determined. There are thus powerful arguments to treat these transitions as fully-fledged phases in their own right.

Third: These days, I believe the distinction between a startup phase in which the foundation for a new business is laid "in peace and quiet" and the subsequent growth phase is an artificial one. New technology, fast-paced markets, the danger that different companies in different places might come up with or even copy the same good idea at the same time and the impatience of many financial backers all lead us to one conclusion: The only good idea is one that gets translated into market

success and occupies a clear position as quickly as possible. As I see it, this view has already been affirmed by the study by the Centre for European Economic Research mentioned earlier, which suggests that the probability of failure increases up to the third year and then decreases again. As a result, inception and growth have now become so closely intertwined that they should be regarded as one and the same phase.

Fourth: The same goes for the distinctions between growth, maturity and transformation or revival. Conceptually, these distinctions are, of course, highly intuitive:

- ◆ During the growth phase, mastering rapid growth is the key issue.
- ◆ In the maturity (or saturation) phase, companies must learn to succeed with slower or low growth rates.
- ◆ The focus of the transformation phase is to realign the company and gather fresh momentum.

Here again, however, entrepreneurial reality refuses to play ball. The advance of globalization, the emergence of new competitors in Asia, constant shifts in factor cost advantages, new technology, demographic change and, by no means least, the fact that stable economic trends – let alone entire cycles – are scarcely to be found these days²⁸ all mean that companies are constantly having to adjust and renew or transform themselves. On top of that, our analysis has long shown that only growing companies can enjoy success in the long term.²⁹ Restructuring must always go hand in hand with growth. Tearing down and building up are two sides of the same coin. Otherwise there will never be any sustainable increase in productivity. Growth and transformation should not be separated: They should form a single phase whose purpose is to realize lasting or constant growth.

Fifth: I have already made clear my opinion that decline, relegation, degeneration or whatever you choose to call the final phase in the lifecycle concept cannot be reconciled with the aims of good management. The objective must surely be to break out of this cycle rather than merely scrape up the crumbs that are left over. We must naturally be realistic in this context too: Markets do contract sharply or disappear altogether. Photographic technology, book selling and mainframes are

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