Finding the Sweet Spot
Value Creation for Consumer Companies in a Lower-Growth Economy
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Finding the Sweet Spot
Value Creation for Consumer Companies
in a Lower-Growth Economy

THE 2010 VALUE CREATORS REPORT FOR CONSUMER COMPANIES

Marcus Bokkerink
Patrick Ducasse
Jeff Gell
Eric Olsen
Frank Plaschke
Daniel Stelter

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bcg.com
The financial analyses in this report are based on public data and forecasts that have not been verified by BCG and on assumptions that are subject to uncertainty and change. The analyses are intended only for general comparisons across companies and industries and should not be used to support any individual investment decision.
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Executive Summary

Finding the Sweet Spot: Value Creation for Consumer Companies in a Lower-Growth Economy has been adapted from the twelfth annual report in the Value Creators series published by The Boston Consulting Group. Each year, we publish detailed empirical rankings of the stock market performance of the world’s top consumer-company value creators and distill managerial lessons from their success. We also highlight key trends in the global economy and world capital markets and describe how these trends are likely to shape future priorities for value creation. Finally, we share our latest analytical tools and client experiences to help companies better manage value creation. This year’s report addresses the challenges consumer companies face in delivering above-average shareholder returns in a global economy characterized by below-average growth.

Although 2009 saw a strong rebound in equity values, global capital markets are still laboring under the shadow of the worldwide financial crisis that began in 2008.

- Global market indexes were up roughly 30 percent in 2009, but the weighted average annual total shareholder return (TSR) for this year’s consumer-company Value Creators database, which covers the five-year period from 2005 through 2009, was 6.7 percent. This is considerably below the long-term historical average of approximately 10 percent.

- Market volatility remains high; as of this writing, most equity indexes are flat for 2010.

- Despite real signs of economic recovery, macroeconomic fundamentals in the developed economies remain under significant pressure.

The top ten value creators in the three consumer-industry sectors we sampled—consumer goods, retail, and travel and tourism—substantially outpaced not only the average annual TSR for their own sector but also that of the total consumer-company sample.

- The average annual TSR of the top ten companies in the consumer goods sector was 16.7 percentage points higher than that of the consumer goods sample; the average annual TSR of the retail-sector top ten was 15.9 percentage points higher than that of the retail sample; and the average annual TSR of the travel-and-tourism top ten was 21.1 percentage points higher than that of the travel and tourism sample.

- The average annual TSR for the top ten performers in all three sectors combined was more than five times greater than that of the total consumer-company sample of 157 companies.

BCG believes that the world’s developed economies are entering an extended period of below-average growth.

- Recession that are preceded by a financial crisis tend to be followed by significant shortfalls in postrecession GDP, according to a recent report by the International Monetary Fund (IMF).

- In recent decades, growth in U.S. GDP has been the engine of the global economy; but the high indebtedness of U.S. consumers makes it unlikely that the U.S. economy will be able to continue to play that role—despite unprecedented stimulus spending by the U.S. government and the Federal Reserve.
Although developing economies such as Brazil, China, and India continue to grow rapidly and consumer confidence there is high, they will not be able to pull the Western economies forward (indeed, these economies continue to depend on exports to fuel their rapid growth)—but companies that gain a solid foothold in those high-growth markets can pull themselves forward.

BCG estimates that the average annual GDP growth in developed economies from 2010 through 2015 will be in the neighborhood of 2 percent, with some countries experiencing growth rates as low as 1 percent or even less.

**A low-growth economy has big implications for how companies create shareholder value.**

Lower revenue growth, growing pressure on margins as companies compete for fewer growth opportunities, and declining valuation multiples (reflecting shifting investor expectations) will make capital gains a relatively less important source of TSR—although profitable growth will continue to be the key performance differentiator for the companies that deliver the highest shareholder returns.

As multiples decline, the yield from payouts of free cash flow will increase, making these direct payments to shareholders in the form of dividends or stock repurchases a more important source of TSR. In other words, optimizing payouts can drive superior shareholder returns.

The very best performers (those that will make our annual rankings of the top value creators in the consumer goods, retail, and travel and tourism sectors in the coming years) will be companies that find the sweet spot of sustained growth representing the right combination of above-average profitable growth in what is a much tougher and more competitive economic environment with increased cash payouts.

**This year’s Value Creators report for consumer companies addresses the special challenges and opportunities for value creation in a low-growth economy.**

We begin by making the case that the world’s developed economies face an extended period of below-average growth.

Next, we describe the distinctive dynamics of value creation in a low-growth environment and a two-speed economy.

We then suggest steps companies should take to re-think their approach to growth and capital deployment and to reset their value-creation strategy in response to these new dynamics.

**About the Authors**

Marcus Bokkerink is a senior partner and managing director in the London office of The Boston Consulting Group and leads the Consumer Goods practice in the United Kingdom; you may contact him by e-mail at bokkerink.marcus@bcg.com. Patrick Ducasse is a senior partner and managing director in BCG’s Paris office and the global leader of the firm’s Consumer and Retail practice; you may contact him by e-mail at ducasse.patrick@bcg.com. Jeff Gell is a partner and managing director in BCG’s Chicago office, a core member of the Consumer and Corporate Development practices, and global coleader of the firm’s mergers and acquisitions sector; you may contact him by e-mail at gell.jeff@bcg.com. Eric Olsen is a senior partner and managing director in BCG’s Chicago office and the firm’s global leader for value creation strategy; you may contact him by e-mail at olsen.eric@bcg.com. Frank Plaschke is a partner and managing director in BCG’s Munich office and the firm’s European leader for value creation strategy; you may contact him by e-mail at plaschke.frank@bcg.com. Daniel Stelter is a senior partner and managing director in BCG’s Berlin office and the global leader of the firm’s Corporate Development practice; you may contact him by e-mail at stelter.daniel@bcg.com.
We are pleased to announce the 2010 consumer-company Value Creators rankings for the five-year period from 2005 through 2009. Our sample encompasses 157 global companies across three consumer-industry sectors: consumer goods, retail, and travel and tourism.

The 2010 consumer-company Value Creators rankings, which conclude this chapter, show our rankings of the overall top ten consumer-industry companies and the top ten companies within each of the three consumer-industry sectors that we analyzed.

We also compare value creation of the top performers with that of the total industry or sector sample. In addition, we reveal the leading companies’ average annual total shareholder return (TSR) by quartile.

As always, the leading companies in our sample substantially outpaced not only the average annual TSR for their own sector but also that of the total consumer-company sample.

For example, the average annual TSR of the top ten companies in the consumer goods sector was 16.7 percentage points higher than that of the consumer goods sample; the average annual TSR of the retail-sector top ten was 15.9 percentage points higher than that of the retail sample; and the average annual TSR of the travel-and-tourism top ten was 21.1 percentage points higher than that of the travel and tourism sample.

The average annual TSR of the overall top-ten consumer companies (across all three sectors—consumer goods, retail, and travel and tourism—combined) was about 35 percent, which was more than five times greater than that of the total consumer-company sample.

