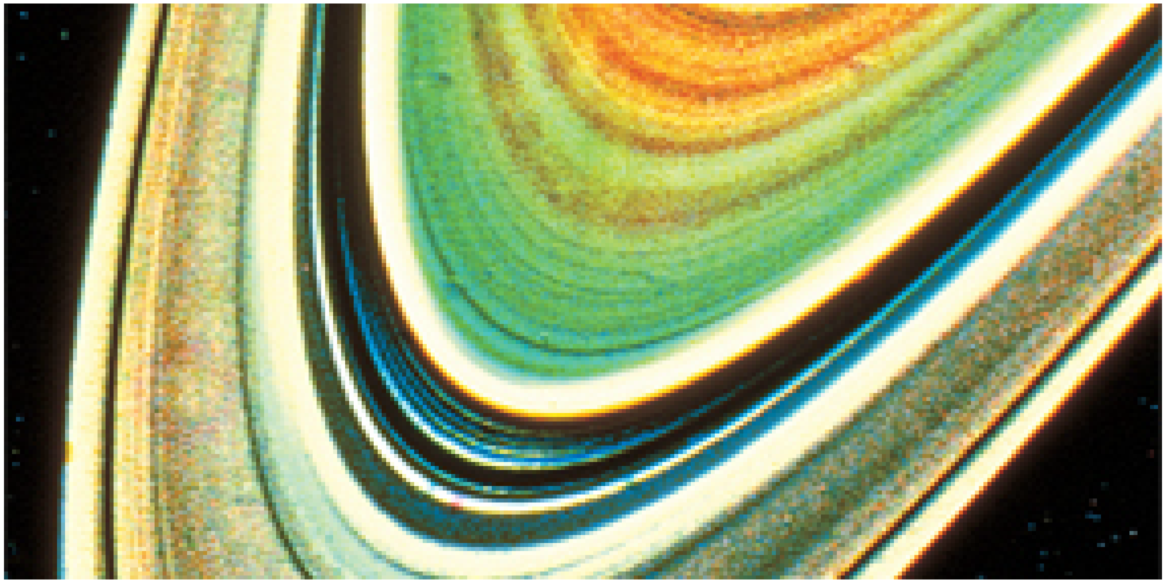


BAIN & COMPANY

Profit from the core & Beyond the core

Yungwook Shin

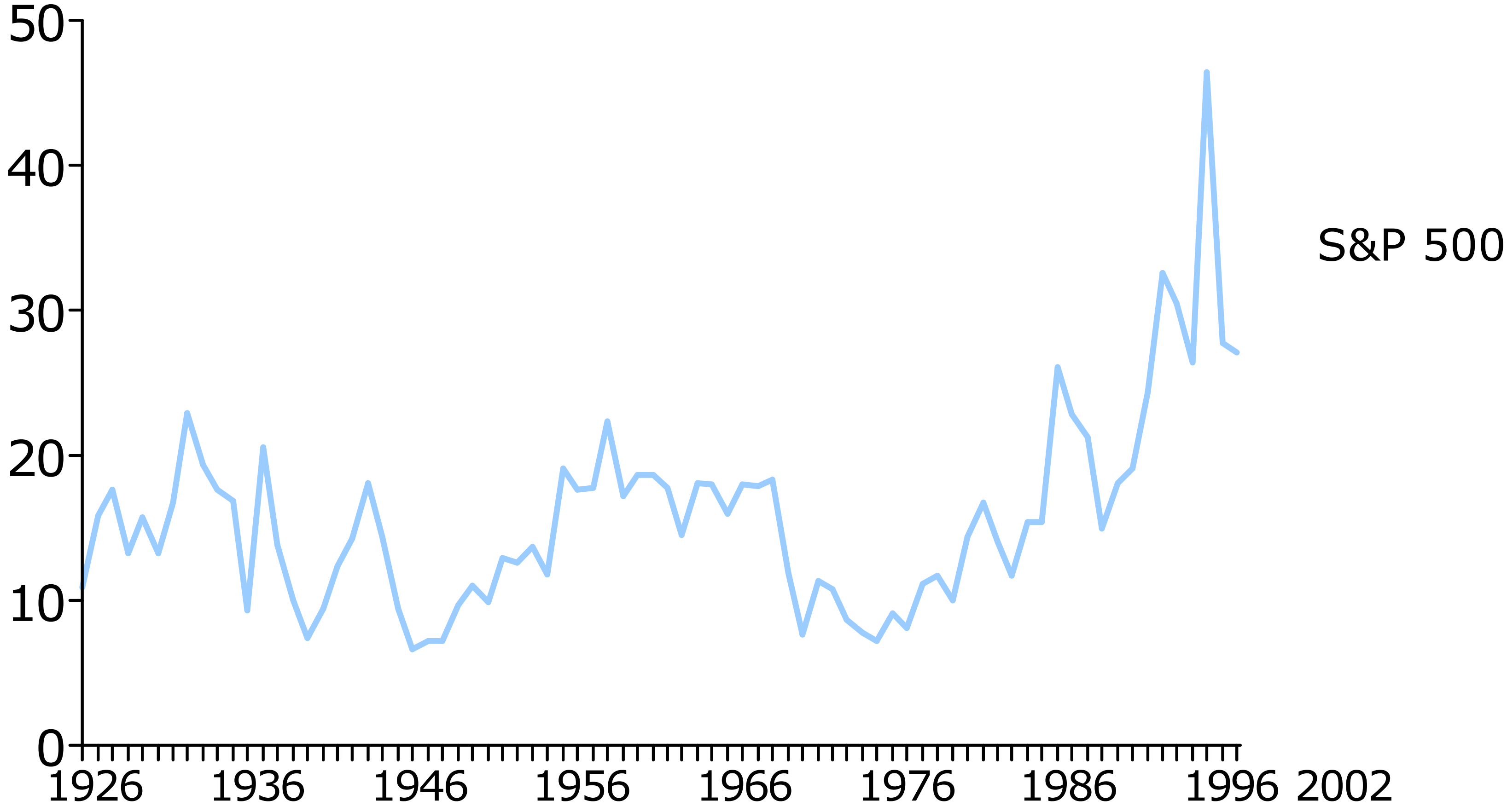
2004. 11. 25

The growth forecast

- Only 1 in 10 companies will achieve sustained, profitable growth
- Less than 1 in 4 growth initiatives away from the core will succeed
- Over 70% of businesses are forecasting performance they will never attain

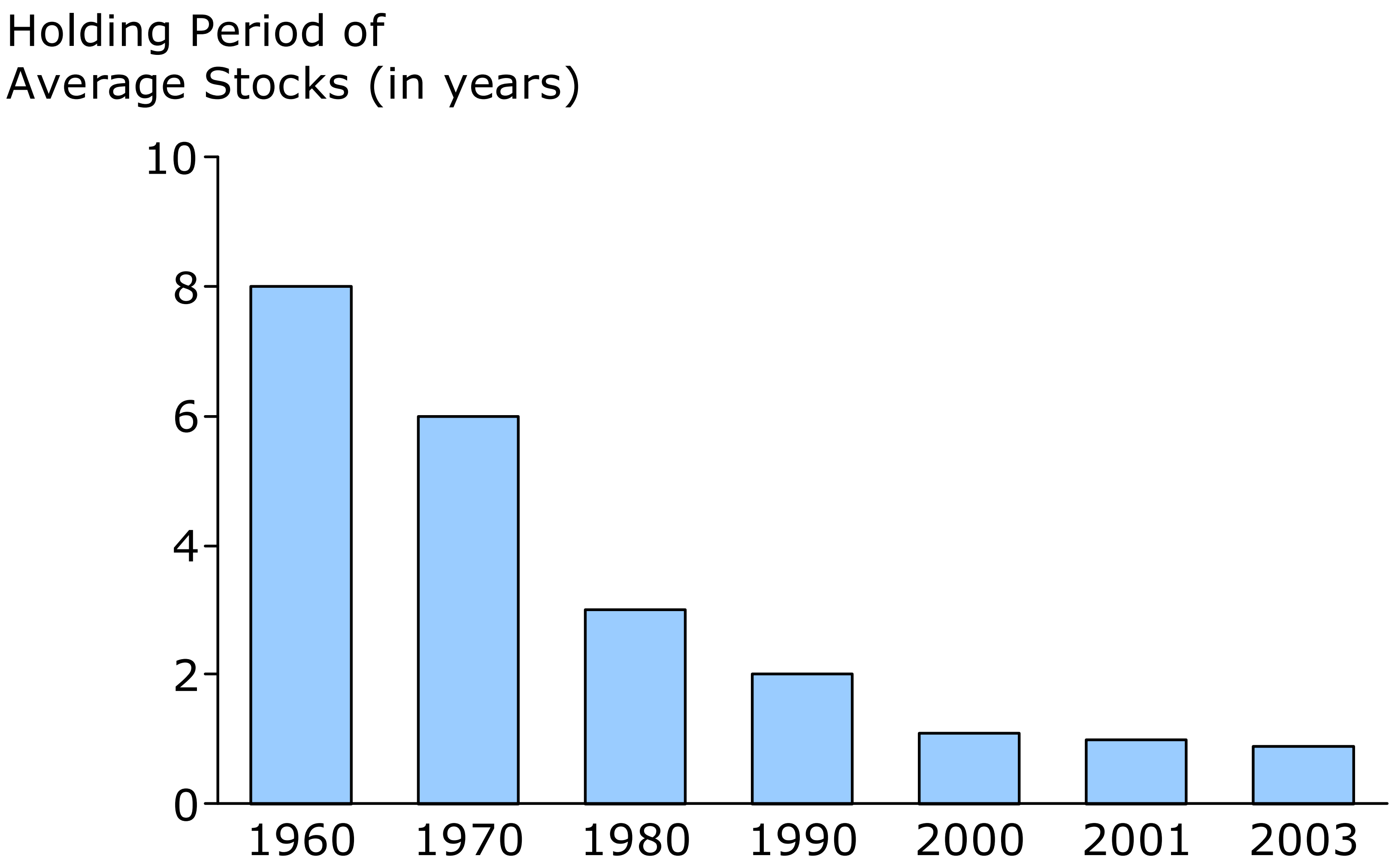
Market growth expectations still high

Price to Earnings Ratio

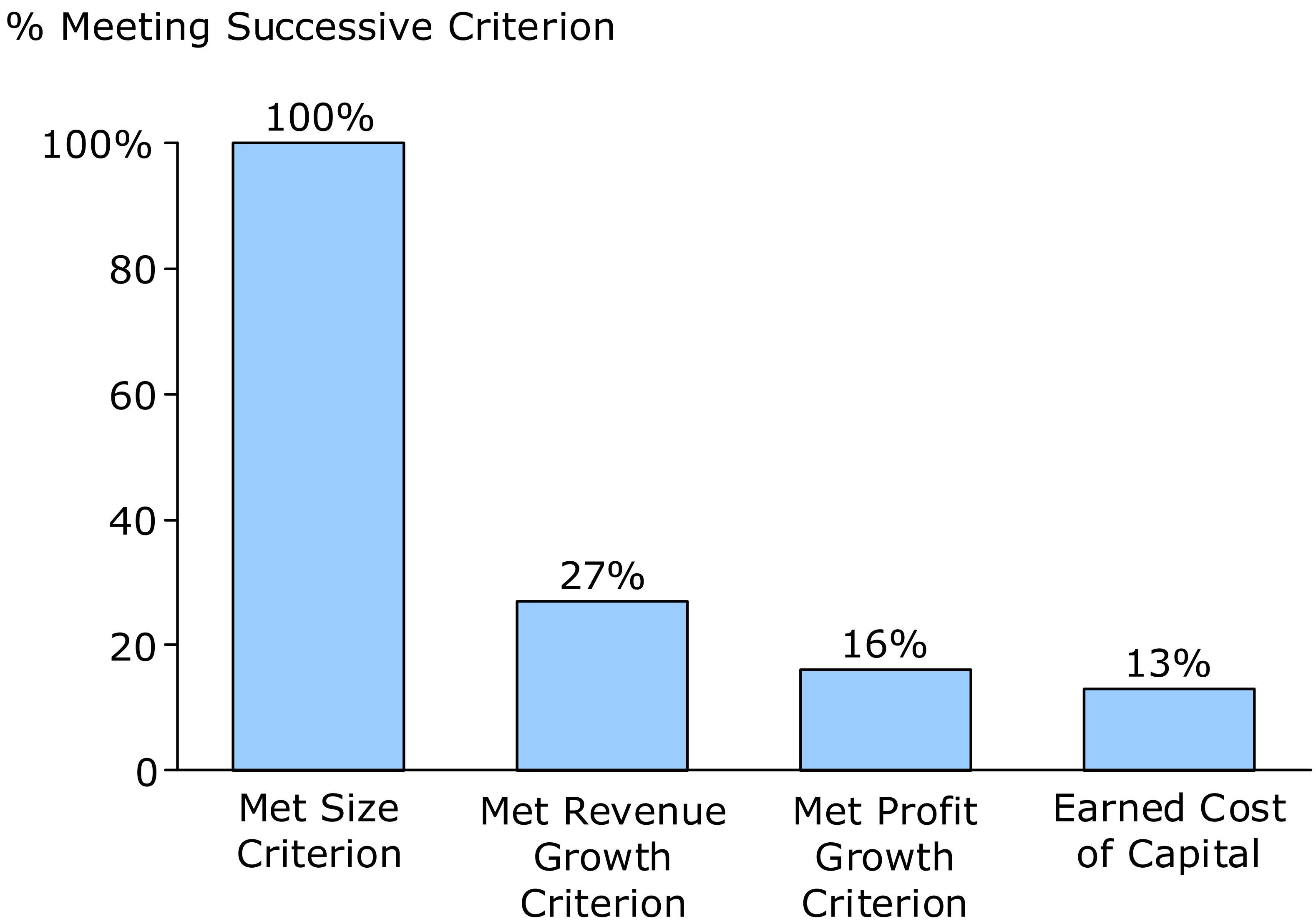


Note: definition is closing price divided by latest 4 quarter as reported diluted earnings per share

