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**IDEA WATCH**

## The Grass Isn't Greener

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## STRATEGY

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**N**ot long ago the CEO of a company we know convened his top executives and asked them to look for new strategic growth opportunities, because revenue had stalled and the existing customer base was shrinking. He encouraged them not to be bound by the company's history, the markets in which it already participated, the expertise of its people, or the assets it had in place. Instead he wanted them to identify new markets. "We've got to find some other way to extend our business," he said. "I don't care if it's a

stretch for us. We'll find a way to make it happen."

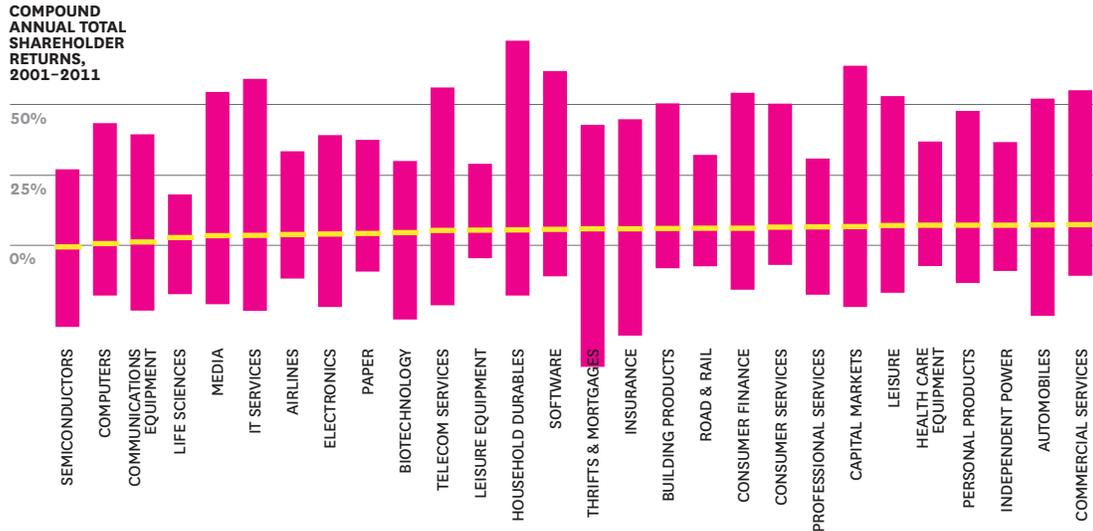
It's amazing how often senior executives conclude that their problems are simply a function of a decline in their core markets—and how often boards accept that conclusion. The underlying belief is that leaders should find the "best" industries and put their companies in a position to compete in them. There's bound to be greener grass somewhere, isn't there?

Actually, no. The idea that some industries are superior—a view promulgated by

Wall Street analysts, media pundits, and managers' own human tendency to look for "easier" businesses—is illusory. The data do not support it. Sure, some industries outperform others, but the differences are far smaller than you might think, and most highfliers eventually revert to the mean. Moreover, the difference in returns within an industry—any industry—is several times greater than the difference across industries, no matter which ones. CEOs and boards shouldn't waste time—and shareholder capital—trying to jump to

# THE LAW OF AVERAGES

Many managers focus on finding a “better” industry to get into. But if you look at the total shareholder returns within various industries over the past decade, you’ll see that the median performances (the yellow hash marks) are strikingly similar. What differs is the range of returns (the pink bars). So instead of switching industries, concentrate on moving to the top of your own.



“better” industries. In almost every case, a bigger opportunity lies in improving your performance in the industry you’re in, by fixing your strategy and strengthening the capabilities that create value for customers and separate you from your competitors.

We reached this conclusion after analyzing shareholder returns for 6,138 companies in 65 industries worldwide from 2001 to 2011. Firms in the top quartile had annual total shareholder returns of 17% or more. Every major industry had at least one company with a TSR that high. Some industries did a little better, some a little worse, but the top performers in all did incredibly well. Their CEOs didn’t have to seek deliverance elsewhere.

Yet it’s hard to find a leader who hasn’t entertained the idea that his or her company was simply in a bad industry or market space and a better opportunity lurked nearby. This notion explains some of the big gaffes firms make. It explains why product or service lines that still have growth potential get exploited as cash cows—made to fund other businesses instead of being allowed to reinvest in their own. It explains the waste and loss of focus that often result when companies place multiple bets in the hope that one will be a big winner. It explains the reckless pursuit of mergers that are billed as “transformational” but often involve overpayment, underperformance, a big write-off, and the loss of the CEO’s job.