However, the weighted average annual TSR for the full set of 157 global companies in our sample was only 6.7 percent. This relatively poor performance (considerably below the long-term historical average of approximately 10 percent) reflects the precipitous decline in market values in late 2008 owing to the global financial crisis—a decline that the rebound in 2009 equity values only partly recovered.1

Our rankings are based on an analysis of TSR at the largest publicly traded global consumer-goods, retail, and travel and tourism companies. This year’s sample includes the 59 largest consumer-goods companies, the 50 largest retailers, and the 48 largest travel and tourism companies for the five-year period from 2005 through 2009. We defined the largest companies by sector-specific market value hurdles.

To arrive at this sample, we began with TSR data for more than 4,000 companies provided by Thomson Reuters. We then refined the sample by taking the following three steps: We eliminated all companies that were not listed on a world stock exchange for the full five years of our study or did not have at least 25 percent of their shares available on public capital markets. We also eliminated all companies that were not in the three sectors of the consumer industry we were tracking, to end up with about 1,000 companies. We then established an appropriate minimum market-valuation hurdle per sector to eliminate the smallest companies.

The rankings are based on five-year TSR performance from 2005 through 2009.\(^2\) We also show TSR performance for 2010, through June 30. In addition, we break down TSR performance into six investor-oriented financial metrics that BCG has identified as critical value drivers.\(^3\)

What kind of improvement in TSR was necessary to achieve truly superior performance, given the sample average? To qualify for the top ten in our sample of 157 global consumer companies, a company had to achieve an average annual TSR of 26.1 percent. Top performers achieved an average annual TSR of 60 to 80 percent. Companies in the top quartile of the three consumer-industry sectors had a TSR of at least 13.4 percent per year. The weighted average annual TSR for the top ten consumer-goods companies was 26.2 percent; for retail companies it was 20.1 percent; and for travel and tourism companies it was 20.4 percent.

In the past five years, companies from rapidly developing economies have come to dominate the consumer-company Value Creators rankings. Of the 157 companies listed in this year’s rankings, nine of the overall consumer-industry top ten are located in rapidly developing economies. Within the three sectors, that number is seven of the top ten in consumer goods, three of the top ten in retail, and five of the top ten in travel and tourism. What’s more, six of the overall top-ten consumer-company value creators in our global sample are from Asia. And there are very few U.S. companies among the top value creators—none in the overall top ten or in the consumer goods top ten and just two U.S. retailers and one U.S. travel and tourism company in these sectors’ top-ten lists.

In 2008, most sectors saw a major narrowing of the gap between the EBITDA multiples of the top ten in a sector and the average multiple of the sector as a whole. This trend reversed itself in 2009, as the EBITDA multiples of the best performers and those of the rest began to diverge. In other words, although multiples increased, on average, they increased more for the top value creators—and, in some sectors, significantly more. This is a sign of the growing divergence in valuation multiples that we expect to be a characteristic of a low-growth economic environment.

Another striking change between 2008 and 2009 is the increase in dividend yields, both on average and for the top ten—in the overall consumer-industry sample and in each of the three sectors analyzed. Given the sharp rise in stock prices in 2009, one would expect dividend yields (which are the ratio of dividend payout to stock price) to decline. The rise in 2009 would seem to indicate that the companies in our sample are devoting a larger portion of their cash flow to dividend payouts, a move in line with investor preferences as shown by our recent investor survey.\(^4\)

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2. TSR is a dynamic ratio that includes price gains and dividend payments for a specific stock during a given period. To measure performance from 2005 through 2009, 2004 end-of-year data must be used as a starting point in order to capture the change from 2004 to 2005, which drives 2005 TSR. For this reason, all exhibits in the report showing 2005–2009 performance begin with a 2004 data point.

3. This value-drivers model has been described in previous Value Creators reports. See, for example, Missing Link: Focusing Corporate Strategy on Value Creation, The 2008 Value Creators Report, September 2008, p. 20.

The 2010 Consumer-Company Value Creators Rankings
The Consumer Industry


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<thead>
<tr>
<th>#</th>
<th>Company</th>
<th>Location</th>
<th>Sector</th>
<th>TSR (%)</th>
<th>Market value ($billions)</th>
<th>Sales growth (%)</th>
<th>Margin change (%)</th>
<th>Multiple change (%)</th>
<th>Dividend yield (%)</th>
<th>Share change (%)</th>
<th>Net debt change (%)</th>
<th>2010 TSR (%)</th>
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<tbody>
<tr>
<td>1</td>
<td>Suning Appliance</td>
<td>China</td>
<td>Retail</td>
<td>81.4</td>
<td>14.2</td>
<td>52</td>
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<td>25</td>
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<td>-23</td>
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<td>9</td>
<td>Wal-Mart de México</td>
<td>Mexico</td>
<td>Retail</td>
<td>26.8</td>
<td>38.3</td>
<td>13</td>
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<td>9</td>
<td>2</td>
<td>1</td>
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<td>10</td>
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<td>Singapore</td>
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<td>26.1</td>
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<td>5</td>
<td>7</td>
<td>0</td>
<td>-1</td>
<td>18.3</td>
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Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

Note: n = 157 global companies in the consumer goods, retail, and travel and tourism sectors.

1Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.


3As of December 31, 2009.

4Change in EBITDA multiple.

5As of June 30, 2010.


Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

1Industry calculation based on aggregate of entire sample.

2Share change and net debt change not shown.

3Industry calculation based on sample average.
Average Annual TSR of the Consumer Industry Top Ten by Quartile, 2005–2009

Rank

First quartile

Second quartile

Third quartile

Fourth quartile

Average annual TSR (%)

Turkish Airlines
Brasil Foods
Dairy Farm

Wuliangye Yibin
Tingyi

Suning Appliance

Kweichow Moutai

Wal-Mart de México
Shenzhen Overseas

20.1
9.7
4.7
–5.4

n = 157

Sources: Thomson Reuters Datastream; BCG analysis.
Note: TSR derived from calendar-year data; values shown for top ten companies only.

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<td>3.5</td>
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</table>

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

Note: n = 59 global companies with a market valuation greater than $10 billion.

1 Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.