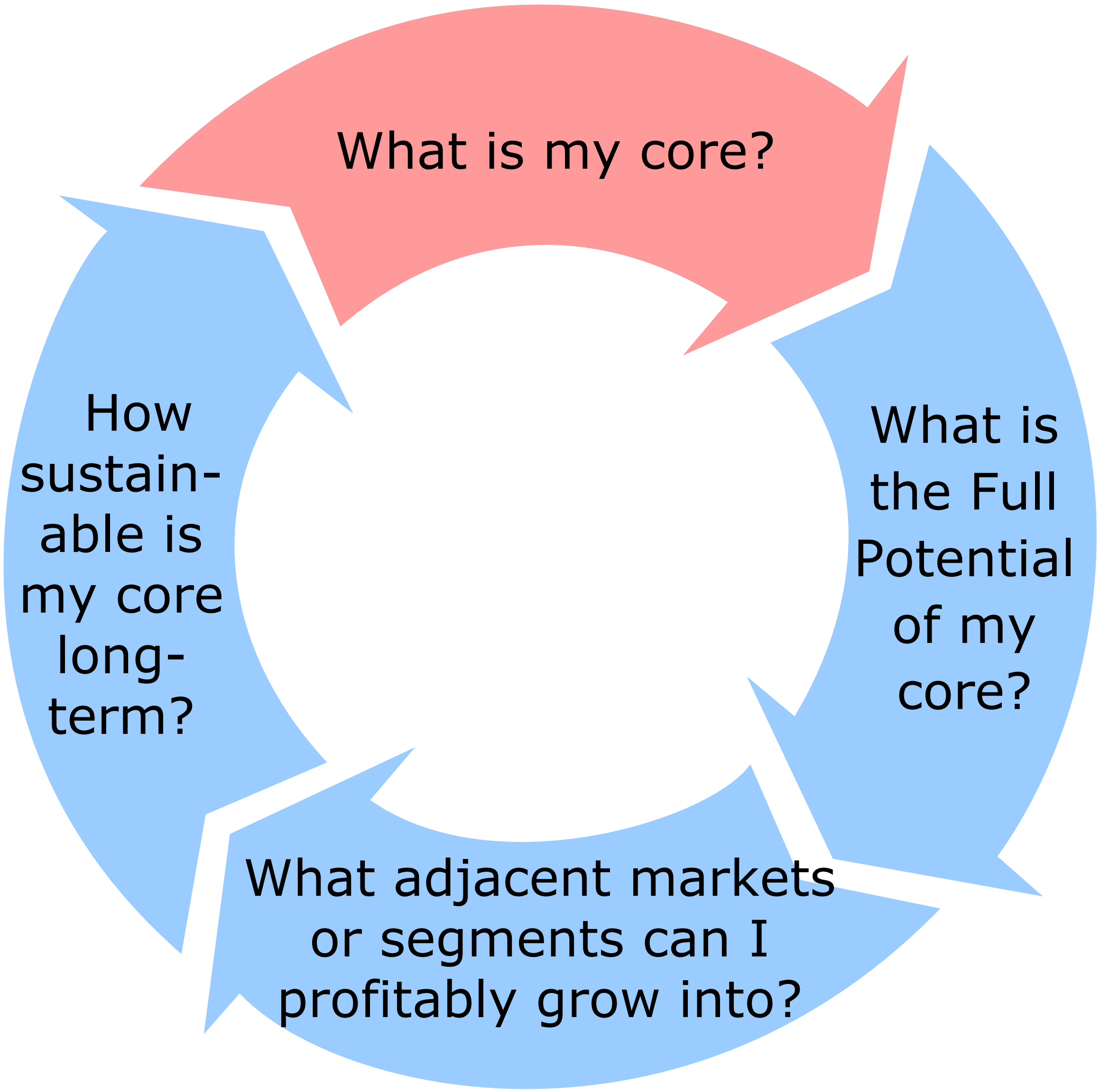
Investor impatience growing



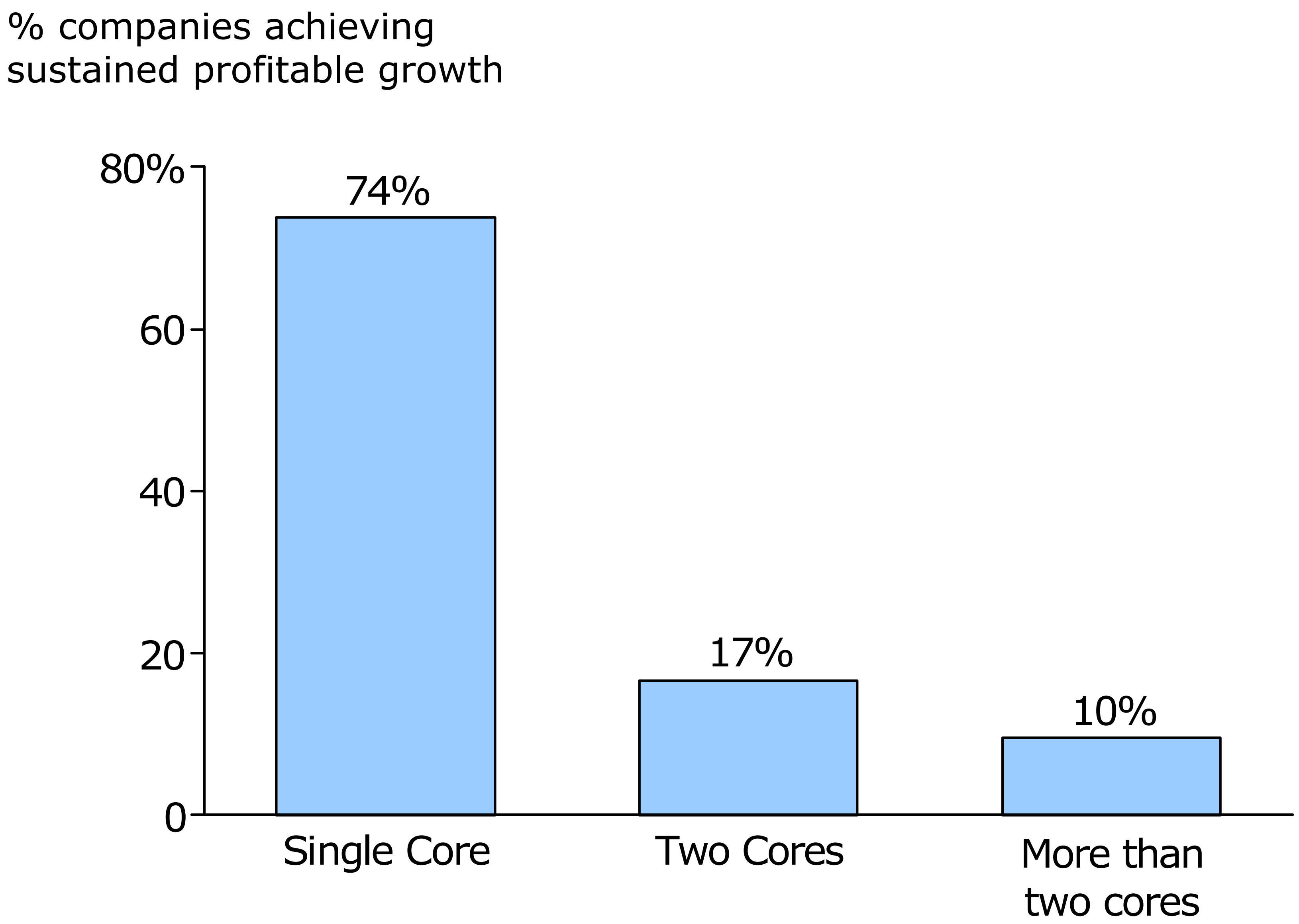
Sustained Growth Companies are rare



Successful businesses address four key questions

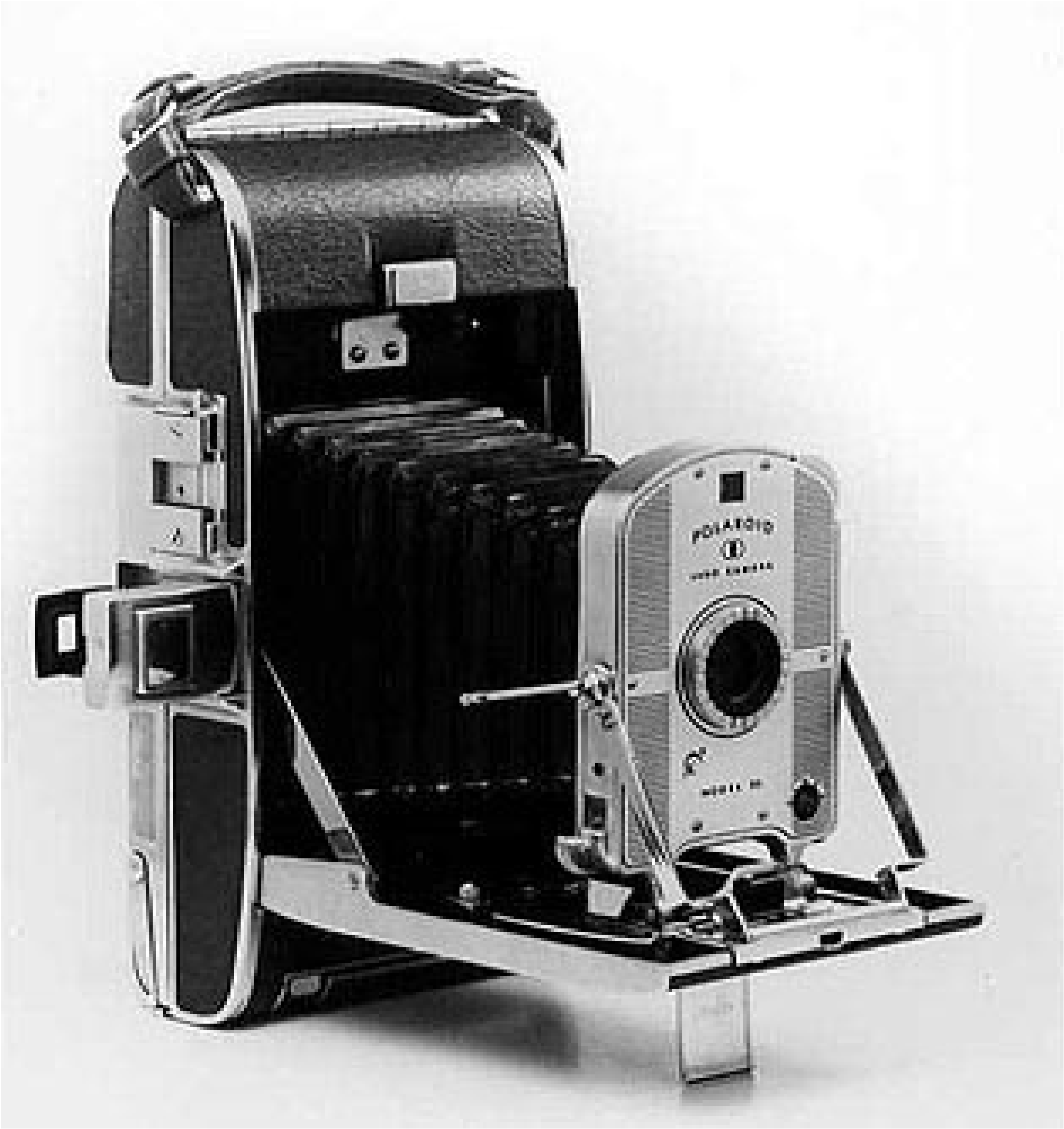


Most profitable growth is built upon a strong, well-defined core



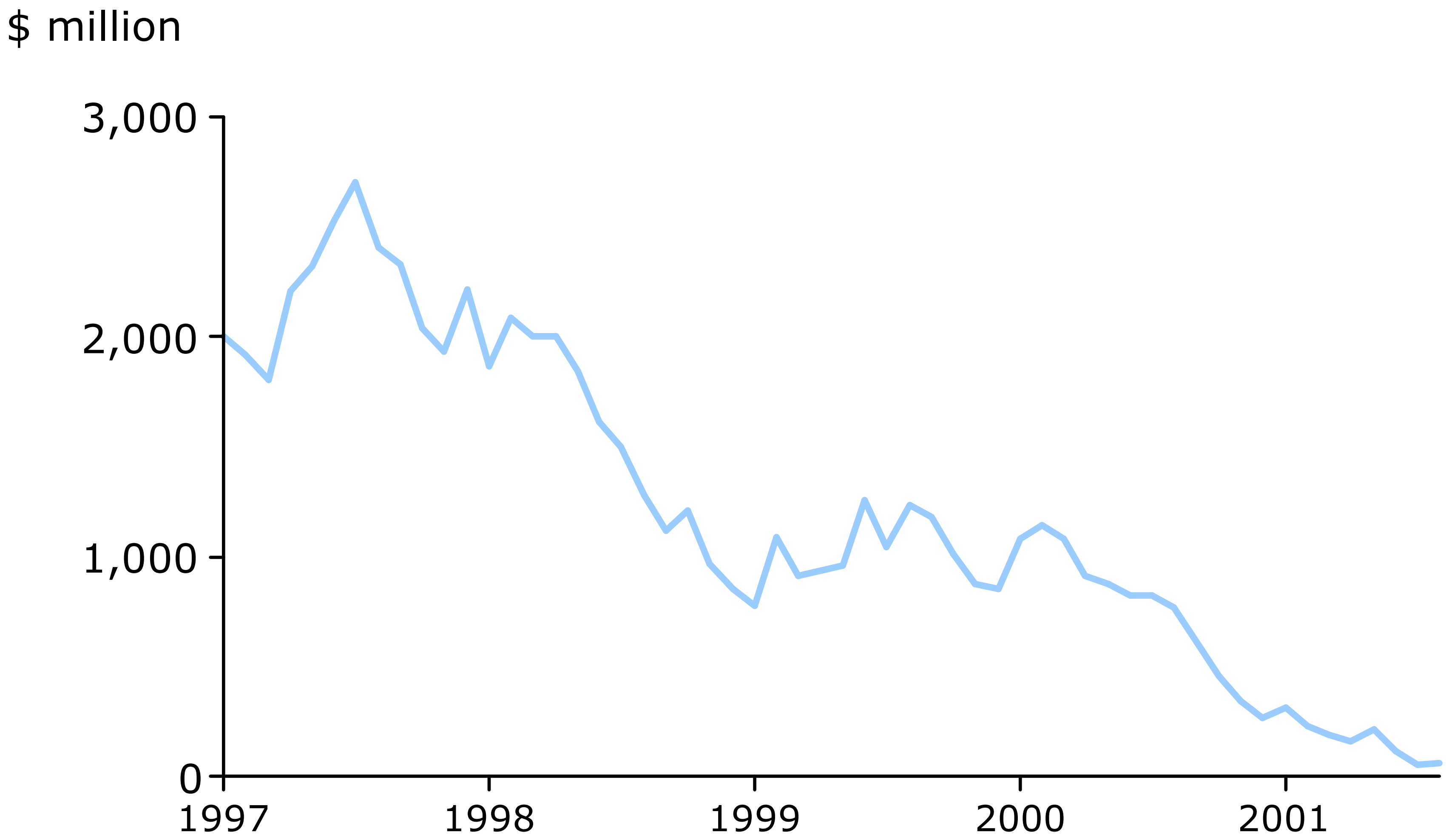
"Can anyone remember what our core business is?"

Polaroid – "chemical based image processing"