One example of the pitfalls of this reasoning is Mattel’s acquisition of the Learn-

ing Company, in 1999. Growth at Mattel (the maker of the Barbie doll) was slowing, and the Barbie franchise was losing market share; CEO Jill Barad thought the company could gain advantage by shifting its attention to a faster-growing market. She saw the Learning Company, which made interactive games and educational software, as the answer. But her optimism (reflected in an acquisition price of \$3.5 billion—4.5 times the Learning Company’s annual revenue) was ill founded. The Learning Company had problems of its own, including low free cash flow and aging brands such as Reader Rabbit, and Mattel didn’t have the know-how to succeed in the interactive-learning market. Far from boosting Mattel’s success, the Learning Company un-

dermined it, erasing Mattel’s profits and wiping out two-thirds of shareholder value. Little more than a year after the acquisition, Barad was out and Mattel had sold the Learning Company for a pittance.

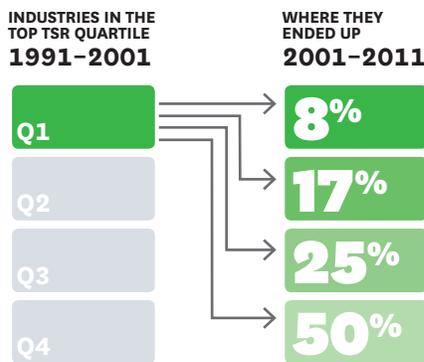
## Faulty Assumptions

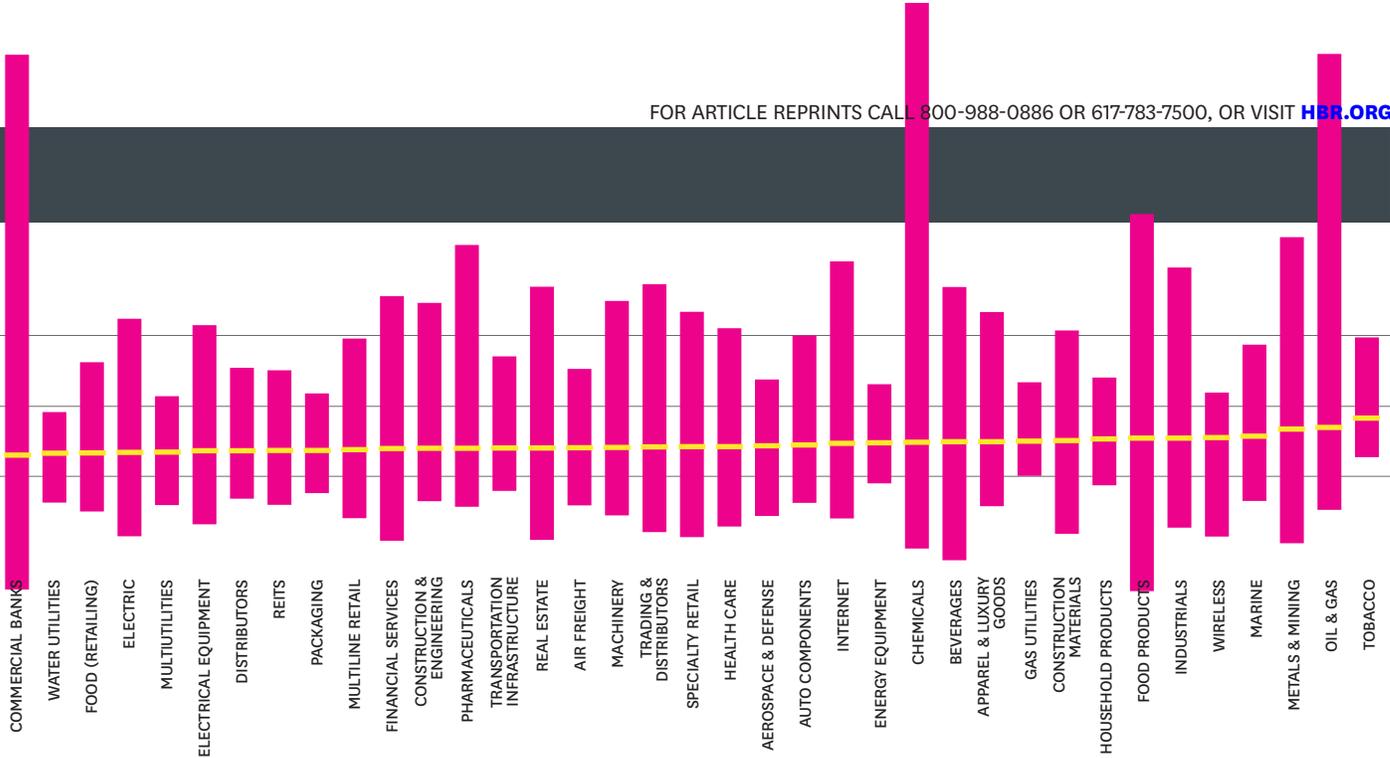
Mattel’s troubles illustrate one problem with grass-is-greener thinking: the assumption that managerial talent and knowledge are fungible. Shareholders often assume that a company that’s capable in one area can rapidly learn to be capable in another. In fact, the capabilities that matter form over decades and may involve millions or billions of dollars in human and financial capital. Firms that have moved into and dominated new areas, such as Apple in online music and Amazon in computer services, chose industries that took advantage of unique capabilities they already had.