3 As of December 31, 2009.

4 Change in EBITDA multiple.

5 As of June 30, 2010.


Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

1 Sector calculation based on aggregate of entire consumer goods sample.

2 Share change and net debt change not shown.

3 Sector calculation based on consumer goods sample average.
Average Annual TSR of the Consumer Goods Top Ten by Quartile, 2005–2009

<table>
<thead>
<tr>
<th>Rank</th>
<th>First quartile</th>
<th>Second quartile</th>
<th>Third quartile</th>
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</tbody>
</table>

Median average annual TSR (%)
- Tingyi: 22.4
- Wuliangye Yibin: 11.9
- Kweichow Moutai: 7.2
- British American Tobacco: -1.9

Sources: Thomson Reuters Datastream; BCG analysis.
Note: TSR derived from calendar-year data; values shown for top ten companies only.
The Retail Sector

The Retail Top Ten, 2005–2009

<table>
<thead>
<tr>
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<td>Singapore</td>
<td>26.1</td>
<td>8.1</td>
<td>12</td>
<td>3</td>
<td>5</td>
<td>7</td>
<td>0</td>
<td>–1</td>
<td>18.3</td>
</tr>
<tr>
<td>4</td>
<td>Amazon.com</td>
<td>United States</td>
<td>24.9</td>
<td>59.7</td>
<td>28</td>
<td>–4</td>
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<td>–2</td>
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<td>–18.8</td>
</tr>
<tr>
<td>5</td>
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<td>Japan</td>
<td>19.3</td>
<td>18.7</td>
<td>15</td>
<td>–1</td>
<td>6</td>
<td>2</td>
<td>0</td>
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<td>–22.0</td>
</tr>
<tr>
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<td>McDonald’s</td>
<td>United States</td>
<td>17.3</td>
<td>67.2</td>
<td>1</td>
<td>7</td>
<td>–1</td>
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<td>1</td>
<td>7.3</td>
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<tr>
<td>7</td>
<td>Inditex</td>
<td>Spain</td>
<td>17.3</td>
<td>39.3</td>
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<td>Australia</td>
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<td>0</td>
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<td>9</td>
<td>H&amp;M</td>
<td>Sweden</td>
<td>15.3</td>
<td>46.7</td>
<td>13</td>
<td>2</td>
<td>–3</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>12.2</td>
</tr>
<tr>
<td>10</td>
<td>Companhia Brasileira de Distribuição</td>
<td>Brazil</td>
<td>14.6</td>
<td>9.5</td>
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<td>–6</td>
<td>6</td>
<td>1</td>
<td>–2</td>
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</tr>
</tbody>
</table>

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

Note: n = 50 global companies with a market valuation greater than $7 billion.

1Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.


3As of December 31, 2009.

4Change in EBITDA multiple.

5As of June 30, 2010.

Value Creation at the Retail Top Ten Versus Sector Sample, 2005–2009

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

1Sector calculation based on aggregate of entire retail sample.

2Share change and net debt change not shown.

3Sector calculation based on retail sample average.

4Sector calculation based on aggregate of entire retail sample.
Average Annual TSR of the Retail Top Ten by Quartile, 2005–2009

Rank

First quartile

Second quartile

Third quartile

Fourth quartile

Median average annual TSR (%)

1. Suning Appliance
2. Dairy Farm
3. Amazon.com
4. Fast Retailing
5. McDonald’s
6. Inditex
7. Woolworths
8. H&M
9. Wal-Mart de México
10. Companhia Brasileira de Distribuição

Average annual TSR (%)

n = 50

Sources: Thomson Reuters Datastream; BCG analysis.

Note: TSR derived from calendar-year data; values shown for top ten companies only.
The Travel and Tourism Sector

The Travel and Tourism Top Ten, 2005–2009

<table>
<thead>
<tr>
<th>#</th>
<th>Company</th>
<th>Location</th>
<th>TSR (%)</th>
<th>Market value ($)</th>
<th>Sales growth (%)</th>
<th>Margin change (%)</th>
<th>Multiple change (%)</th>
<th>Dividend yield (%)</th>
<th>Share change (%)</th>
<th>Net debt change (%)</th>
<th>2010 TSR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shenzhen Overseas Airlines</td>
<td>China</td>
<td>39.2</td>
<td>7.8</td>
<td>66</td>
<td>–6</td>
<td>–15</td>
<td>1</td>
<td>–9</td>
<td>1</td>
<td>–35.4</td>
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<td>2</td>
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<td>Turkey</td>
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<td>3</td>
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<td>Chile</td>
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<td>6.0</td>
<td>11</td>
<td>12</td>
<td>4</td>
<td>5</td>
<td>–1</td>
<td>–5</td>
<td>19.3</td>
</tr>
<tr>
<td>4</td>
<td>Korean Air Lines</td>
<td>South Korea</td>
<td>24.6</td>
<td>3.3</td>
<td>5</td>
<td>–8</td>
<td>16</td>
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<td>0</td>
<td>11</td>
<td>49.4</td>
</tr>
<tr>
<td>5</td>
<td>Bally Technologies</td>
<td>United States</td>
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<td>2.2</td>
<td>14</td>
<td>5</td>
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<td>–1</td>
<td>6</td>
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<tr>
<td>6</td>
<td>Bein Interactive Entertainment</td>
<td>Austria</td>
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<td>2.2</td>
<td>41</td>
<td>24</td>
<td>–33</td>
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<td>–8</td>
<td>1</td>
<td>–11.6</td>
</tr>
<tr>
<td>7</td>
<td>SMRT</td>
<td>Singapore</td>
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<td>2.1</td>
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<td>7</td>
<td>6</td>
<td>0</td>
<td>4</td>
<td>16.2</td>
</tr>
<tr>
<td>8</td>
<td>Shanghai Oriental Pearl</td>
<td>China</td>
<td>20.1</td>
<td>5.3</td>
<td>12</td>
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<td>12</td>
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<td>9</td>
<td>easyJet</td>
<td>United Kingdom</td>
<td>13.5</td>
<td>2.4</td>
<td>18</td>
<td>–15</td>
<td>31</td>
<td>0</td>
<td>–1</td>
<td>–19</td>
<td>12.7</td>
</tr>
<tr>
<td>10</td>
<td>Singapore Airlines</td>
<td>Singapore</td>
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<td>12.7</td>
<td>10</td>
<td>–3</td>
<td>–2</td>
<td>4</td>
<td>–1</td>
<td>4</td>
<td>–2.3</td>
</tr>
</tbody>
</table>

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

Note: n = 48 global companies with a market valuation greater than $2 billion.

1Contribution of each factor shown in percentage points of five-year average annual TSR; any apparent discrepancies in TSR totals are due to rounding.


3As of December 31, 2009.

4Change in EBITDA multiple.

5As of June 30, 2010.

Value Creation at the Travel and Tourism Top Ten Versus Sector Sample, 2005–2009

Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; Bloomberg; annual reports; BCG analysis.

1Sector calculation based on aggregate of entire travel and tourism sample.

2Share change and net debt change not shown.

3Sector calculation based on travel and tourism sample average.
Average Annual TSR of the Travel and Tourism Top Ten by Quartile, 2005–2009

<table>
<thead>
<tr>
<th>Rank</th>
<th>Median Average Annual TSR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>23.4</td>
</tr>
<tr>
<td>5</td>
<td>7.6</td>
</tr>
<tr>
<td>15</td>
<td>–2.0</td>
</tr>
<tr>
<td>45</td>
<td>–10.3</td>
</tr>
</tbody>
</table>

Sources: Thomson Reuters Datastream; BCG analysis.
Note: TSR derived from calendar-year data; values shown for top ten companies only.
Although 2009 saw a strong recovery in equity values, global capital markets are still laboring under the shadow of the worldwide financial crisis that began in 2008. Market volatility remains high; as of this writing, most equity indexes are flat for 2010. And despite real signs of economic recovery, macroeconomic fundamentals in the developed economies remain under significant pressure—most recently from the sovereign-debt crisis in European countries such as Greece, Portugal, and Spain.