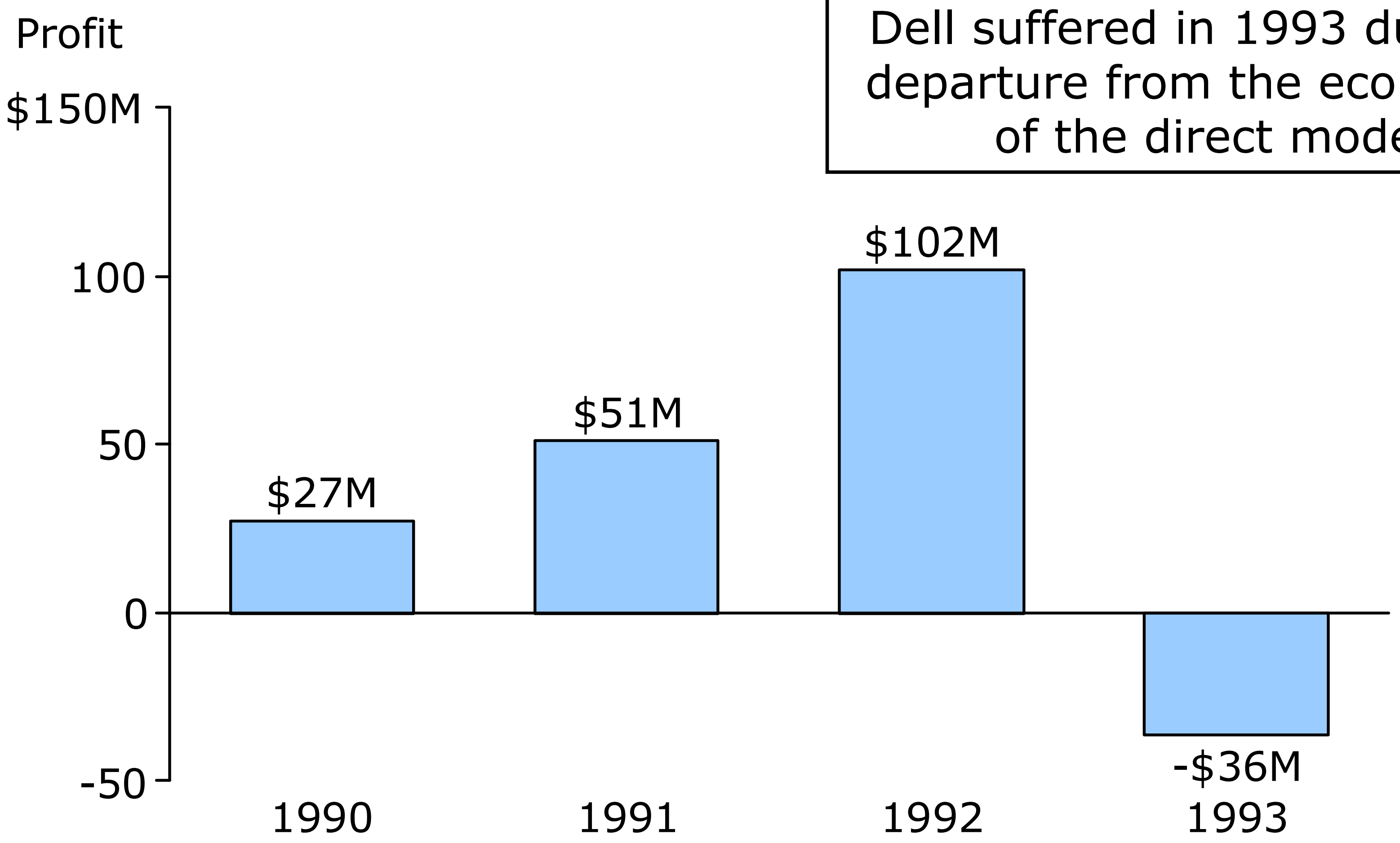
The digital threat

Polaroid Corporation market value

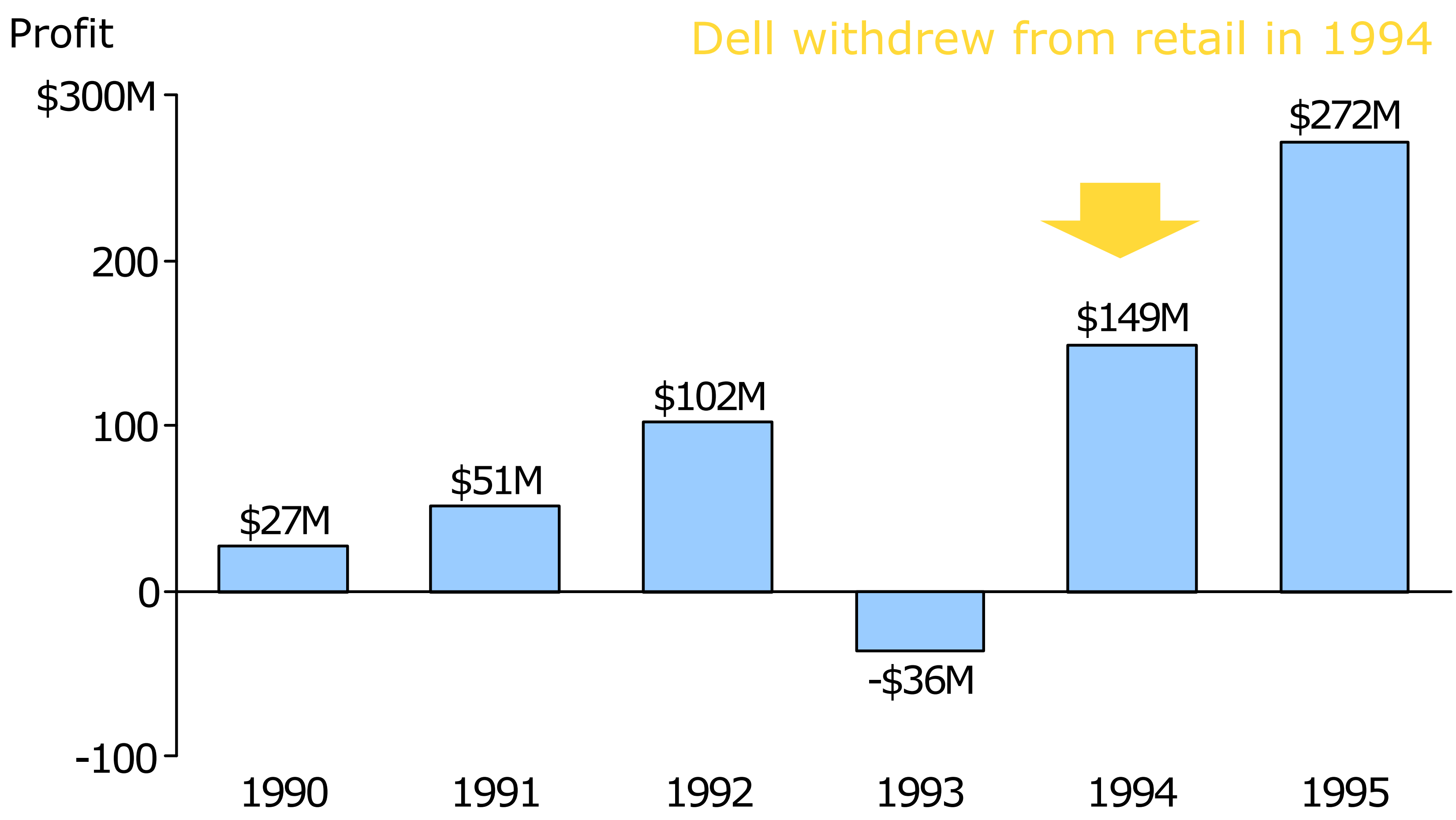


Dell misadventure of 1993

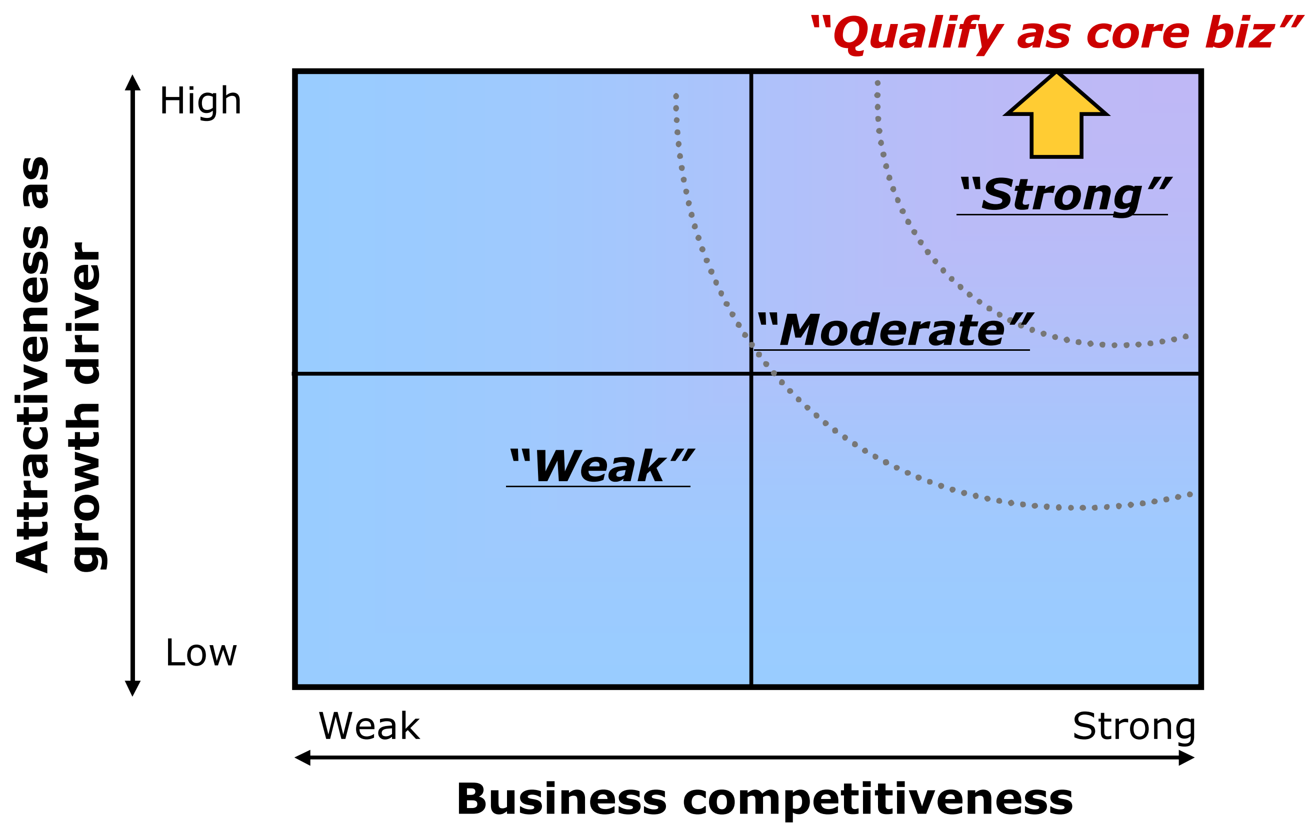
Dell suffered in 1993 due to a departure from the economics of the direct model



Dell refocused on its core



Framework to define core business



- Market growth
- Revenue contribution
- Operating profit contribution
- Revenue growth
- Operating profit growth

Quantitative

Qualitative

- Market dominance: market share, cost competitiveness
- Customer dominance: brand power, customer Loyalty
- Technology dominance: Core technology & management technology

Dangers of misdefining the core

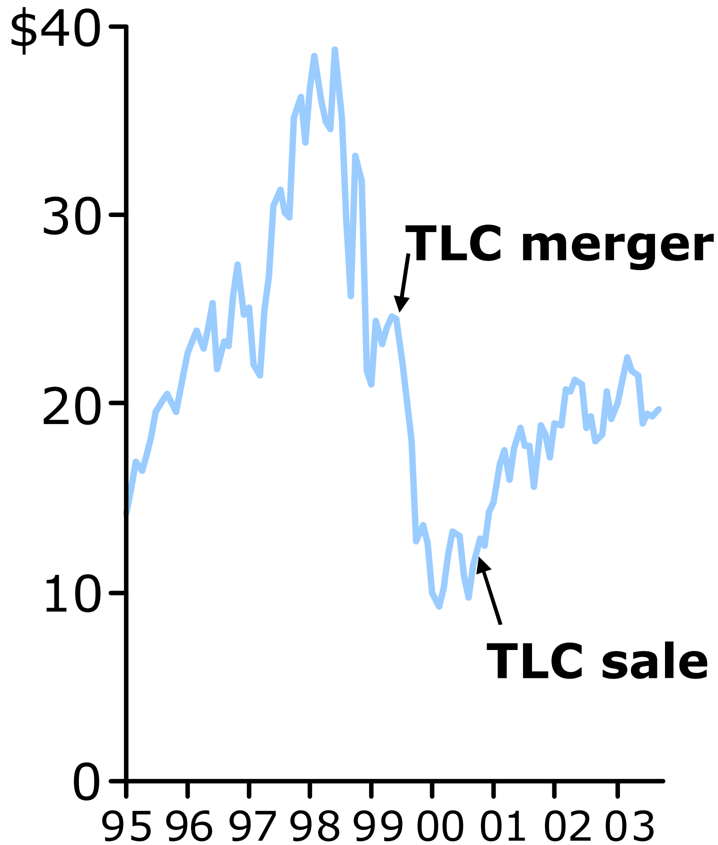
- Spread resources too thin
- Inadequately defend the true core
- Prematurely abandon growth in the core
- Pursue wrong adjacencies

Breakdown #1: Spread resources–Mattel

"*We have begun the process of transforming Mattel from a* ***traditional toy company*** *to a global* ***children's products company****…*

Jill Barad,
Mattel CEO,
December 1998

Mattel stock price



"*We had a tremendous run…everything went well. And then* ***we lost our focus****.*"

Bob Eckert,
Mattel CEO,
April 2001

Breakdown #2: Inadequately defend the true core

First Wal-Mart store opened

1962

First Kmart store opened

Wal-Mart:

1970: 32 stores

Focused on small & midsize towns

1970

Wholesale Club

Supercenter format

Discount retailers*

1980

Wholesale suppliers**

Deep discounter

Mexico

Canada

1990

Wal-Mart overtakes Kmart as #1 US retailer

Germany
Brazil
Asia
U.K.
Smaller scale format

2002

WAL*MART

Ranked #1 Company on Fortune 500

Kmart:

Australia

1970: ~200 stores

Aggressive expansion of Kmart stores

Book Stores

Home Improvement stores

Drug Stores Canadian

Discount outlets

Warehouse Clubs

Specialty Sports Stores

Office Supply stores

Czechoslovakian Department stores

Mexico

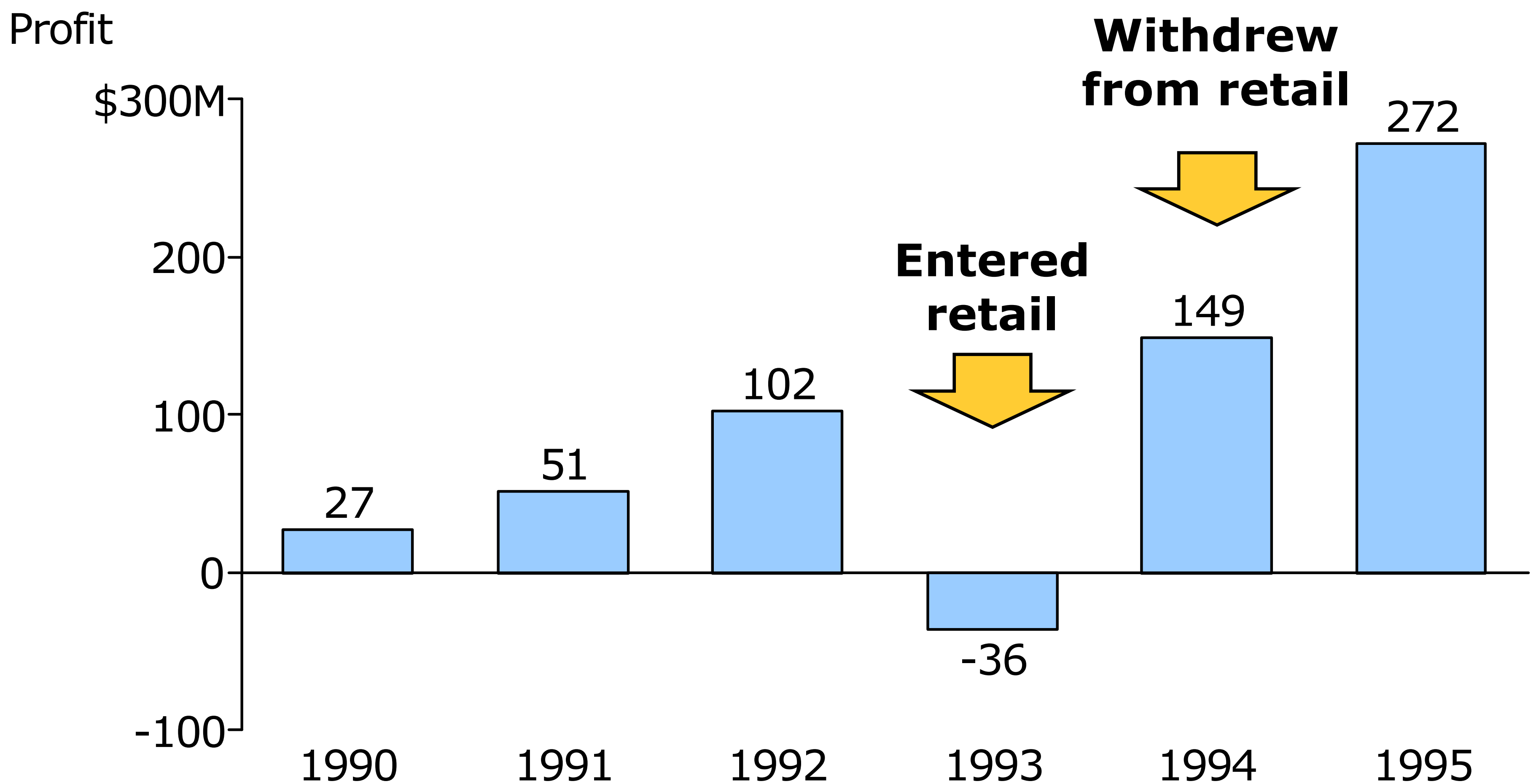
Book Stores

Desperate

Divestitures

Filed for Chapter 11 Bankruptcy

Breakdown #3: Prematurely abandon growth in the core

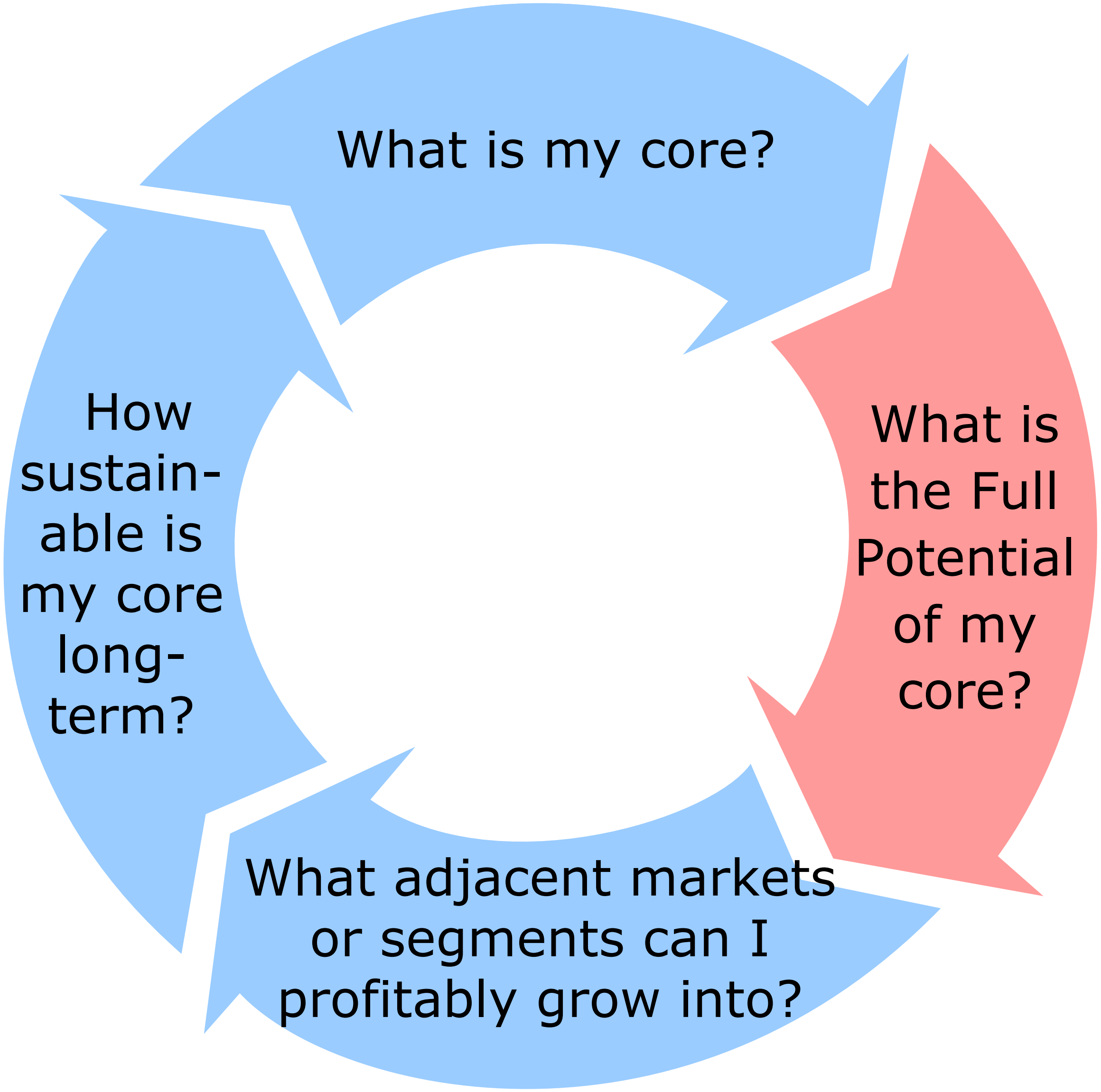


Breakdown #4: Pursue wrong adjacencies — Anheuser-Busch

Eagle Snacks

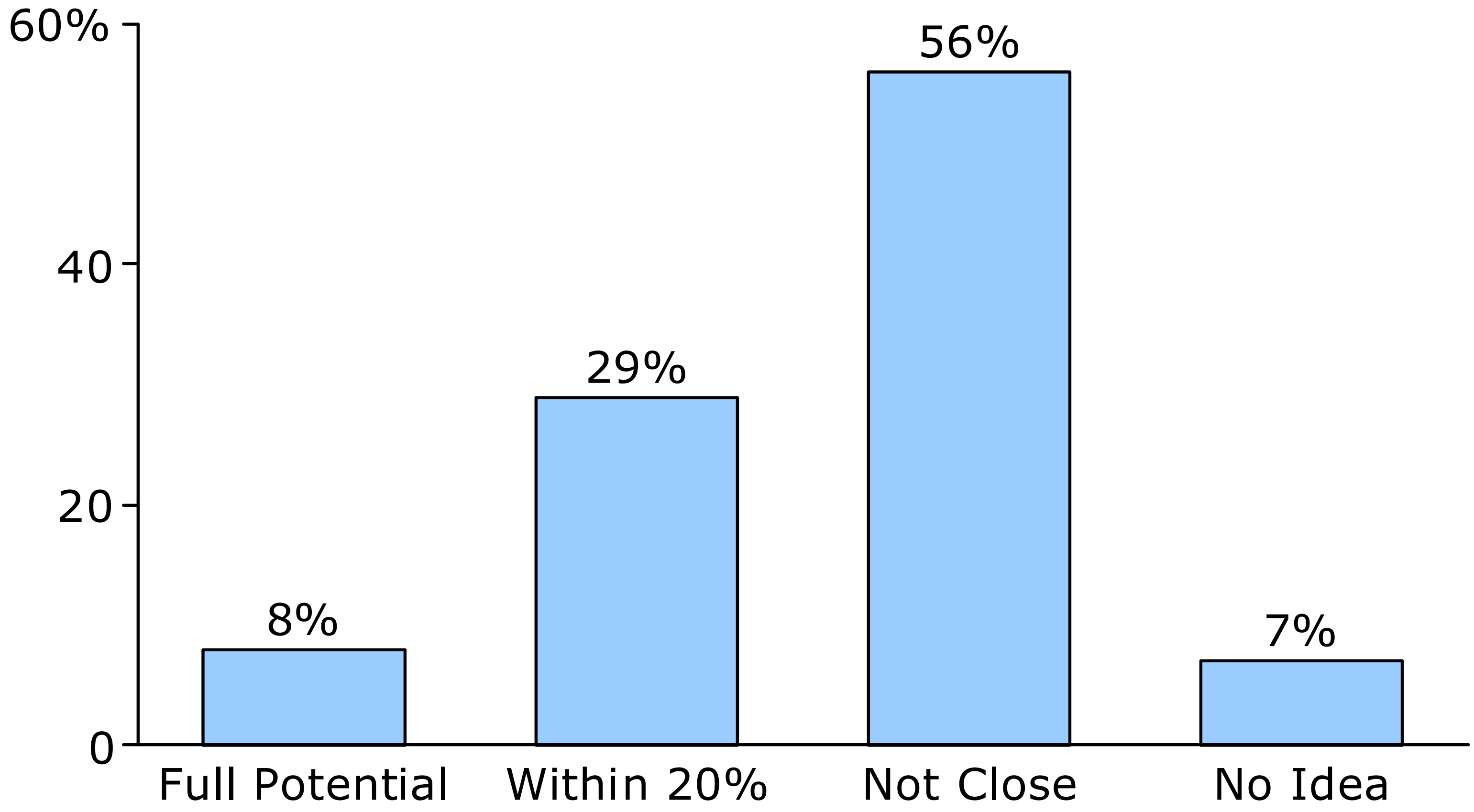
EARTHGRAINS

Successful businesses address four key questions

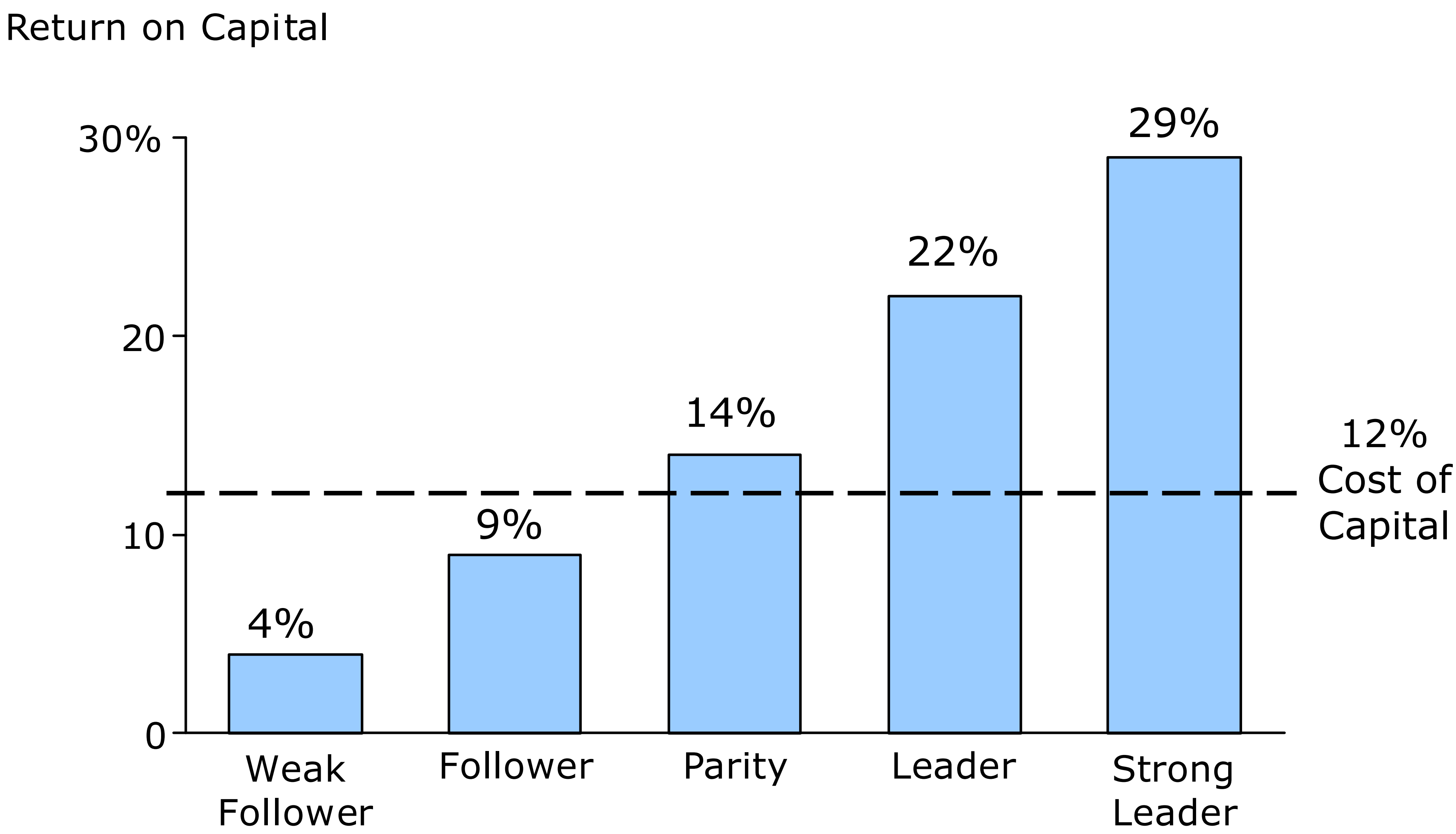


Bain/EIU Survey

How close is your #1 core business to its full potential for profitable growth?



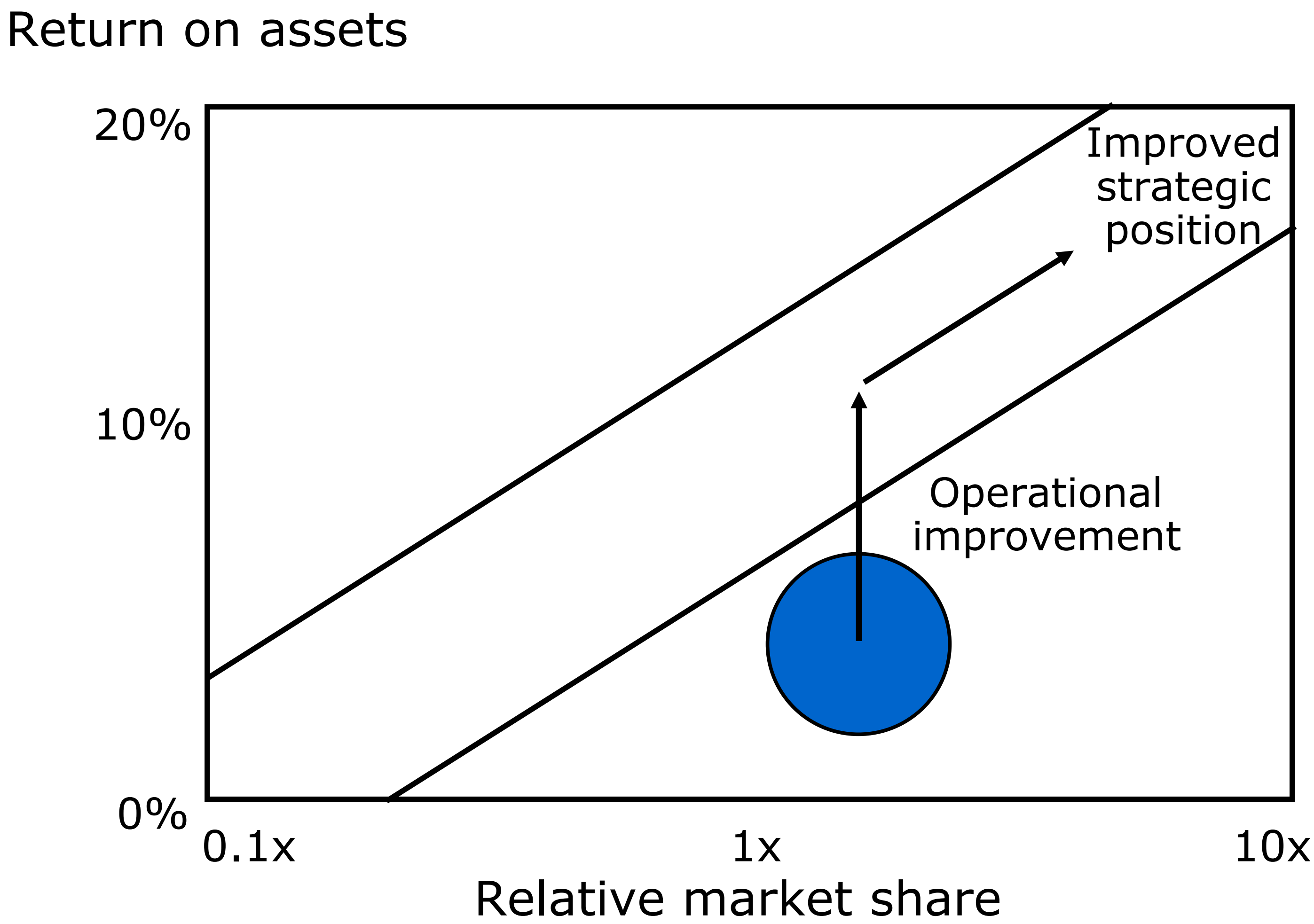
Market leadership drives superior returns



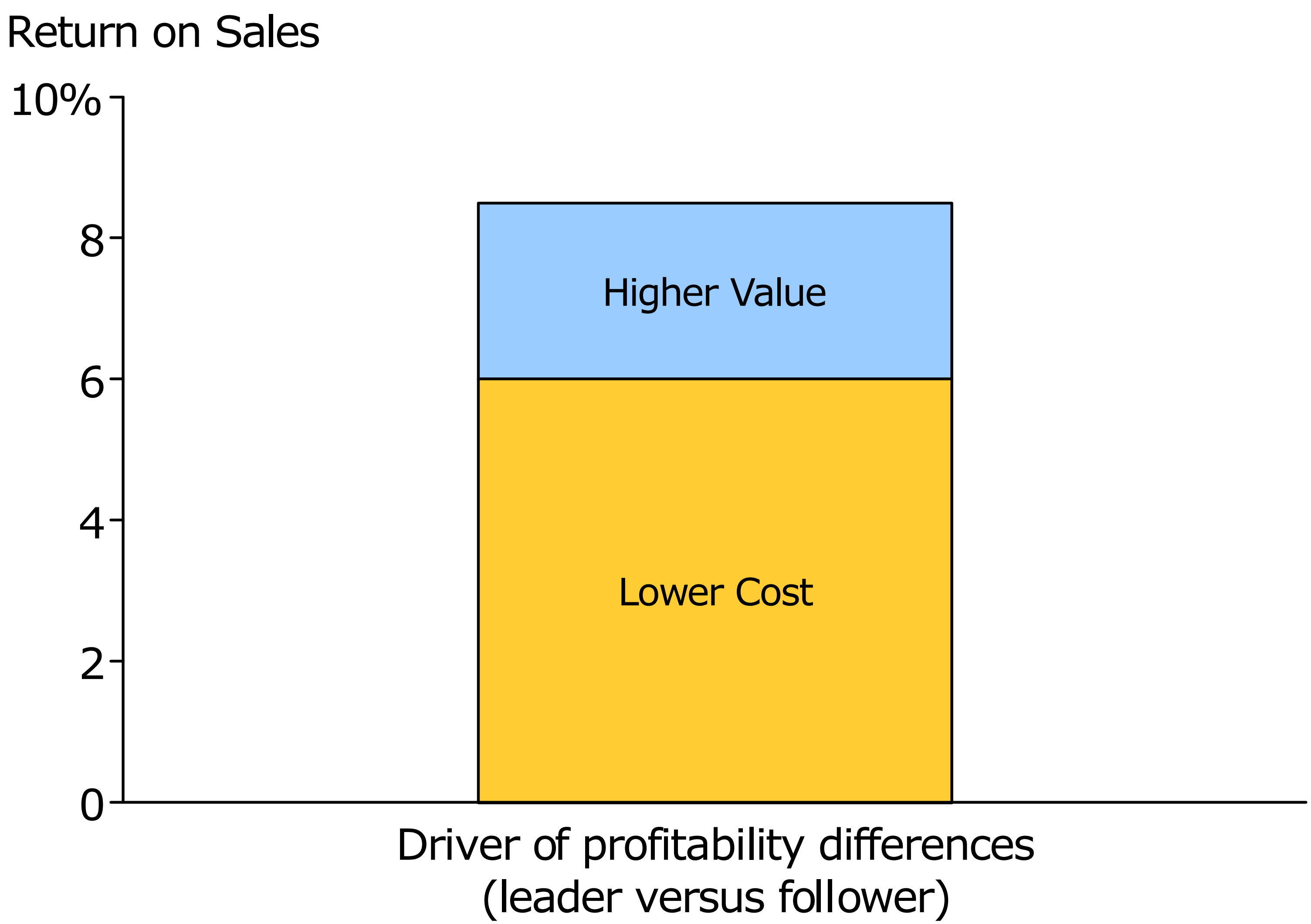
The trap of leadership

The stronger your market position the more likely you are operating below full potential