The second problem is the assumption that an industry that seems superior today will remain so. There are always some industries in a “hot” part of the growth cycle because of a breakthrough innovation, favorable regulations, or some other advantage. But hot industries often cool. Half the companies we studied that were in the top quartile from 1991 to 2001 ended up in the bottom quartile during the next decade. This variability, found in every type of economic cycle, shows why it is generally very risky to enter an industry at its peak. Time Warner’s disastrous 2000–2001 merger with AOL provides a cautionary example.

### HOT, THEN NOT...

A big reason not to shift industries: One decade’s leaders can become the next decade’s laggards.





At the time of the deal AOL had a five-year TSR of 40%. A year later, as the dot-com bubble deflated, the combined company's stock fell from \$90 to \$33.

The fact that there's no such thing as a bad industry is even more relevant to CEOs. Yes, temporary issues may depress returns—overcapacity, say, or a discontinuous change that means customers can meet their needs more easily elsewhere. But the fear that an industry is doomed—that its products and services have become so many buggy whips—is usually overblown. History suggests that periods of turmoil within industries, just like periods of high growth, rarely last. Most industries and market segments have remarkably consistent returns over the long term.

Our 10-year analysis of TSRs proves the point. If you throw out the number one and number 65 industries in our study (tobacco and semiconductors), the median returns of the “best” and “worst” industries are within 16% of one another. The gap within industries is far greater: The top companies in each industry have annual TSRs that are 72% higher, on average, than the TSRs of the worst companies. Be a good or a great company in just about any industry, and you won't be looking for new businesses to enter—you'll be popping champagne.

The takeaway is clear: Your chance of getting superior returns is far better if you stay in your own industry and improve your performance than if you move into a new one. It's a bit like having faith, when

darkness falls, that the sun will return tomorrow: You can pretty much count on it.

One company that maintained faith in its industry—and has been rewarded for doing so—is Polaris Industries. Like its competitors, this maker of off-road vehicles underwent a period of choppy growth from 2001 to 2007. In 2008 Scott Wine came in as CEO, but rather than shift the company's attention to an “easier” market, as new CEOs in such cases often do, he staked everything on winning in the core business. He poured resources into R&D and capitalized on two of the company's exceptional capabilities—rapid innovation using deep customer insights, and flexible manufacturing. Before long Polaris had successful new vehicles in both the utility and the performance-enthusiast markets, including vehicles used by the military and in desert riding. Its market share in off-road vehicles—roughly 25% when Wine took over—shot up to the high 30s and is now more than twice that of its nearest competitor. Polaris made similar gains in heavyweight motorcycle product lines. It was on track for record revenue in 2012.

### Winning in Your Own Industry

If trying to succeed in your own industry is your smartest move, what can you do to improve performance there?

First, rethink your definition of growth. Most companies divide growth initiatives into two categories: organic (which usually means “growing with the market”)

and inorganic (“growing in adjacencies”). This can be counterproductive. Instead, a singular focus on market-share gains leads to superior performance, as Polaris's story shows.

Second, funnel resources to the few capabilities that are really critical to the company's success, and minimize all other costs. For Polaris, this meant heavy investment in R&D and operations. The share of sales of its new products keeps rising, and a new retail management system has reduced stock-outs and strengthened relationships with distributors.

Finally, change the focus of your business units and teams. Many CEOs manage by issuing numerical targets—for revenue growth, profitability, and expenses. Companies would often do better to focus on market share, a more independent variable. After Lou Gerstner joined a teetering IBM, in 1993, he would carry around two charts, one on customer satisfaction and one on market share, and show them to managers throughout the company. The managers got the point: Their job was to serve customers and beat the competition. It didn't matter how badly the industry was suffering; what mattered was that IBM maneuver itself into a position of relative strength. Gerstner was betting that the industry wasn't the problem. Not surprisingly, he was right. ♥

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