We don’t know precisely how the recovery will play itself out. But we do feel confident about one prediction: the developed world is entering an extended period of below-average growth—with profound implications for how consumer companies create value. That’s why we have devoted this year’s Value Creators report for consumer companies to the theme of value creation in a lower-growth economy.

Why Lower Growth Is Likely

At first glance, this focus may seem misguided. After all, economic growth in 2010 has been better than most observers had anticipated. This past summer, the International Monetary Fund (IMF) announced it was raising its global growth forecast for 2010 to 4.6 percent—up from the 4.2 percent projection it had issued in April.

And yet, the same IMF forecast estimates that growth will slow in the second half of 2010 and will be lower (4.3 percent) in 2011. What’s more, it points out that in the world’s developed economies, growth rates in 2011 will average only 2.4 percent—with the growth rate in some, such as Japan, as low as 1.8 percent. And although emerging markets in Asia and other parts of the developing world will grow much faster (8.5 percent, on average, in 2011), the growth rates in these economies will also slow down compared with their growth rates this year.

There are at least four reasons for believing that the world’s developed economies are likely to experience a period of below-average growth.

The Nature of the “Great Recession.” The downturn that began in late 2008 was a globally synchronized recession brought on by a worldwide financial crisis. History shows that recessions preceded by systemic financial upheaval tend to be far deeper and longer lasting than other recessions, and the subsequent recovery is slower. In 2009, for instance, the IMF released a study analyzing the medium-term implications of 88 historical financial crises in developed, emerging, and developing countries.

It found that in the seven years after such a crisis, economies tend to have a significant output gap (that is, a deviation of actual output from what one would expect by extrapolating from the precrisis growth trend) of, on average, a negative 10 percent.

Earlier this year, BCG used empirical data from the IMF study to simulate GDP growth rates from 2010 through 2015. Our model suggests that while major developing countries such as Brazil, China, and India will soon return

to a level of GDP growth that approaches their precrisis growth rates, the more developed economies may see significantly lower growth for a number of years. Specifically, the simulation shows GDP growth rates of less than 2 percent per year for the United States, Europe, and Japan, leading to an overall output gap ranging from a negative 8.7 percent (France) to a negative 16.7 percent (United Kingdom). (See Exhibit 1.)

**The Indebtedness of U.S. Consumers.** In the two decades preceding the downturn, median inflation-adjusted U.S. hourly wages remained relatively flat. And yet, the American consumer (whose spending accounts for 70 percent of U.S. GDP) continued to spend with the sort of abandon that only unconstrained credit can provide. That spending was a critical engine of global economic growth.

Now, however, U.S. consumers are worried about jobs, reduced asset values from the bursting of the property and stock bubbles, and the consequent threat to their retirement accounts. Their spending is unlikely to fuel a new wave of global growth. And although economies of the developing world are growing at a significantly faster pace than those in the developed world, they remain, in aggregate, too small and too focused on exports to pick up the slack.

**Reduced Availability of Credit.** Although the situation has improved somewhat since the dark days of late 2008, the damaged global banking system is still leery about granting credit. Given that in recent years it has taken about five dollars of credit to sustain each dollar of GDP growth, less credit is also a serious constraint on growth.

**The End of Government Stimulus.** To be sure, the fast reaction and unprecedented financial stimulus by the Obama administration and other governments has propped up growth rates and contributed to the economic recovery in 2010. But as of this writing, all signs indicate that world governments are shifting from economic stimulus to deficit reduction.8

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**Exhibit 1. Lower Growth Rates Could Lead to Significant Gaps in GDP**

<table>
<thead>
<tr>
<th>Country</th>
<th>Estimated decline in GDP growth, 2010–2015 (%)</th>
<th>Estimated gap in GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>7.7</td>
<td>9.5</td>
</tr>
<tr>
<td>India</td>
<td>3.1</td>
<td>2.3</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.1</td>
<td>0.2</td>
</tr>
<tr>
<td>United States</td>
<td>1.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Euro zone</td>
<td>1.1</td>
<td>0.1</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.1</td>
<td>0.1</td>
</tr>
<tr>
<td>France</td>
<td>1.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Germany</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Italy</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Japan</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

**Sources:** Economist Intelligence Unit; Bloomberg; IMF; OECD; BCG analysis.

**Note:** The output gap is the estimated shortfall in total 2015 GDP owing to the financial crisis, based on regressions derived from an IMF analysis of 88 historical examples. The precrisis growth rate is calculated by a various-length ordinary least squares (OLS) regression spanning at least ten years before the financial crisis. The postcrisis growth rate is the amount of growth necessary to achieve postcrisis GDP, using the Solow growth model. Brazil shows a positive value (output surplus) because its growth rate was above its precrisis trend in 2008 and was relatively unaffected by the downturn.
Once government stimulus winds down, can private demand sustain the recovery?

For all these reasons, both executives and investors are anticipating an economic environment characterized by low growth. In March 2010, BCG surveyed 440 senior executives in seven major world economies. When asked what “shape” they thought the emerging recovery would take, fully half said that they expected the recovery to be “L-shaped”—that is, relatively slow and difficult. This response is significantly higher than in March 2009, when only 17 percent of respondents to a similar survey were so pessimistic.

In April 2010, we surveyed 110 professional investors and equity analysts in the United States and Europe who cover economies around the world and represent some $1 trillion in assets under management. Although respondents disagreed on precisely when the recovery would be in full gear (in general, those covering Europe and other global markets were more pessimistic than those covering the United States), they agreed that lower GDP growth would have an impact on corporate net income. The vast majority were convinced that growth in company net income in the years to come would be below the long-term historical average for developed markets of approximately 5 percent. A plurality (46 percent) estimated that annual net-income growth rates in the next few years could be as low as 2 to 4 percent during the recovery. Another 40 percent were slightly more optimistic, seeing net income growth in the neighborhood of 4 to 6 percent. And only 9 percent expected earnings growth to be 6 percent or higher.

### Challenges and Opportunities for Consumer Companies

Whatever the precise level of future growth, a low-growth economy poses major challenges when it comes to value creation. Lower GDP growth will put pressure on corporate revenues and profits. For many companies, maintaining historical levels of revenue growth will only come by winning market share. Competitive intensity will increase, and real winners (and losers) will emerge. How to deliver profitable growth that beats the average without undermining other drivers of TSR—in particular, margins?

After a 20-year period in which valuation multiples have been above the long-term historical average, lower growth is also likely to mean lower multiples as investors factor lower growth expectations into a company’s stock price. (See Exhibit 2.) What’s more, after nearly all companies have, first, suffered from the late-2008 market selloff and, then, benefited from the 2009 rebound in equity values, valuation multiples will become more differentiated as investors reward those companies that combine above-average growth with clear competitive advantage, strong margins, and appropriate capital deployment. How to ensure that a company benefits from the increasing differentiation in valuation multiples and avoids becoming its victim?