Full Potential Requires Operational and Strategic optimization

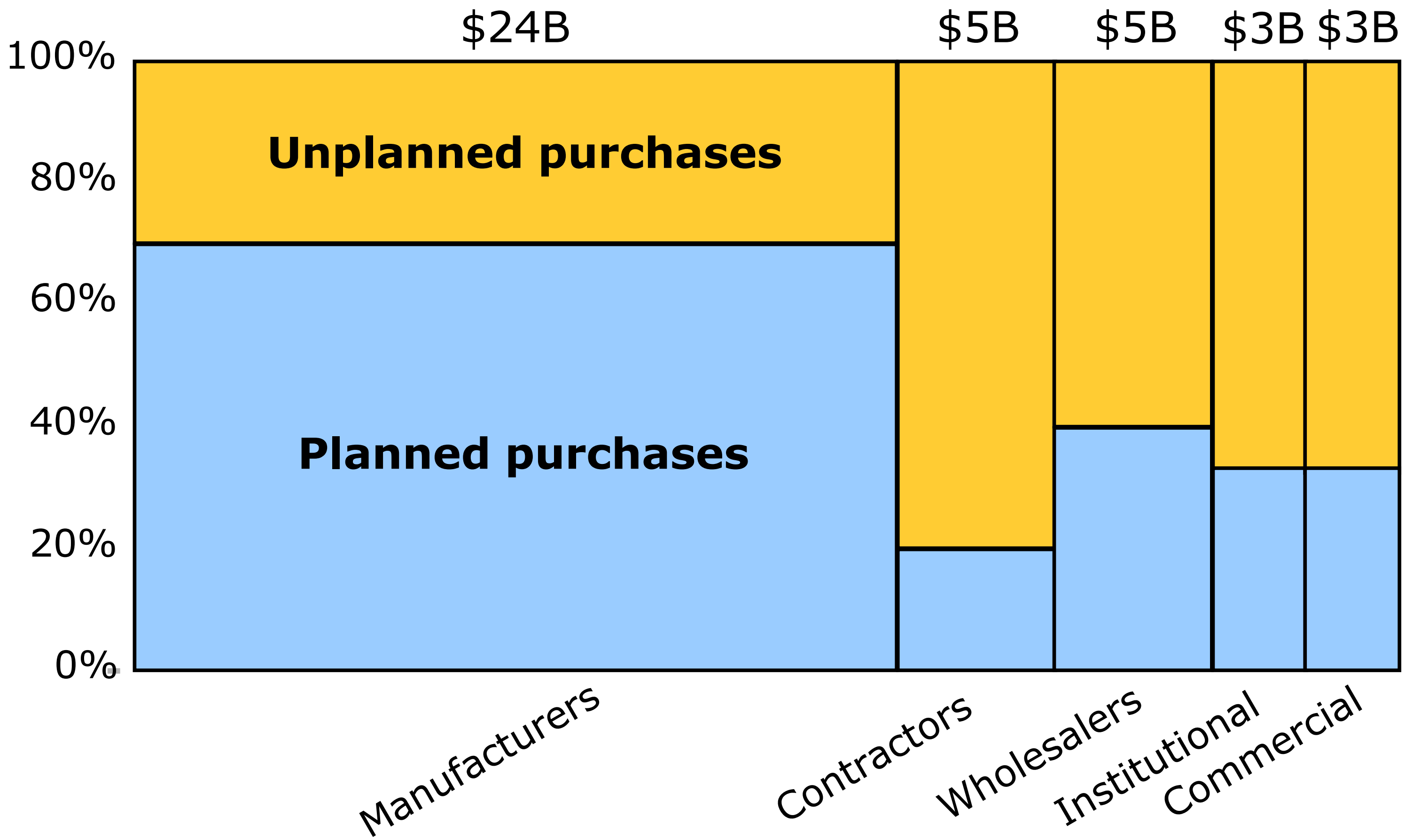


Cost control is key



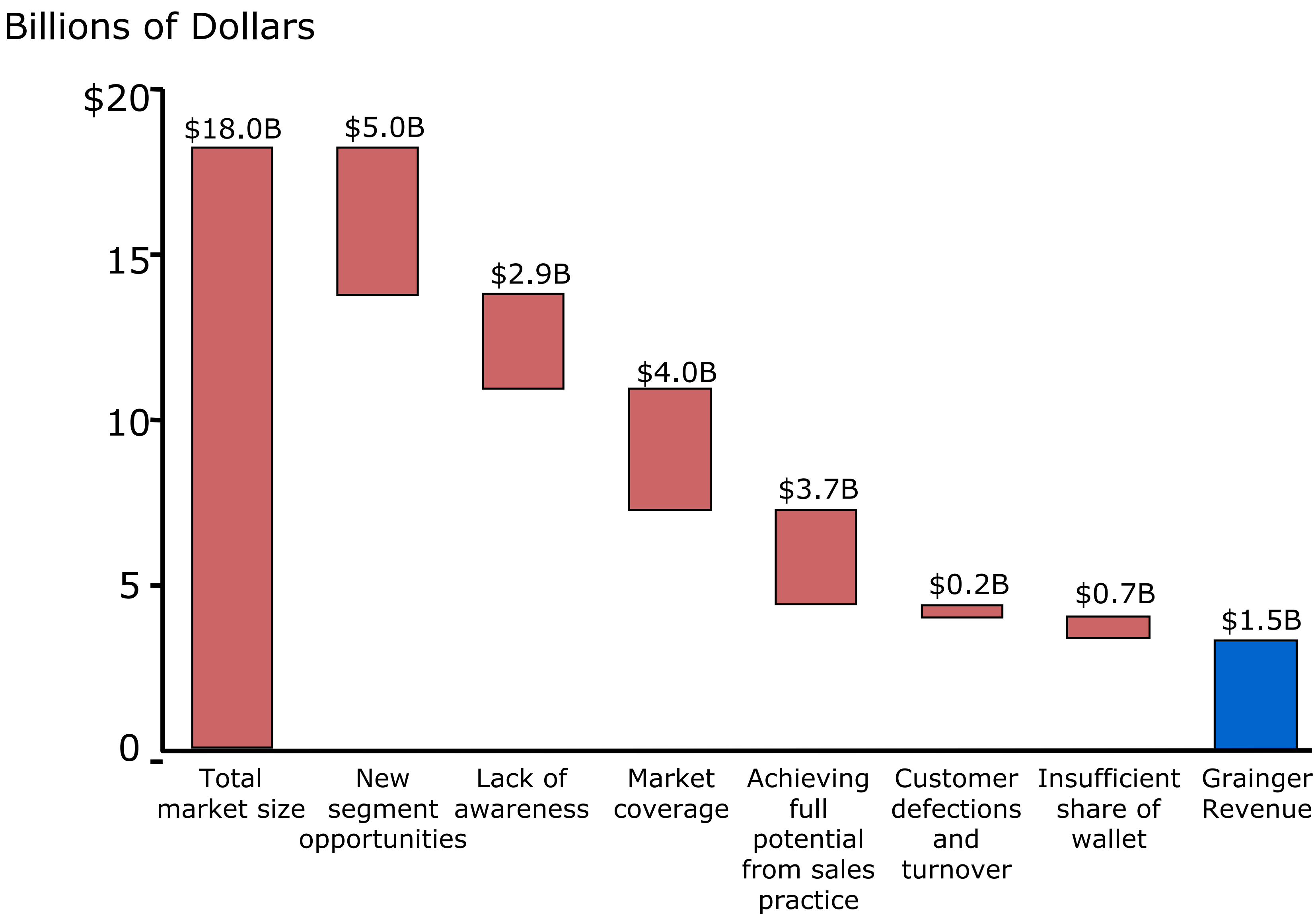
Target market can be defined more broadly - Grainger

Percent of total purchases



Unplanned purchases = $18B

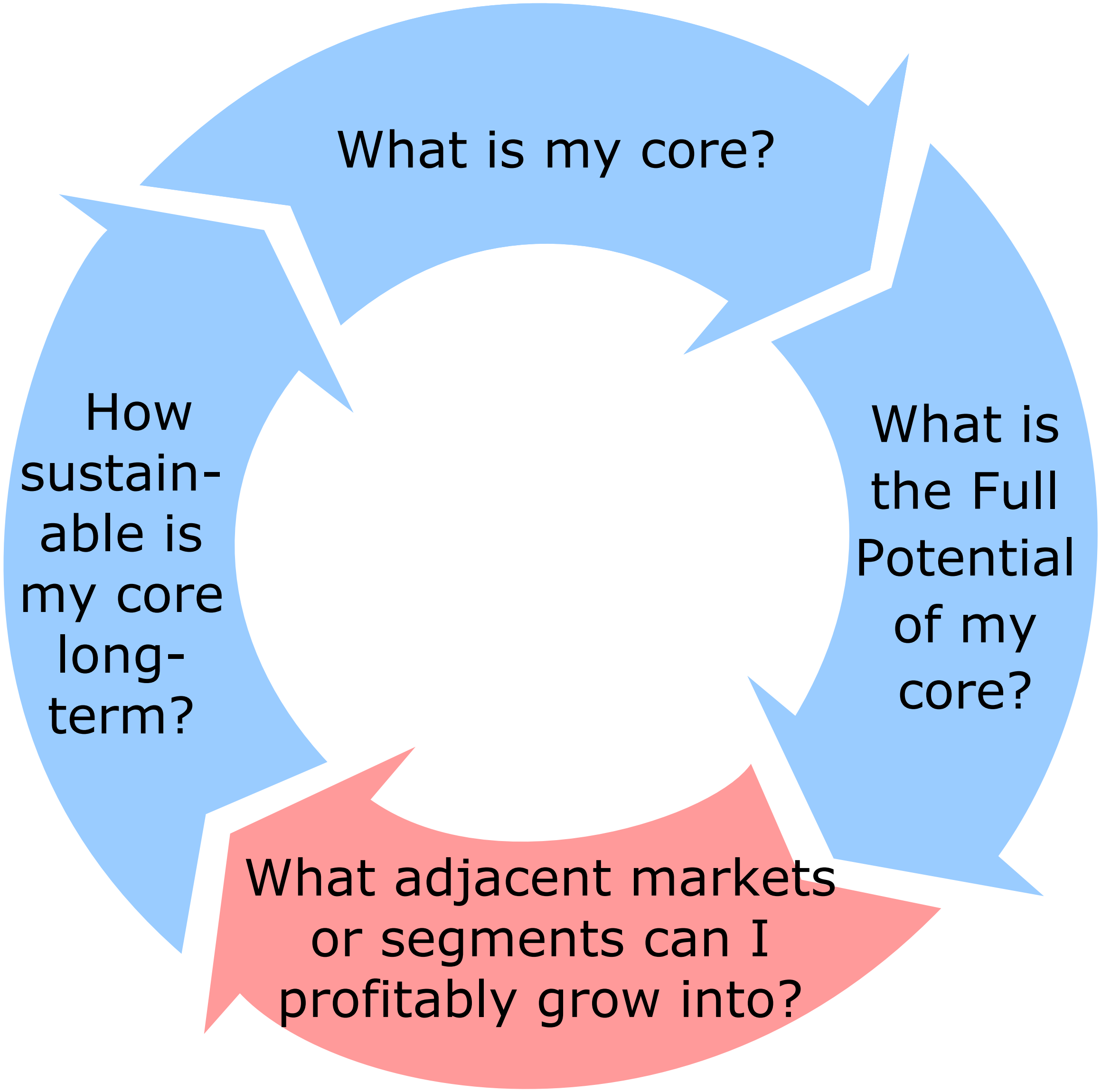
Grainger's "Revenue Sieve"



Actions taken

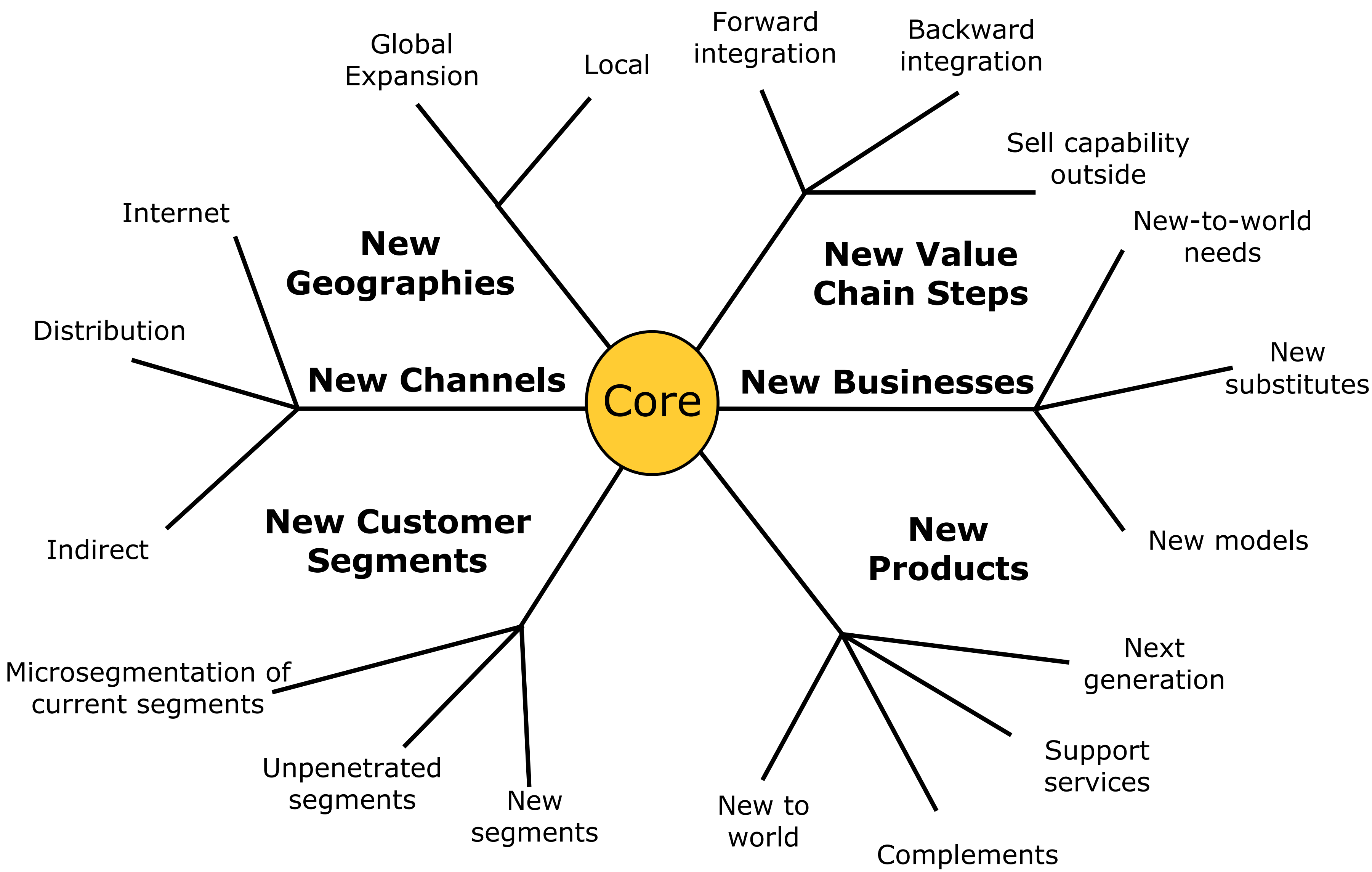
- Added 100 Branches; planned 150 additional branches
  - Untapped markets
  - Better proximity to existing customers
- Refocused product lines
  - From specialty oriented to convenience
  - Low profit items eliminated
- Restructured sales force
  - Best sales practices across districts
  - Sales resources increased
- Improved customer service procedures
  - Specific weakness vs. competition identified
  - Needs better understood from customer perspective

Successful businesses address four key questions



Don't build on a weak core

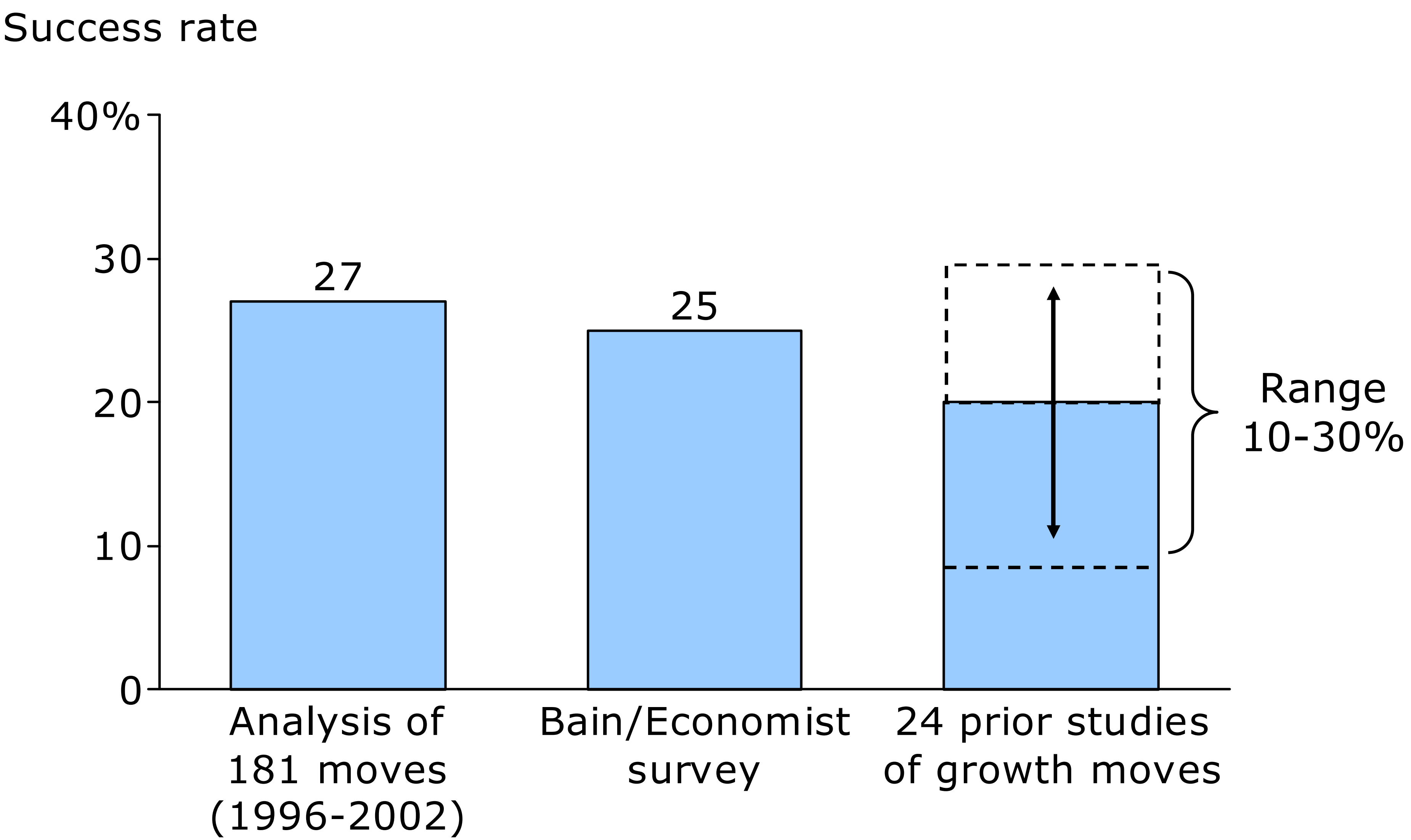
Complexity of growth



Adjacency growth study: Sources

- 25 in-depth case studies and interviews with companies that have extensive adjacency success records
- 100 CEO interviews
- Data base of 181 adjacency moves
- Paired comparisons of 24 companies with different growth paths and move sequences
- Bain/Economist executive surveys
- Bain case data base
- Complete secondary source analysis

Different studies all say 3 out of 4 growth initiatives fail

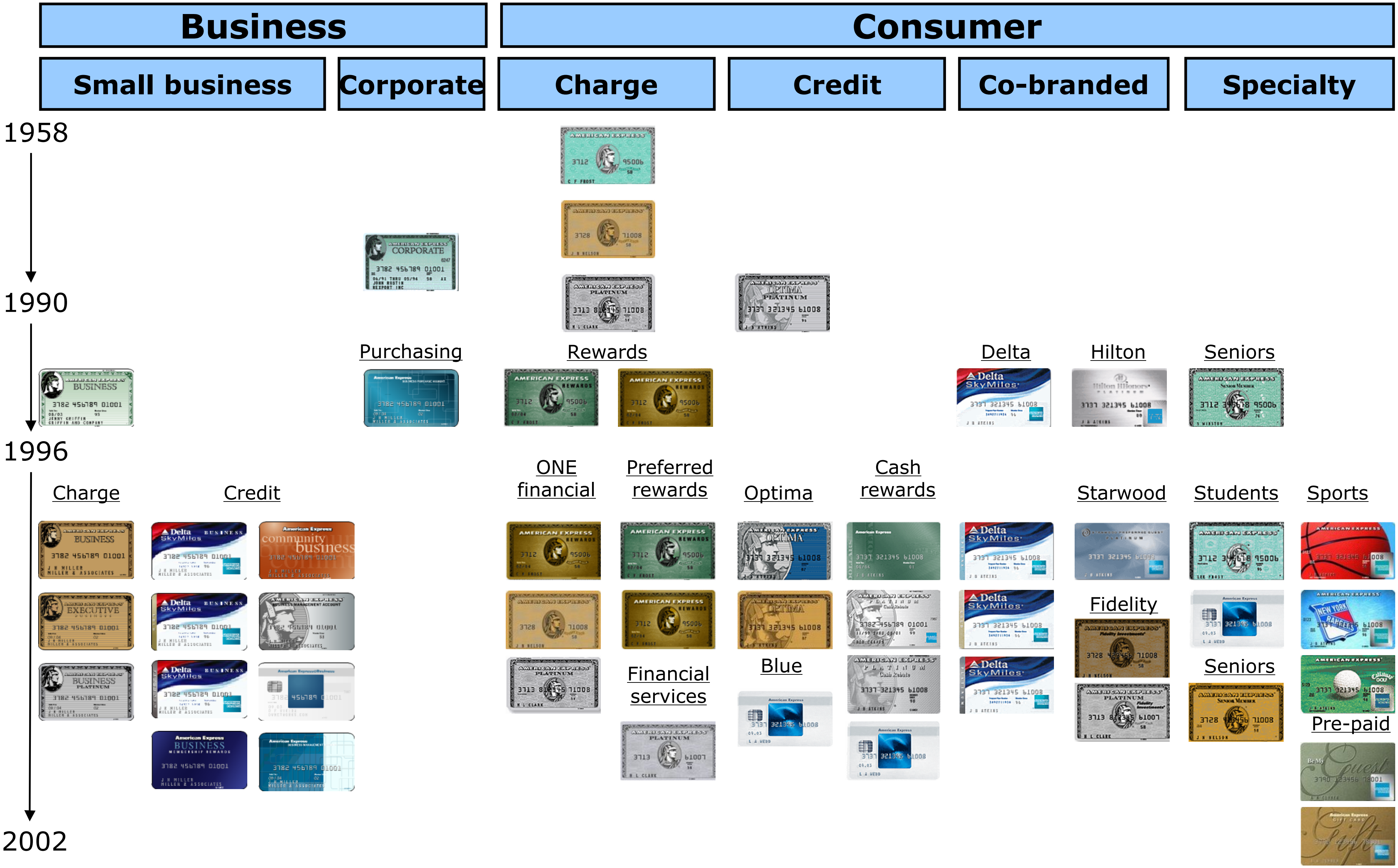


How can the odds be improved?