An irony of the current economic environment is that opportunities for growth are becoming constrained precisely at the moment when, due to widespread cost cutting and cash accumulation in response to the recession, corporations have built up an unprecedented amount of cash on their balance sheets. For example, the U.S. Federal Reserve reported in early June that U.S. companies, excluding financial services companies, held $1.84 trillion in cash, the highest level as a percentage of assets since the 1960s. To be sure, the size of any company’s cash hoard has to be evaluated in terms of its level of debt and its potential need to use that cash to pay down that debt in the future. Still, the question remains, how should companies best deploy this cash and their high levels of ongoing free cash flow to create value in the future?

Finally, as a result of the turmoil over the past several years, governments are becoming more involved in the private sector, and many observers are questioning the legitimacy of shareholder value as an appropriate model for corporate governance. How to balance the interests and priorities of different stakeholders (investors included) in an environment in which the “economic pie” is likely to grow at a lower rate than in the recent past?

But if an extended period of low growth presents challenges for public companies, it also presents a singular opportunity. The stagflation of the 1970s, Japan’s “lost decade,” and even the Great Depression all offer examples of companies that prospered in tough economic times. The big winners didn’t succeed by playing it safe—that is, paying down debt, driving down costs to preserve the bottom line, conserving cash, and simply waiting for conditions to get better. Rather, they took advantage of their competitors’ paralysis to create new sources of competitive advantage that endured for a long time.

What’s more, the belief that the downturn is ushering in a period of below-average growth is creating a fundamental shift in investor expectations. For the first time in a long time, investors are focusing on longer-term fundamentals. Instead of riding marketwide trends, they are assessing the quality and sustainability of individual company stocks. They care more about a company’s business strategy and management track record and less about quarterly earnings growth rates. In short, they are giving companies permission to focus on long-term competitiveness and sustainable value creation—more so than in a long time.

No one knows how long this shift will last. But investors have reset their focus and strategies to achieve superior TSR. Managements need to do the same. The first step is understanding the distinctive dynamics of value creation in a low-growth environment.

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What characterizes value creation for consumer companies in low-growth environments? Two broad trends and a paradox. Their implications for an individual company will, of course, depend on its particular situation. But understanding the underlying dynamics of value creation in a low-growth economy is a necessary first step. Once that has been done, there are a number of ways companies can navigate the paradox.

The Declining Importance of Capital Gains

As regular readers of the Value Creators reports know, BCG has a model for quantifying the relative contribution of the various sources of TSR. (See Exhibit 3.) The model uses the combination of revenue (that is, sales) growth and change in margins as an indicator of a company’s improvement in fundamental value. It then uses the change in the company’s valuation multiple to determine the impact of investor expectations on TSR.15 Together, these two factors determine the change in a company’s market capitalization. Finally, the model also tracks the distribution of free cash flow to investors and debt holders in the form of dividends, share repurchases, or payments on debt in order to determine the contribution of free-cash-flow payouts to a company’s TSR. Using this model, executives can analyze the sources of TSR for their company, its business units, a peer group of companies, an industry, or an entire market index over a given period.

How is low GDP growth likely to affect these drivers of TSR? In general, lower economic growth will mean lower revenue growth for many companies. In addition, lower revenue growth will mean lower profits—a result of reduced operational leverage and pressure on margins owing to increased competition. What’s more, as a company’s growth in net income declines, the overall level of its valuation multiple will likely drop as well, as investors factor that decline into the company’s stock price. To be sure, earnings are currently rebounding from their depth-of-recession lows, and corporate profitability is at an all-time high—but that won’t stop valuation multiples from declining as a reflection of the low-growth future outlook.

All these changes will cut significantly into a company’s ability to deliver capital gains, making this source of TSR relatively less important in the future than in the past. At first glance, this might seem to imply that overall TSR will be lower as well. This logic is true as far as it goes; however, it neglects the inherently dynamic nature of TSR.

The Growing Importance of Cash Payout

Investors set stock prices in order to earn a required rate of return on their capital. The required rate of return for equities is a function of expected returns on risk-free bonds, plus a premium for the risk in equities. The main factor driving equity risk premiums is volatility in earn-

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15. There are many ways to measure a company’s valuation multiple, and different metrics are appropriate for different industries and different company situations. In the Value Creators rankings, we use the EBITDA multiple—the ratio of enterprise value (the market value of equity plus the market value of debt) to EBITDA—in order to have a single measure with which to compare performance across our global sample.
ings growth and stock prices. Given how uncertain the current environment is, one would expect that investors’ required rate of return would be, if anything, higher (to account for the increased risk). Investors are unlikely to accept a lower rate of return just because revenue growth is likely to be lower (and potentially riskier) in the future. Instead, they will set lower prices for equities so that stocks continue to deliver the required rate of return despite lower revenue growth.

As investors reset their expectations about future growth, reducing the absolute level of valuation multiples, the long-term result is to increase the value of a company’s free-cash-flow yield. Free-cash-flow yield is the return investors get from cash payouts that companies make to investors. These payouts come in the form of dividends, stock repurchases, and debt paydown. The percentage contribution of free-cash-flow yield to TSR is calculated by the amount of cash paid to investors divided by the company’s market capitalization. A company’s market capitalization is a product of its earnings and the valuation multiple assigned to those earnings. If valuation multiples decline, then the yield goes up on the same amount of cash paid out.

The significant amount of cash that companies have accumulated on their balance sheets and the currently high levels of free cash flow that resulted from cost cutting during the downturn have given many companies the opportunity to improve their free-cash-flow contribution (the numerator in free-cash-flow yield) dramatically. There are signs that at least some companies are realizing that cash payout is becoming a more important source of TSR. After cutting back on dividends and share buybacks during the depths of the downturn, more and more companies are starting to return some of that cash to shareholders.

There are also indications that investors have begun to put a higher value on cash returned to shareholders, resulting in a positive impact on a company’s valuation multiple from higher cash payouts. When we asked participants in our investor survey to set their priorities for the use of excess cash, increases in a company’s dividend shot up to number three on the list, chosen by 32 percent of respondents as either their first or second priority. (See Exhibit 4.) Last year, by contrast, it was the lowest priority on the list, chosen by only 10 percent. This shift in investor sentiment helps explain why, as of late June, the

<table>
<thead>
<tr>
<th>Exhibit 3. BCG’s Model Allows a Company to Identify the Sources of Its TSR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fundamental value</strong></td>
</tr>
<tr>
<td>Revenue growth</td>
</tr>
<tr>
<td>Margin change</td>
</tr>
<tr>
<td>Profit growth</td>
</tr>
<tr>
<td><strong>Valuation multiple</strong></td>
</tr>
<tr>
<td>Multiple change</td>
</tr>
<tr>
<td><strong>Free-cash-flow contribution</strong></td>
</tr>
<tr>
<td>Dividend yield</td>
</tr>
<tr>
<td>Share change</td>
</tr>
<tr>
<td>Net debt change</td>
</tr>
<tr>
<td><strong>TSR</strong></td>
</tr>
<tr>
<td><strong>Gain in market capitalization</strong></td>
</tr>
<tr>
<td><strong>Free-cash-flow contribution</strong></td>
</tr>
</tbody>
</table>

**Sources:** Thomson Financial Datastream; Thomson Financial Worldscope; Bloomberg; BCG analysis.

**Note:** This calculation is based on an actual company example; the contribution of each factor is shown in percentage points of average annual TSR.
For some consumer companies, a value creation strategy that emphasizes cash payout and strong free-cash-flow yield may be a sensible approach in a low-growth environment. This is especially true for companies in mature sectors with high returns on invested capital that are generating far more cash than they can invest in profitable growth—in other words, in many consumer sectors in the developed world.

But there are two important caveats to this scenario. First, it is unclear how long the current high levels of free cash flow will last. As governments around the world cope with high deficits and anemic tax revenues, cash-rich corporations will become a tempting new revenue source—whether through new corporate taxes such as the recent U.K. tax on bonuses in the financial sector or through the kind of political pressure that forced BP to contribute to a $20 billion cleanup fund to defray the economic losses due to the Deepwater Horizon oil spill.\(^{17}\)

Second, although a value creation strategy emphasizing free-cash-flow yield can occasionally generate superior TSR, it is extremely difficult to sustain that performance over time. As a company’s yield rises, investors will eventually bid up its valuation multiple—which, of course, has the parallel effect of causing the yield to decline. Only in special situations, when a company’s valuation multiple remains low, can it sustainably deliver superior TSR from a value creation strategy based on free-cash-flow yield.\(^{18}\)

In order to be a top TSR performer, most companies will, sooner or later, need to find a way to grow. To understand why requires grasping a phenomenon that we call the growth paradox.

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17. Indeed, there are some signs that investors are already expecting growing government pressure on dividends. For example, the 2012 futures on the Euro Stoxx 50 Index of major companies predicts that dividends will amount to €90 per share (about $110), down from €158 at the market’s peak in 2007—and well below the 2012 consensus analyst forecast of about €130. See “The Short View,” *Financial Times*, June 29, 2010.

The Growth Paradox

Exhibit 5, which is based on data from the S&P 500, illustrates the paradoxical role of growth in value creation. On the one hand, revenue growth is by far the main driver of superior value creation. And yet, not all companies that deliver above-average growth necessarily create above-average TSR. The right-hand chart in Exhibit 5 shows that a great many companies grow without creating value because their growth comes at the expense of other drivers of TSR—for example, declining margins or a lower valuation multiple.

A macroeconomic environment characterized by low growth exacerbates this growth paradox. Precisely because it is the scarce resource in a low-growth economy, a company’s ability to generate even modestly above-average sales growth will be a key differentiator between TSR winners and losers. For example, during the last prolonged bear market—from 1966 through 1982—nearly all of the top 20 companies that most strongly outperformed their industry peers in TSR did so through growth in sales rather than growth in margins or dividends.19

Therefore, it is critical that companies do not become so reconciled to the lack of growth opportunities that they focus exclusively on cost cutting and cash payouts at the neglect of making the necessary investments to secure future revenue-growth opportunities. The companies that are tempted to milk the business in order to prop up their earnings per share (EPS) may end up underinvesting in the future—in effect, making low growth a self-fulfilling prophecy.20

At the same time, however, a company has to be careful to avoid the opposite problem: growth without value. Because companies are so flush with cash as a result of the cost cutting and cash accumulation of recent years, they may be tempted to overcommit to growth. But as more

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20. For example, when we asked the participants in our senior-executive survey in which areas they would be making significant efforts in 2010, only 41 percent said that they were planning to increase R&D, only 35 percent were planning to hire new talent, and fewer than 40 percent were thinking of extending their geographic reach, expanding capacity, or exploring acquisitions. See Collateral Damage, Part 9: In the Eye of the Storm; Ignore Short-Term Indicators, Focus on the Long Haul, BCG White Paper, May 2010.
and more companies compete for fewer growth opportunities, the odds that improvements in revenue growth will come at the expense of other drivers of TSR go up. As a result, a company may win on growth but not win on TSR.

**Five Growth Strategies for a Lower-Growth Economy**

Through our work with clients around the world, we have identified five ways companies can successfully navigate the growth paradox—that is, five growth strategies that have served companies well during periods of low growth.

**Invest in innovation.** During periods of low growth, innovation becomes more important, not less. In the Great Depression, for example, DuPont, IBM, Chrysler, and GE all outspent their rivals and developed products ahead of their competitors. And many companies—P&G most dramatically—acquired unassailable brand leadership by systematic investment in their brands. Through a commitment to innovation when other companies were cutting back, these companies established a dominant position in their industries that would last for decades.

**Exploit megatrends.** Megatrends are major trends with the power to shape the landscape of economic opportunity and risk for decades to come. They can take decades to gather strength and then suddenly burst forth to rearrange the competitive environment. But because of the long buildup before takeoff, companies often underestimate the power of megatrends or assume that they have already accounted for them in their plans.

BCG has been tracking the development and interaction of 78 megatrends since 2005. Nearly 80 percent continued to grow during the downturn—with 23 actually strengthening in importance. Of the trends that kept growing, we estimate that 44 percent represent opportunities with a global market size greater than $500 billion. Take, for example, the demographic trend of the aging of the population. The so-called silver market (goods and services for consumers over 60) is now worth more than $700 billion worldwide and is fast become a valuable source of growth for companies in sectors as diverse as cosmetics and financial services.

The growth of consumer spending in major emerging markets is also a rapidly developing megatrend. By 2015, emerging-market cities will account for around 30 percent—or $2.6 trillion—of the total global consumption of clothing and household items. And these cities are already some of the fastest-growing markets for luxury goods in the world. Spotting the megatrends that will sweep through a company’s markets over the next decade is a critical step in reigniting growth.

**Pursue breakout growth.** Some industries grow faster than others. But in every industry, there are always a few companies that achieve breakout growth at rates that are anywhere from two to seven times the average for the industry as a whole and that create correspondingly above-average shareholder value. These companies do so by actively managing their corporate portfolio, focusing on developing and expanding their core business, and exercising discipline to sustain or expand margins while pursuing top-line growth.

**Engage in business model innovation.** A company’s business model—the value proposition that it offers customers and the operating model it creates to deliver that value at a profit—is key to creating shareholder value in any economic environment. In times of instability, when the potential for competitive disruption is high, business model innovation is especially important. Business model innovation can provide companies with a way to break out of intense competition, establish competitive barriers around new markets, or create new growth opportunities where none existed before.

**Practice pricing fluency.** In a low-growth environment in which margins are likely to be under pressure, a company’s pricing policies and implementation will be a crit-
ical lever to manage. The winners will be those companies that resist the temptation to offer concessions on prices in order to maintain share. Companies that can defend their prices with disciplined processes will have a competitive advantage. But it requires building a capability that reaches deep into a company’s sales and marketing organization. A comprehensive “pricing fluency” program focuses on improving a company’s pricing model with better policies for setting prices and on enhancing the pricing platform for organizational implementation. In our experience, the result is sustainable revenues that are 1 to 3 percent greater than those of competitors.25

The challenge for companies today: to shift from an approach to value creation that is focused on delivering quarterly earnings growth to one that emphasizes managing TSR over the long term. How companies can begin charting a course to deliver superior TSR over the long term is the subject of the next section of this report.