Follow the customer

Customer segmentation

Customer segmentation



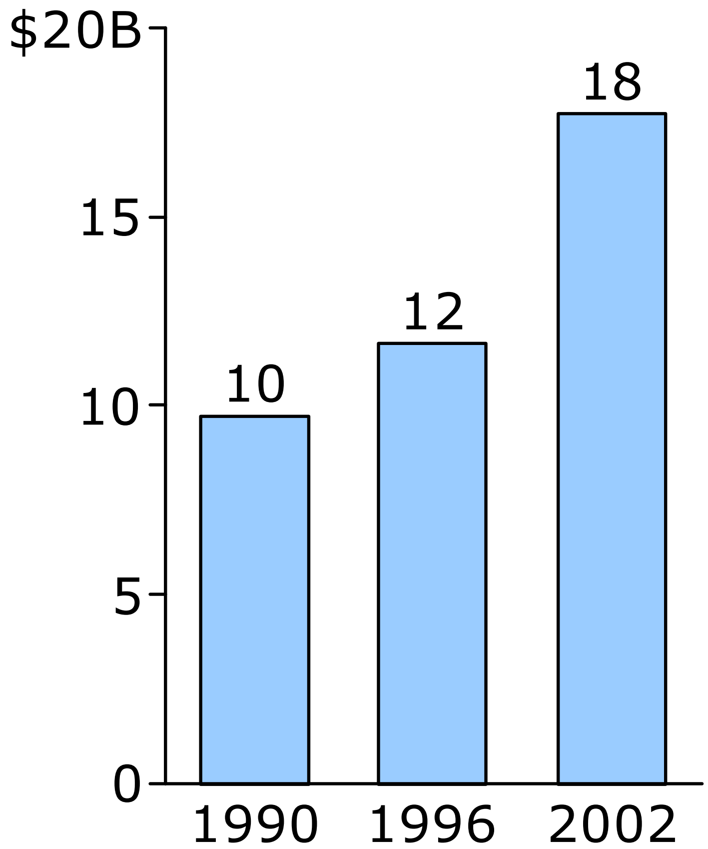
Results of Amex customer segmentation strategy