The shift to a low-growth economy requires a parallel shift in how companies set their value-creation strategy. Put simply, they need to stop managing to momentum targets for short-term revenue and earnings growth and start managing for superior TSR over the long term. Doing so requires rethinking their approach to growth and their criteria for capital deployment. It also requires innovations in the strategic-planning process.

**Value-Creating Growth**

Achieving profitable growth is going to be harder in a low-growth economy. There will be more competition—especially from global challengers from the fast-growing emerging economies. It is no coincidence, for instance, that six of the companies in our list of the overall consumer-industry top ten for the five-year period from 2005 through 2009 are from Asia—since this economy has experienced tremendous growth. As everyone competes for relatively fewer growth opportunities, margins will be under threat to a degree not seen in recent years. Still, the growth of emerging markets, which global challengers benefit from, also represents opportunities for others. But competition will be tough, and success will depend on a company’s starting position and the investments it makes.

Coping with these challenges will require discipline. Companies will need to take a tough look at existing business plans so as to weed out those growth investments that do not create value and to focus on those that do. It will also require creativity. Companies will have to be far more systematic in finding new ways and new places to grow.

Given the likelihood of increased competition, the place to begin the pursuit of value-creating growth is with any investments necessary to build a competitive moat around the core business. Competitors will be coming after that business, so it is critical to preserve and protect existing sources of competitive advantage.

As a company develops its growth strategy, it also must be especially alert to the impact of growth on margins. In today’s environment, achieving profitable growth will be harder, and margins will be under threat. Therefore, it is necessary to manage the growth-margin tradeoff very carefully. To be sure, there may be situations in which it is necessary to accept lower margins in order to remain competitive. But, by all means, companies should avoid simply chasing share based on a weak competitive position because such a move is likely to wreak havoc on margins.

Once weaknesses in a company’s core business have been addressed, a company can begin thinking about new ways and new markets in which to grow. When a company has few opportunities for organic growth, growing through acquisitions can be an effective way to create value. But investments in M&A tend to be riskier than equivalent investments in organic growth, so a company needs to assess its opportunities carefully and be realistic about its capabilities, both for doing deals and for the subsequent postmerger integration (PMI).

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When it comes to M&A, the main shift companies need to make is to think less about whether a particular deal is “EPS accretive” in the short term and more about whether it is actually going to create shareholder value in the long term. A deal may appear to be “cheap” and deliver one-time EPS gains without necessarily improving a company’s TSR. By the same token, deals that dilute EPS in the near term can improve TSR over the long term. Indeed, in a low-growth economy, some of the most value-creating acquisitions—those of companies with a higher growth rate than that of the acquirer—will initially dilute EPS because the target will likely be trading at a higher valuation multiple than the acquirer. But over time, such an acquisition should lead to higher growth for the acquirer and a higher overall multiple.

Last but not least, no company should be thinking about where to grow without thinking about where not to—either because it lacks advantage, is not producing returns above the cost of capital, or faces an industry environment that makes a cash payout strategy preferable. It is the rare company, for example, that knows precisely where it is creating value—by business unit, by product line, or by customer segment. Yet that kind of detailed assessment is all the more necessary in today’s environment.

Balanced Capital Deployment

Unless the economy witnesses severe erosion in margins, many companies are going to have a lot more cash flow than they can effectively reinvest in profitable growth. The worst outcome would be to waste that cash by pursuing value-destroying growth or to fail to exploit the value-creating potential of that cash by simply leaving it on the balance sheet. Rather, executives need to ask how best to deploy that cash in order to create shareholder value.

Getting to the right answer will require challenging some legacy assumptions. The first is the lingering belief that dividends are to be avoided because they signal to investors that a company has few growth prospects. As we have argued in these pages, investors’ views of dividends have changed. Increasingly, they see a strong dividend not as a sign that a company can’t grow but, rather, as an indication that management is disciplined about using its capital to fund only value-creating growth.28

A related assumption worth challenging is the management preference for share repurchases over dividends as the best means to return cash to shareholders. This mistaken belief is yet another artifact of too narrow a focus on EPS rather than on TSR. Many executives prefer share buybacks because, unlike dividends, buybacks boost EPS above the level that underlying organic growth in net income would on its own. They also think that boosting EPS growth is a convenient way to boost an “undervalued” stock price. And, of course, their incentives are often tied directly to EPS growth, and the value of their stock options depends on appreciation in stock price, not on increases in dividend yield.

But there is growing evidence that investors prefer dividend increases to recurring share repurchases because they are a far more robust signal of a company’s financial health and stability. BCG’s research demonstrates that dividends have a far more positive impact on a company’s valuation multiple than share repurchases do. Indeed, in many cases, buybacks can actually reduce a company’s multiple in the near term.29 And, as discussed earlier, the respondents to our investor survey rated dividend increases as a higher priority for excess cash than share repurchases—in part because, by a large majority (76 percent), they believe that most companies do a poor job of timing their share repurchases.

Finally, a third assumption about capital deployment that companies will have to rethink concerns the desirability of leverage. Leverage exacerbates the volatility of a company’s value-creation performance. But in a low-growth economy, investors will be looking for quality and sustainability. Some companies may want to retire debt in order to become a “safer,” less risky stock. Other companies may want to preserve current levels of leverage because interest rates are so low and because it may be difficult to take on new debt in the future. But what-

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ever a company’s situation, it would be prudent to plan future value-creation strategy on the assumption that the company will need to fund that strategy out of its ongoing operating free cash flow. One big advantage this kind of “living-within-our-means” discipline has for planning purposes is that it will force sharpened consideration of a company’s potential tradeoffs around capital deployment.

### Scenario-Based Strategic Planning

By now, it should be clear that the approach to value creation strategy we are describing is not something that can take place within the normal strategic-planning process. As strategic planning exists at most companies today, business units develop their momentum plans, which are then aggregated into an overall corporate strategy. Re-thinking value creation strategy requires a top-down overlay to that process, led actively by the CEO and involving the board.

One approach that helps sharpen the tradeoffs a company faces is to create alternative future scenarios that emphasize significantly different uses of capital. For example, assign three different teams to develop the “best-case scenario” for three different value-creation strategies—one emphasizing investments in organic growth (such as expansion into emerging markets), one emphasizing acquisitive growth (such as the acquisition of a close competitor or a key emerging-market challenger), and one emphasizing cash payouts (such as substantially higher dividend payouts). What would be the differential impact of each of these scenarios on TSR? What would be the associated risks given the company’s starting position, organizational capabilities, and investor base?