TRS revenue

CAGR

90-96 = 3%

96-02 = 7%

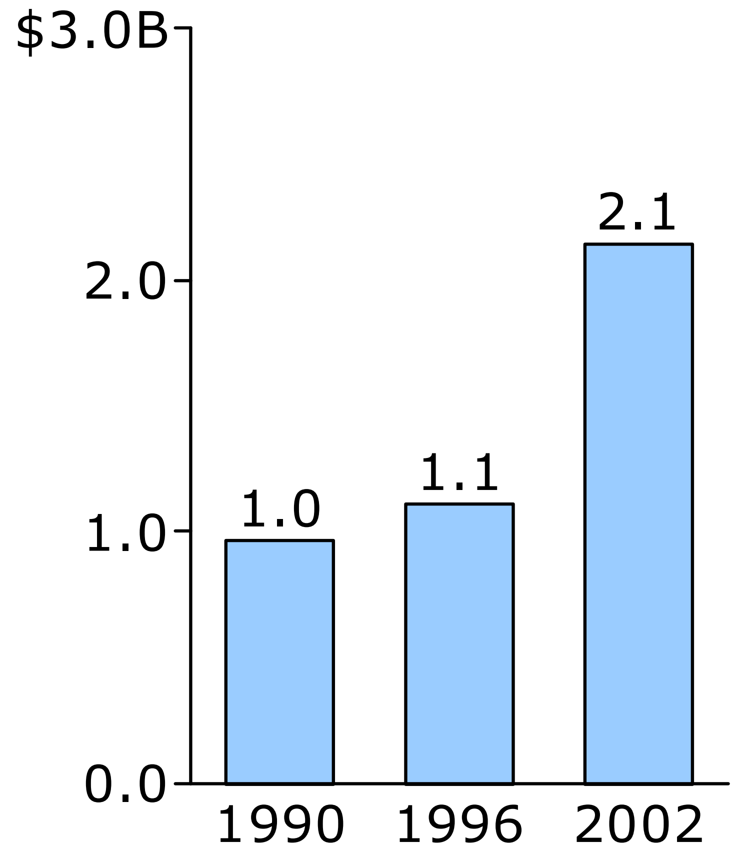


TRS net income

CAGR

90-96 = 2%

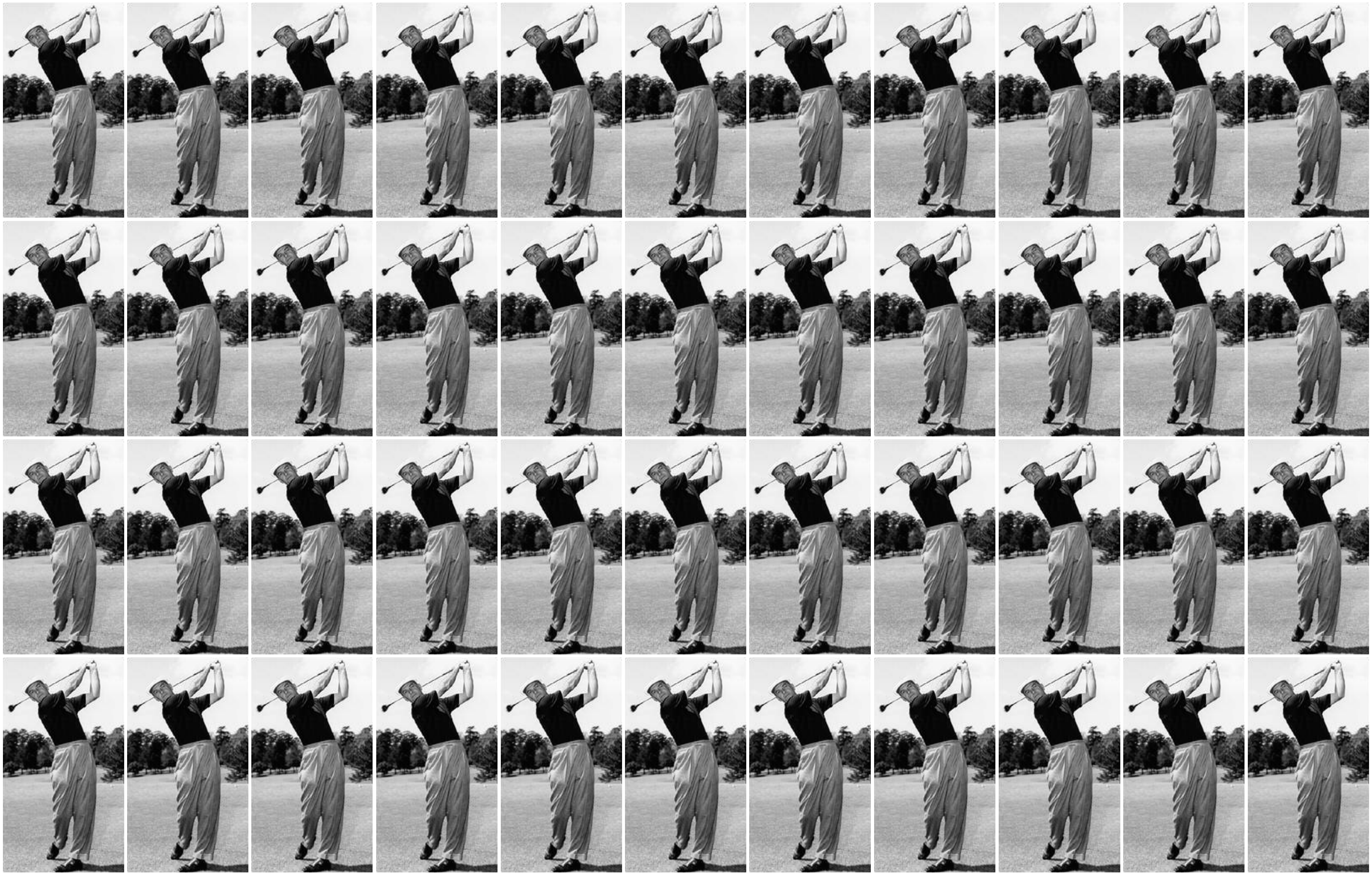
96-02 = 12%



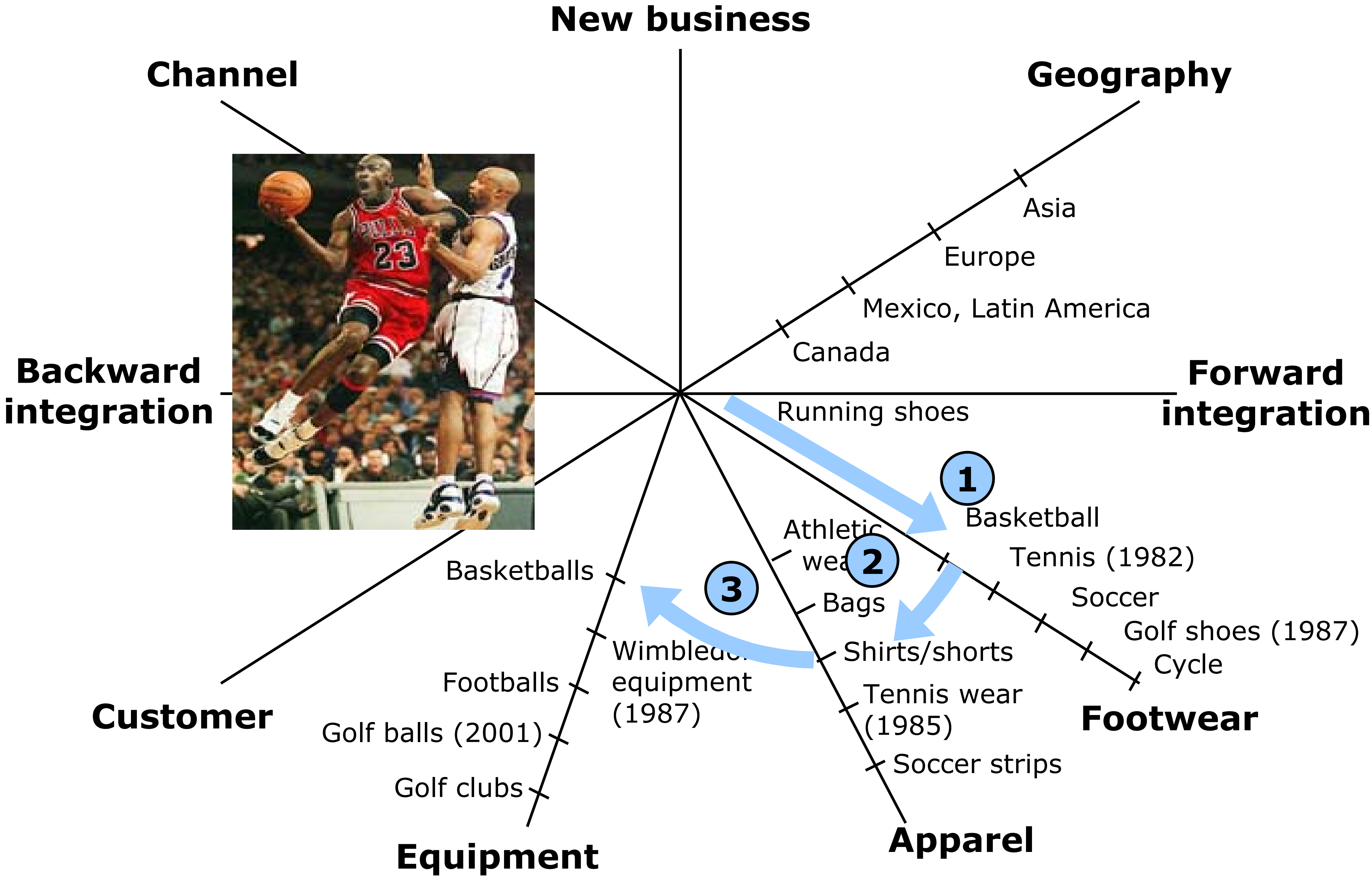
Relentless repeatability

Ben Hogan

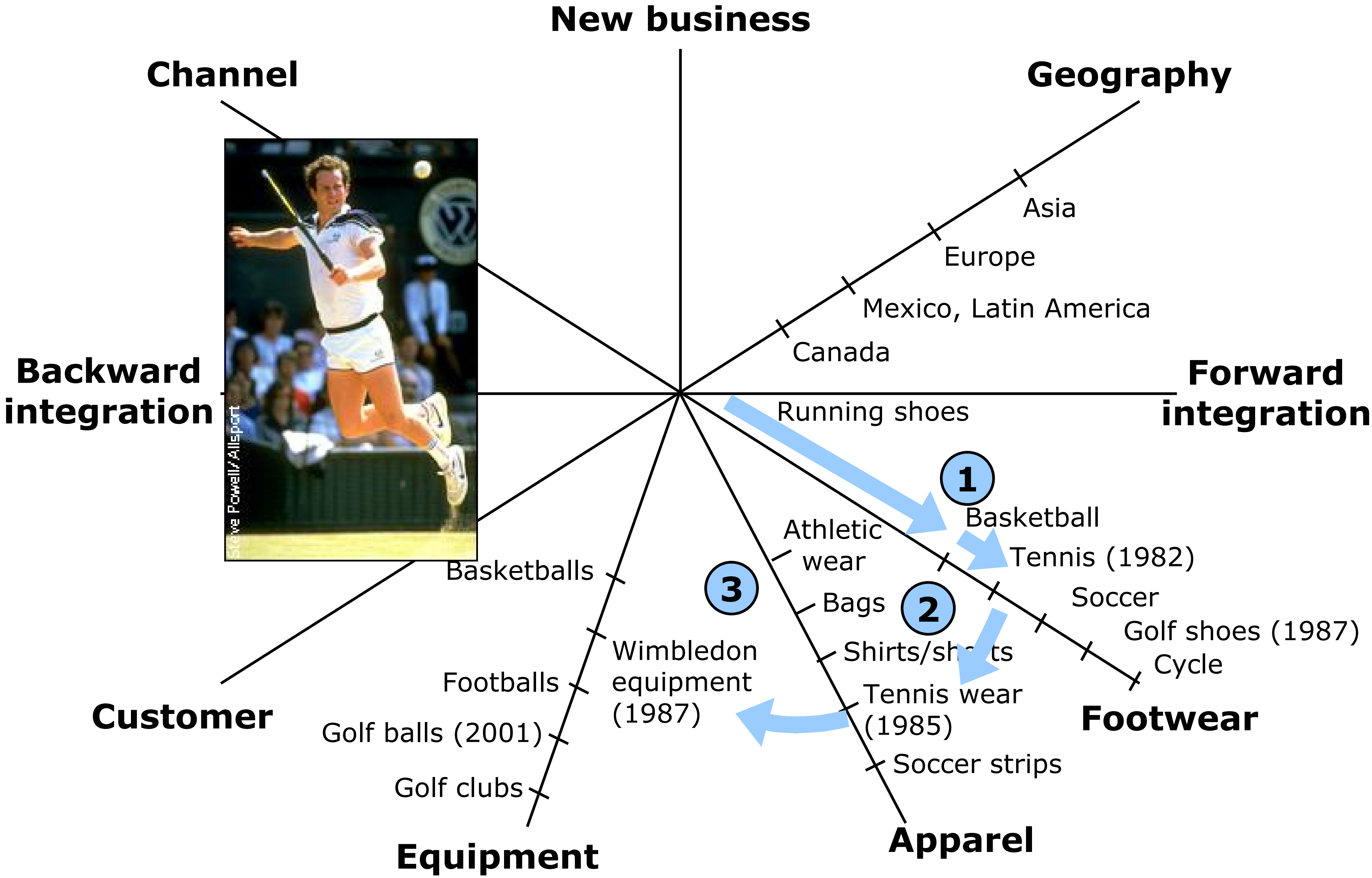
Relentless repeatability



Nike has relentlessly repeated its growth formula



Nike has relentlessly repeated its growth formula



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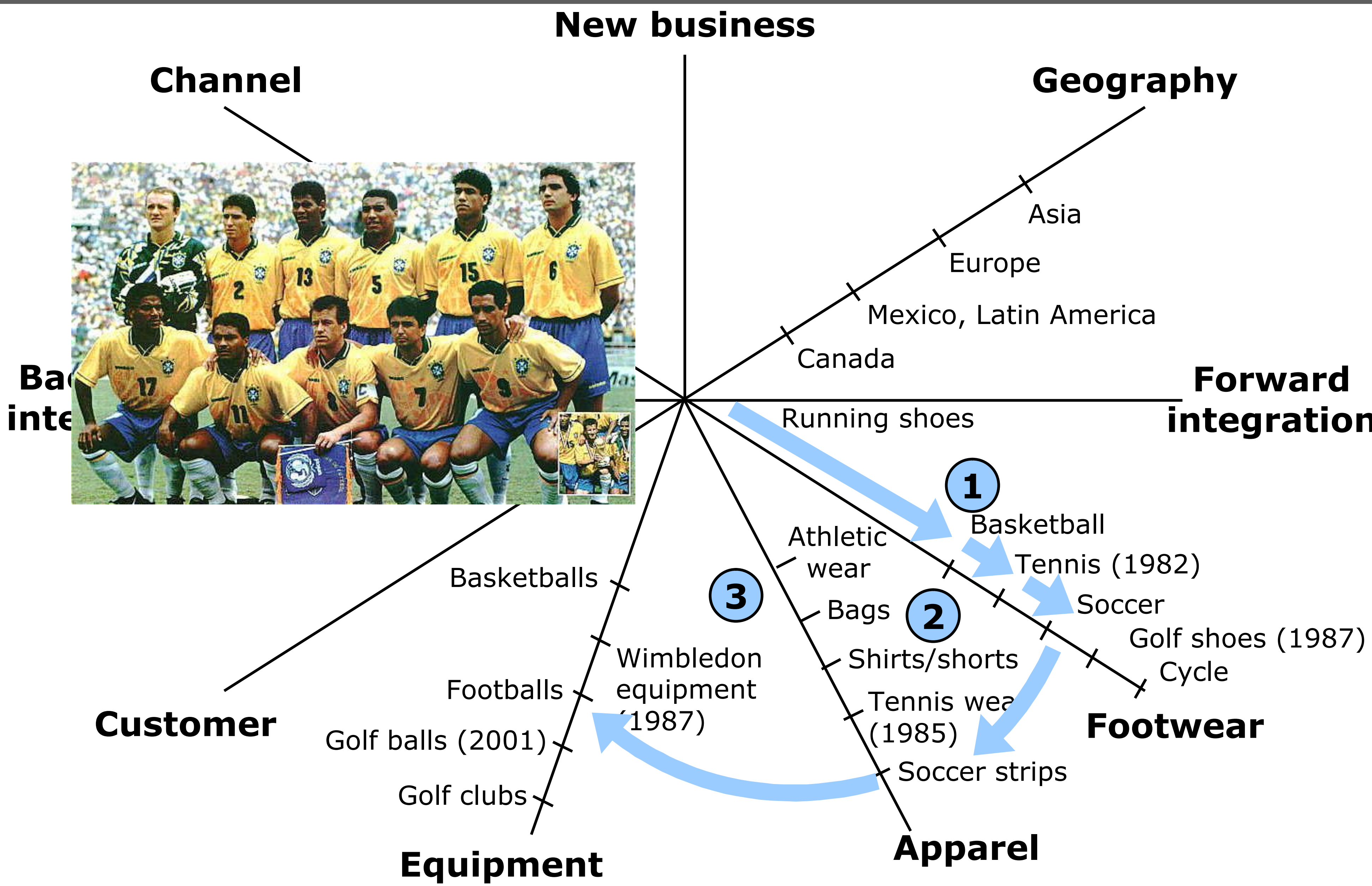
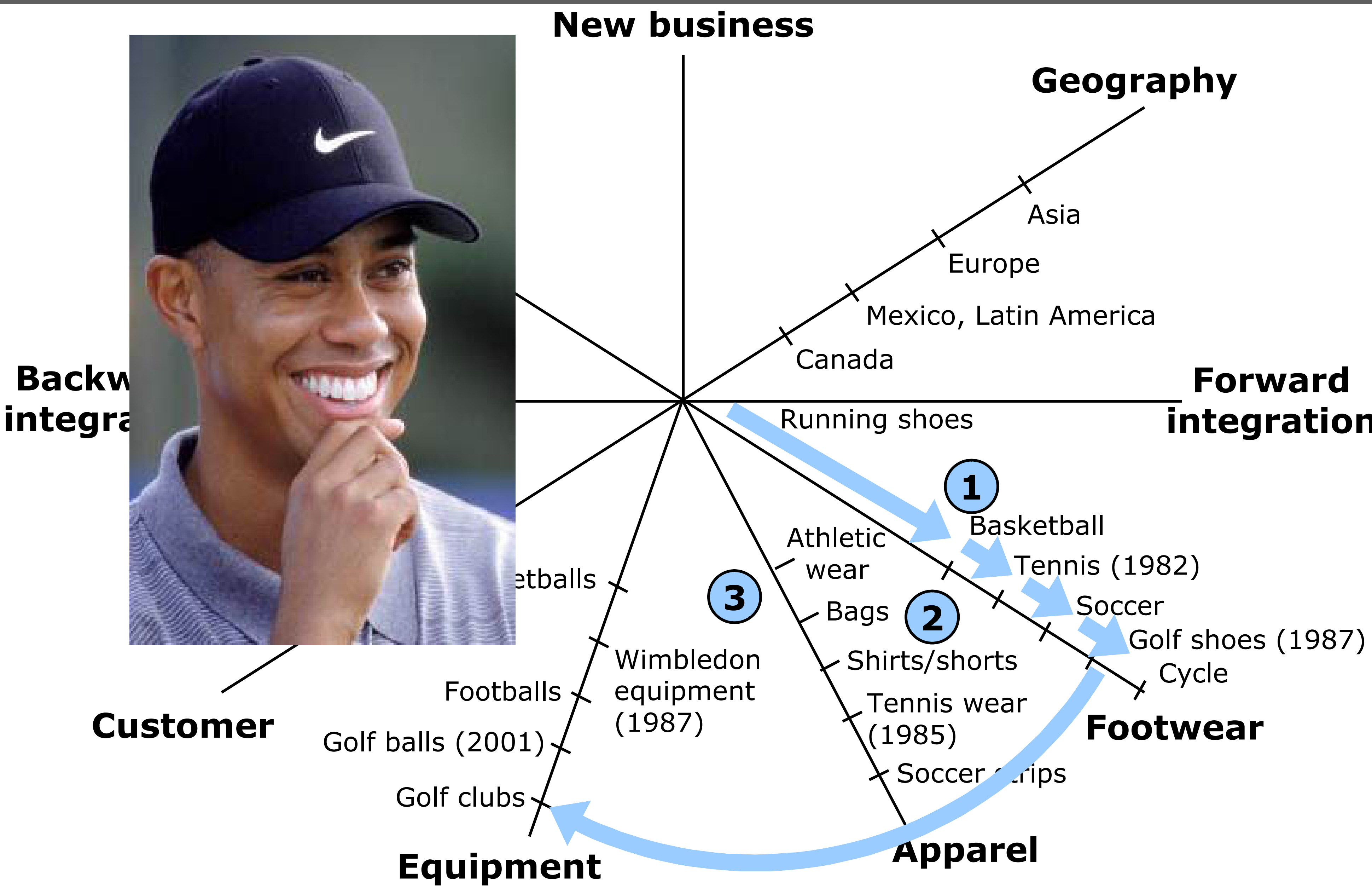
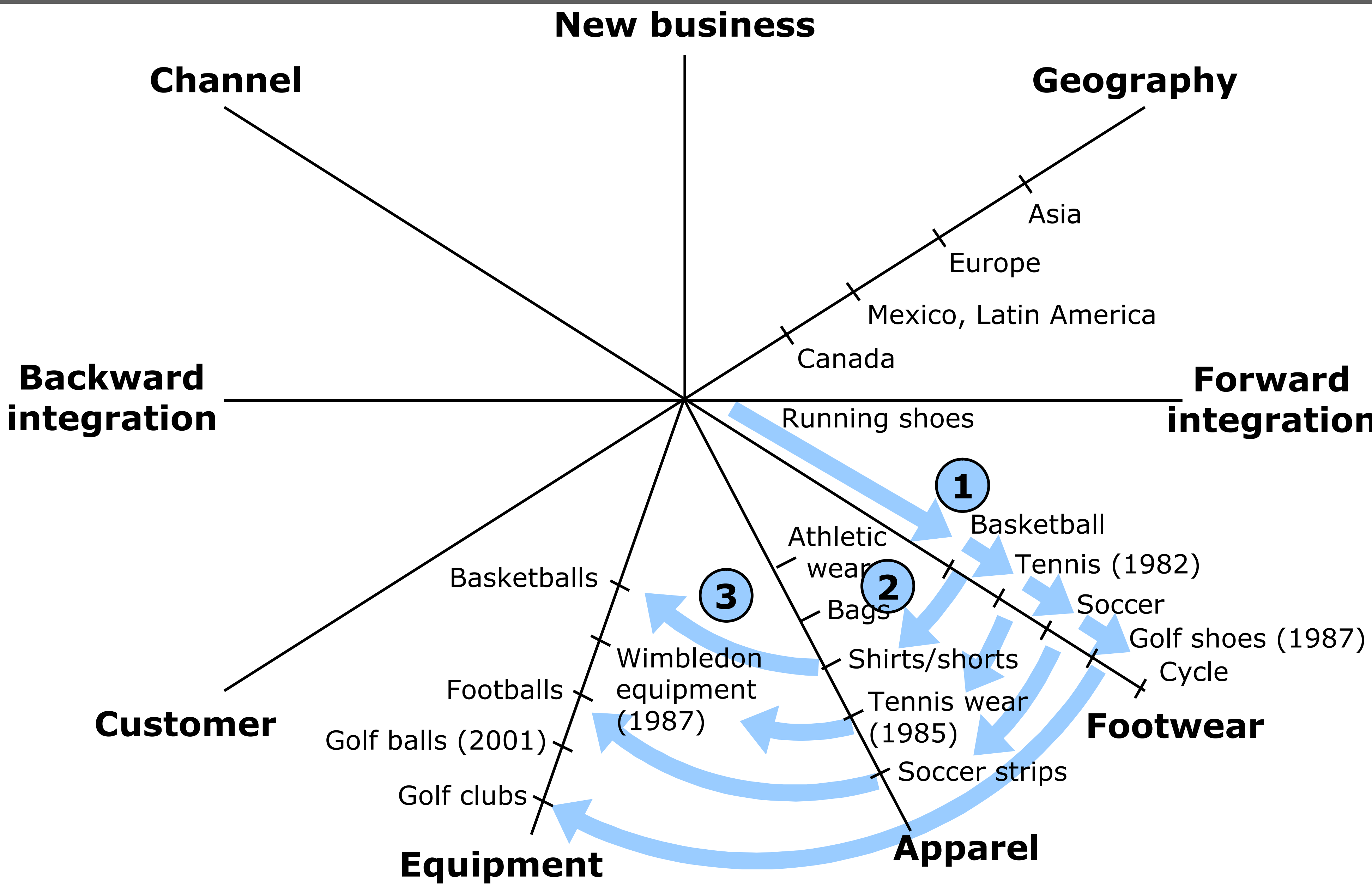


Nike has relentlessly repeated its growth formula



Nike’s growth formula



Nike vs. Reebok: Late 1980s

"You've got two winners," said LaMoine Adams, VP and GM or Foot Locker. "Nike and Reebok have both been very strong, ***neck and neck****."*

Wall Street Journal, Dec. 19, 1989

"In the race for athletic footwear supremacy, Nike and Reebok are headed for ***a photo finish."***

USA Today, Oct. 27, 1988

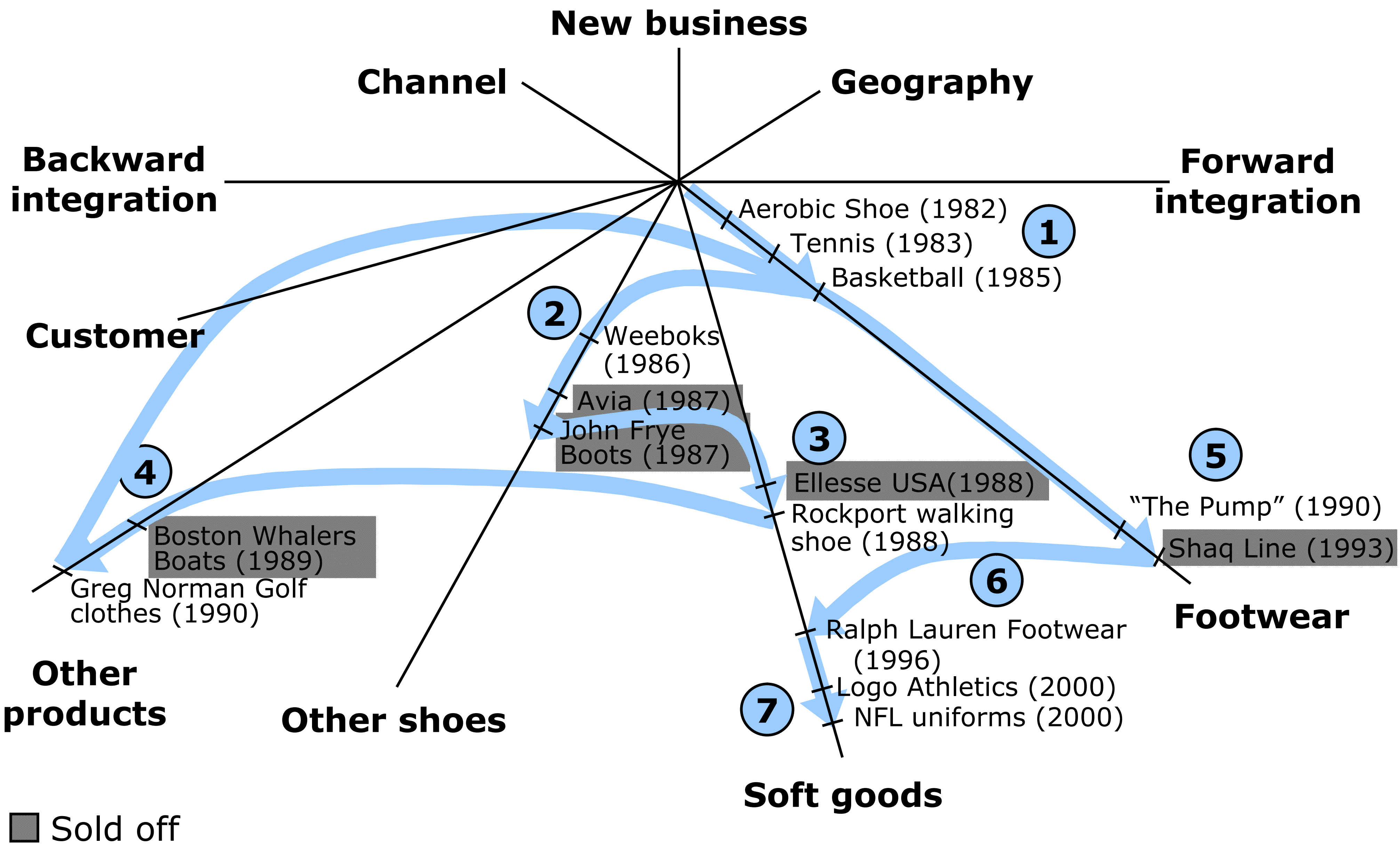
"When a customer laces up a new pair of sneakers at Foot Locker, it's likely they'll choose Reebok or Nike. They are the titans of the industry, ***the Coke and Pepsi of athletic footwear!*** "

The Boston Globe, Oct. 3, 1988

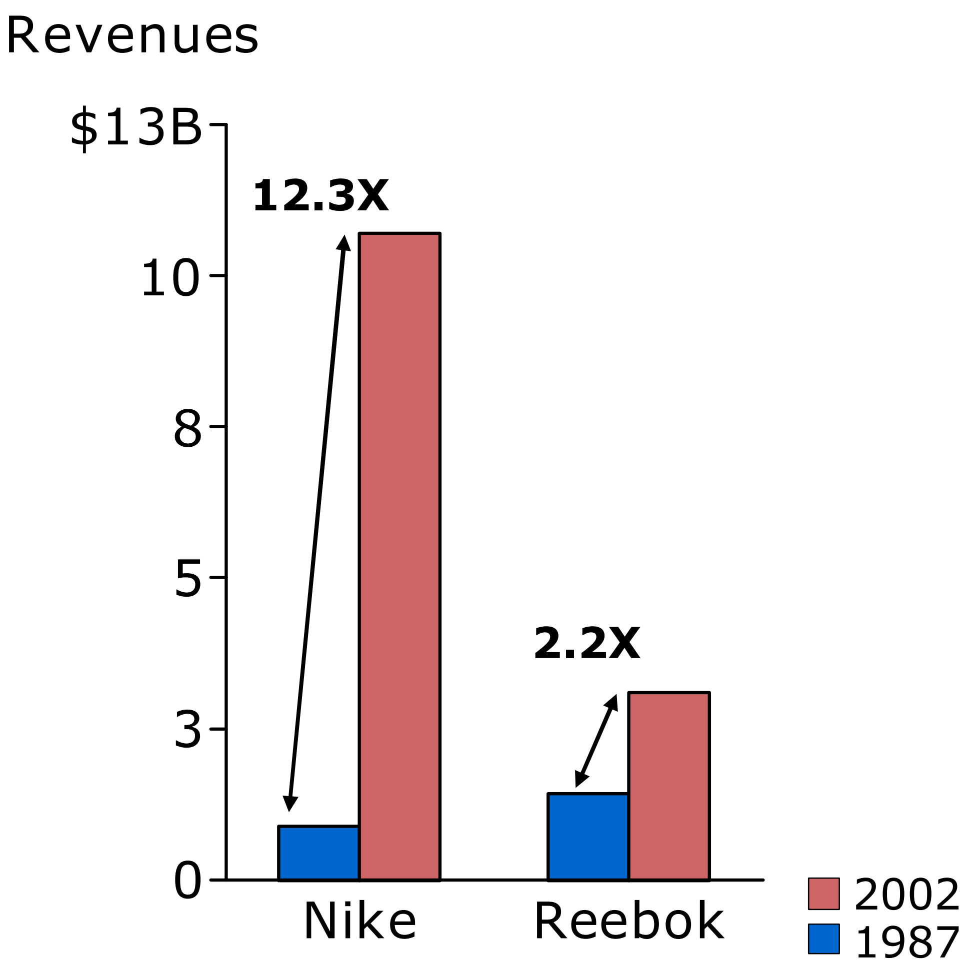
"These two archrivals (Nike and Reebok) are now ***locked in a tense battle*** *for America's feet."*

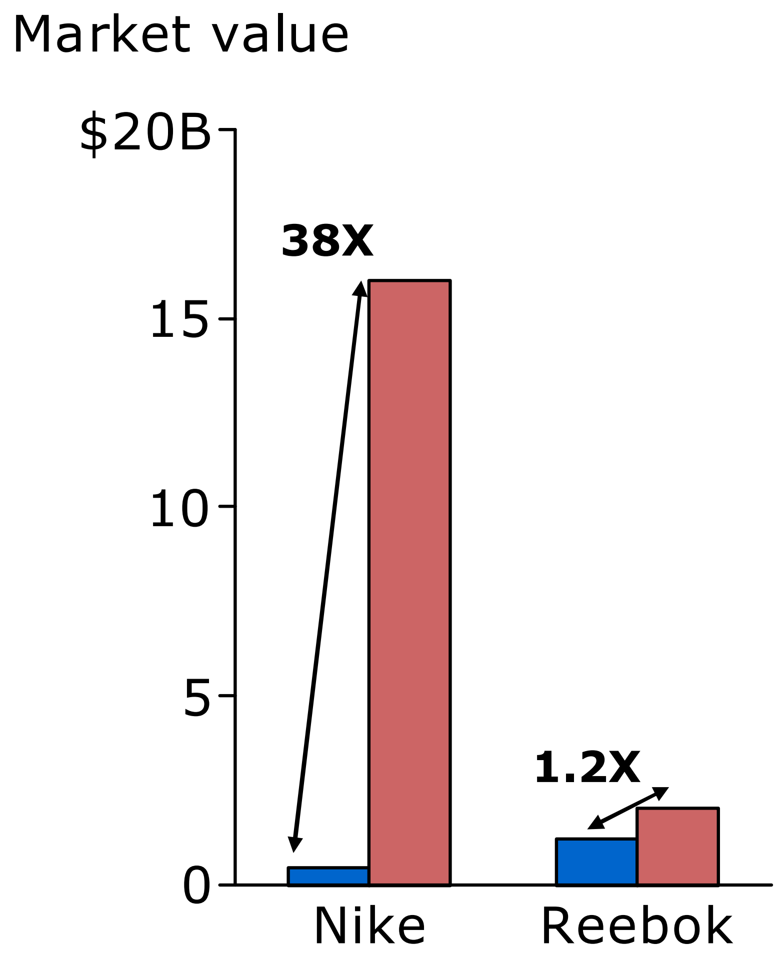
Newsday, Nov. 22, 1987

Reebok: Inconsistent adjacency moves



Nike vs. Reebok





Vodafone growth

	Employees	Customers	Market cap.	Revenue	EBITDA
1996:	5.6K	3.5M	£7.3B	£1.4B	£0.5B
2002:	99K	101M	£78B	£22.8B	£8.0B
Growth	**18x**	**28x**	**10x**	**15x**	**15x**

Global growth

Dell vs. Gateway: Selling PCs direct

	1995 Starting position			2002 Ending position		
	Revenues	Margin	MV	Revenues	Margin	MV
Dell	$5.2B	7%	$2.0B	$35.4B	6%	$75B
Gateway	$3.7B	7%	$1.7B	$4.1B	<0	$1B

How did this happen?

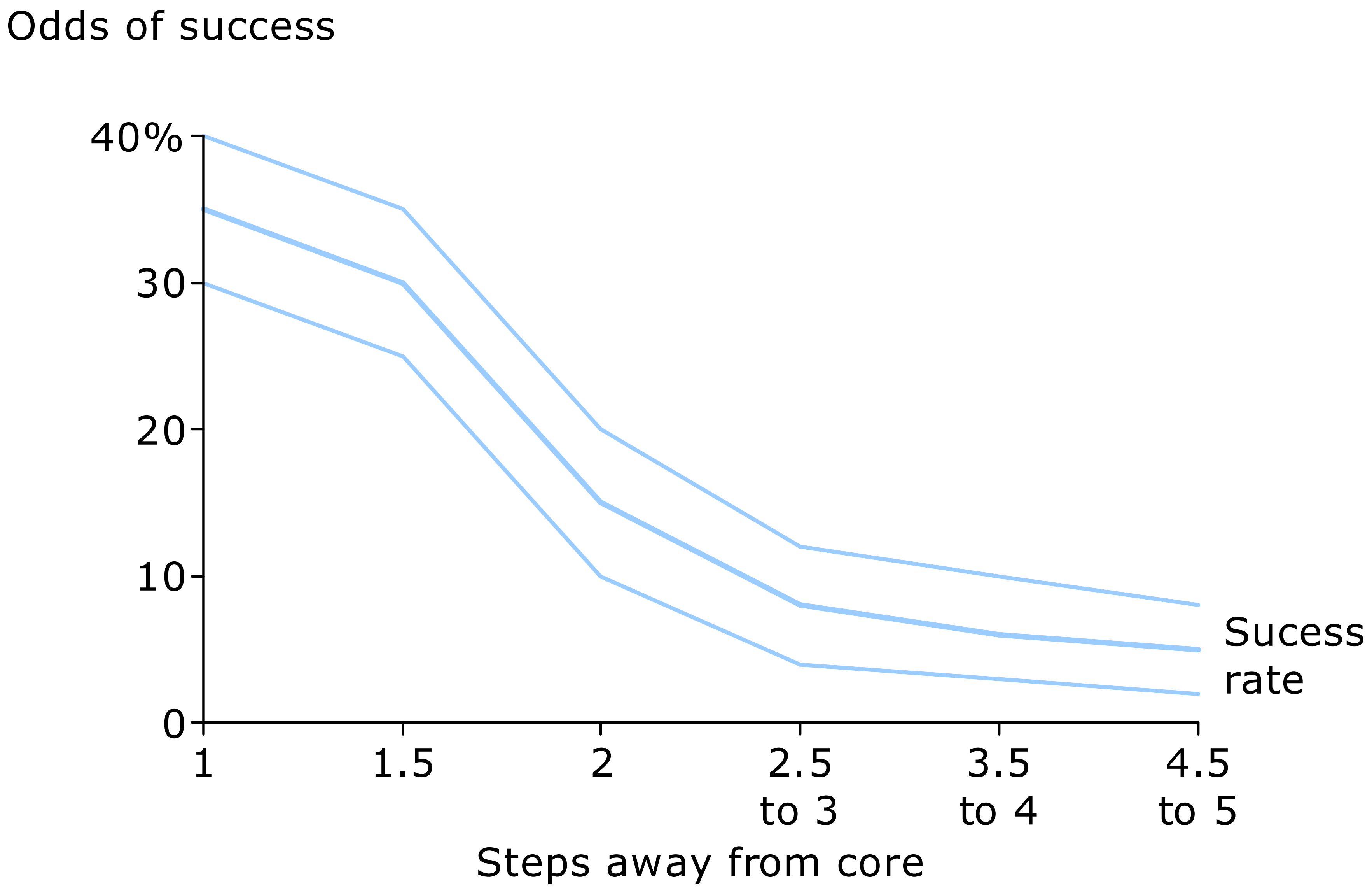
Dell vs. Gateway: International expansion

	Dell	Gateway
Method	• Organic	• Organic or acquisition - Australia, Osborne 1995 - New Zealand, PC Direct 1998 - Etc.
Model	• Direct only	• Direct only, retail (60 stores) & JV
Focus	• 6 primary countries • Primarily business ↓ • Low complexity/repeatability ↓ • Steadily growing profits	• Business & consumer, many countries ↓ • High complexity, not repeatable ↓ • Overhead rose to 33% of revenues in 2001 • 1996 profit → ($60MM) loss 2001

How repeatability creates a competitive advantage

- Greater **learning curve effects** through repetition
- **Reduced complexity** by adapting a known pattern
- **Faster and more reliable decision making** on investments
- Ability to build the organization for a **focused purpose**
- **Strategic clarity** for employees and investors
- Ability to “drill down” into deeper and **deeper understanding of customers**
- Ability to think **several moves ahead**

Success is harder the farther moves are from the core



Economic distance from the core is measured on five dimensions

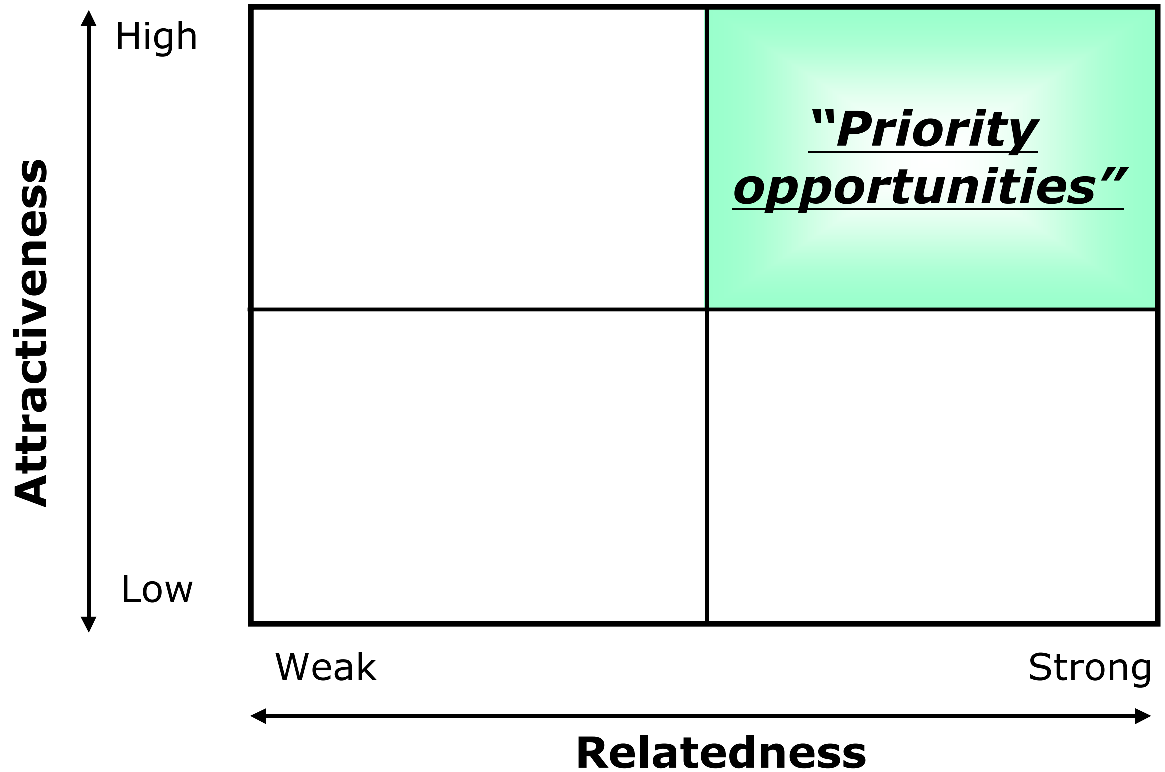
	Shared customers	Shared costs	Shared channels	Shared competitors	Shared capabilities/ technology
Core	●	●	●	●	●
1 step adjacencies	◕	◕	◑	◑	◕
2 step adjacencies	◑	◑	●	◑	◑
3 step adjacencies	○	◕	●	○	◑
Diversification	○	○	○	○	◑
Primary dimensions	✓	✓			

● Full Share
◑ Partial Share
○ No Share

Evaluation of adjacency opportunities

Item	Weight
• Future market size	Xx%
• Annual growth rate until 2010	Xx%
• Avr. operating margin	Xx%
• Industry concentration	Xx%
• Competition	Xx%

Quantitative analysis



Qualitative analysis

Item	Weight
• Customer sharing	Xx%
• Cost sharing	Xx%
• Relevance to KT Group's core capabilities	Xx%

Myth on customer base

- 5 Replacement relationship
- 4 Complementary relationship
- 3 Occasional sharing
- 2 Physical sharing
- 1 No sharing

Summary(1/2)

Fact

- Sustained and profitable growth is becoming more difficult to achieve.

Core business

- The most important growth driver is a strong core business with leadership economics.
- Strong core businesses usually perform far below their full potential.
- Achieving full potential in the core is the most important task of management.
- Weak or unstable cores don’t support strong adjacency moves.

Summary(2/2)

Adjacency moves

- Growth opportunities must be judged in relation to the core.
- Relatedness to the core is one of the most difficult management judgments.
- Strong cores are at the greatest risk from a misconceived adjacency move.
- Repeatability is a profound idea central to the math of profitable growth.

Change

- Organizations preserve the status quo and inhibit growth
- There is no status quo strategy in business; you are either gaining or losing share.

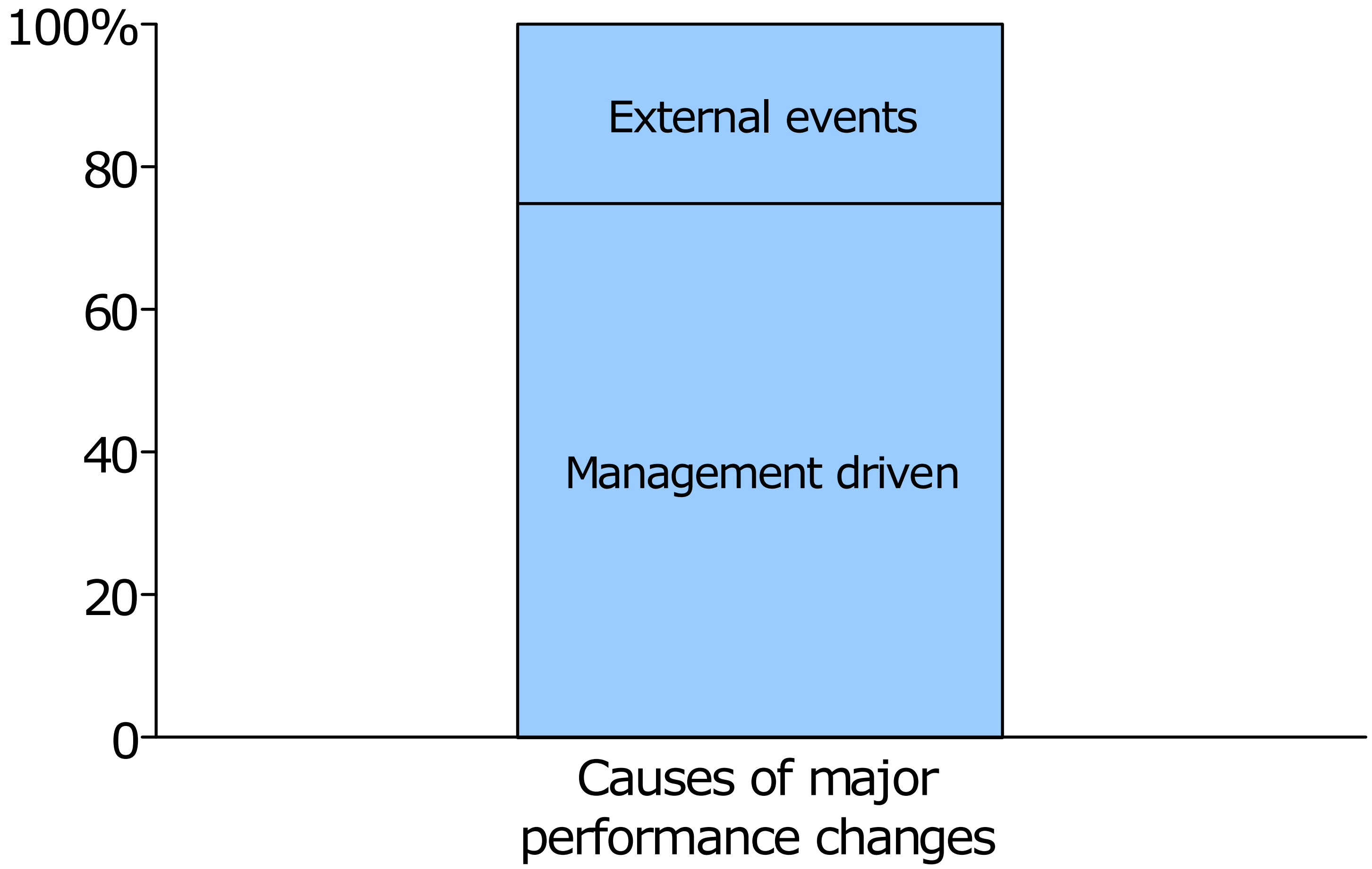
Monday morning questions

- Do I know what is my core business? Is that recognition shared among management team?
- How close am I to full potential in the core? How do I know?
- How do I evaluate growth opportunities and assess relatedness to the core?
- Have we taken full account of the hidden power of repeatability?
- Will I need do redefine my core? How?

Competitor returns vary dramatically: Why?

Industry	Company	10-year rate of return	Company	10-year rate of return
Airline	Southwest	14%	Delta	(7%)
Computers	Dell	43%	Gateway	--
Defense	General Dynamics	20%	Raytheon	4%
Drugs	Cardinal	24%	McKesson	12%
Drug stores	Walgreen	19%	CVS	4%
Food	Sysco	18%	Fleming	(13%)
Retail	Wal-Mart	13%	Kmart	(37%)
Semiconductors	Intel	19%	AMD	(3%)
Athletic Shoes	Nike	9%	Reebok	(1%)

Management is the key



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