The point of this exercise is not necessarily for any one scenario to win out over the others. It is likely that the final strategy will include elements drawn from each scenario, perhaps with different moves playing a more central role at different moments in time. But developing multiple scenarios has the advantage of surfacing unanticipated opportunities, sharpening the choices and tradeoffs that a company has to make, and forcing a tough, realistic assessment of what the company can actually achieve.

As a company develops and evaluates these different scenarios, it should keep in mind the financial fundamentals, as well as the likely impact of various moves on its investor base and, therefore, on its valuation multiple.

One way to do so is to develop a fine-grained understanding of the factors that actually determine differences in valuation multiples in a company’s peer group. BCG’s research shows that it is possible to identify and actively manage the factors that determine approximately 80 percent of the differences in valuation multiples across a company’s peer set.³⁰

Another way to gauge investor reactions to a company’s plans is by conducting a detailed investor segmentation to determine who the company’s dominant investors are, as well as who future investors might be, and to identify their key priorities for the company.³¹ BCG regularly conducts interviews with the fund managers of leading asset managers on behalf of our clients. In our experience, only by talking directly to investors, asking probing questions, and carefully listening to and interpreting their responses can a company’s management gain a clear view of the expectations and priorities of the company’s investor base.³²

### A Success Story

Adapting to lower growth after decades of relatively high growth is a bit like having to use muscles that one has not exercised in a long time. It can be painful—but in the end, it produces a healthier organism. By focusing on value-creating growth, optimizing the tradeoffs among various uses of capital, and taking a scenario-based approach to strategic planning, companies will be in good shape to address the challenges of value creation in a lower-growth economy.


Consider the experience of a leading retailer that had been growing successfully for the past 20 years by adding new stores across its home market. Its rapid expansion had delivered above-average growth and considerable shareholder value from gains in market share. But as the global economy began to slow, opportunities to open new stores disappeared and the retailer’s current stores became less profitable. Consequently, investors began to penalize the retailer as profitable growth slowed down. The retailer realized it needed a more nuanced growth strategy for the low-growth era.

In working with the retailer, our first step was to evaluate the company’s fundamental economics. It had a successful format with stores delivering strong cash returns, and a modest improvement in same-store sales could drive significant incremental cash flow. Therefore, the next step was to determine how best to deploy that cash for maximum shareholder returns—balancing investments back into the business with cash payouts to investors.

We talked to the retailer’s biggest investors, as well as to investors in other retail companies who had chosen not to invest in our client. These investors told us that although they would like to see our client direct a substantial portion of its cash toward growth, they doubted that there were many high-return investments to be made—either by diversifying into new formats or by expanding into new regions. However, they saw the potential for very attractive financial returns if our client invested modestly in the business and returned most of its cash to investors. What’s more, they thought such a move would be even more attractive if the cash returns came predominantly through dividends rather than stock buybacks, since the returns would be “guaranteed,” and our client would be signaling its confidence in the future.

Given this information from investors and the company’s economic fact base, we worked with the retailer to identify which of a broad range of strategic scenarios would deliver the best mix of strengthened competitive advantage, attractive shareholder returns, and appropriate risk exposure. The scenarios considered included the following seven:

- The status quo plan, which called for modest investment in the business combined with high returns to investors (predominantly through stock buybacks)
- The status-quo plan with “optimized” financial policies, which focused cash payouts more on dividends than on stock buybacks
- Aggressive investment in growing the domestic fleet of stores, combined with lower cash returns to investors
- Aggressive investment in existing stores (to drive same-store sales), combined with lower cash returns to investors
- Acquisition of a close competitor in order to consolidate the company’s sector domestically
- Diversification into a new format, either organically or through M&A
- Diversification into new regions

We concluded that the status quo plan would deliver average shareholder returns. The second scenario (the status quo plan with optimized financial policies) would increase shareholder returns—through a higher free-cash-flow yield and a stronger valuation multiple, as investors developed more confidence in the company’s outlook from the signals its financial policies sent. This would put the retailer on a par with the top-third companies in terms of returns to shareholders. Most of the other investment options did not deliver materially higher returns and took on substantially higher risk. But higher reinvestment into the existing portfolio of stores could place the company in the top quartile of companies in terms of shareholder returns, with only modest additional risk.

The retailer’s management team and board considered the pros and cons of all of the options and decided on the following cash deployment strategy: increased reinvestment in the existing portfolio of stores, very modest expansion into additional stores, higher dividends to shareholders, and stock buybacks to redistribute any remaining cash to investors. Since implementing this plan, the company has delivered a very attractive return to shareholders. It has outperformed the overall market, as well as its peer group, and it has strengthened its leadership in the marketplace.

This process of assessing strategic options is replicable for any consumer company and is a key enabler for delivering superior value creation in a lower-growth economy.
Ten Questions Every CEO Should Know How to Answer

In conclusion, we offer ten questions about value creation in a lower-growth economy that every consumer-company CEO should know how to answer. The questions synthesize the basic arguments and recommendations made in this year’s report.

1. Do you know where and how your businesses are creating value? By business unit, by product category, by customer segment?

2. Do you have a process in place for discovering new ways to deliver value-creating growth? Are you looking at longer-term, longer-payout investment options, or merely at immediate-payback investments? Are you aware of the megatrends that apply to your business and how you might capture the opportunity?

3. Are you emphasizing shareholder value performance over relatively long time horizons (three to five years), rather than quarterly or annual EPS?

4. Are you evaluating future acquisitions by their long-term value-creation potential, not by whether the deals would happen to accrete or dilute EPS in the short term?

5. Do you know what drives differences in valuation multiples in your peer group?

6. Do you know the segmentation of investors who own your stock? Which types of investors dominate? Are they the right ones given your value-creation strategy? Are you engaged in an active dialogue with your core investors in order to understand their objectives and priorities?

7. Are your financial policies—such as debt-to-capital ratio and dividend payout—likely to appeal to your target investors in a low-growth environment?

8. Are your management processes—for example, planning, budgeting, and capital allocation—aligned with the goal of increasing shareholder value over the long term?

9. Are you rethinking your executive-compensation system for an environment in which capital gains will be a less important contributor to TSR? Does your system require that senior executives have substantial “skin in the game” in the form of long-term direct equity exposure (not stock options)?

10. Have you thoroughly explored different scenarios for creating value in the future? Do you know the different benefits and risks of emphasizing organic growth, M&A, or cash payout?
For Further Reading

The Boston Consulting Group publishes many reports and articles on corporate development and value creation that may be of interest to senior executives. Examples include:

**Big Prizes in Small Places: China’s Rapidly Multiplying Pockets of Growth**  
A report by The Boston Consulting Group, November 2010

A report by The Boston Consulting Group, September 2010

**Investors’ Priorities in the Postdownturn Economy**  
An article by The Boston Consulting Group, July 2010

**Accelerating Out of the Great Recession: Seize the Opportunities in M&A**  
A report by The Boston Consulting Group, June 2010

**Cross-Border PMI: Understanding and Overcoming the Challenges**  
A Focus by The Boston Consulting Group, May 2010

**Megatrends: Tailwinds for Growth in a Low-Growth Environment**  
A Focus by The Boston Consulting Group, May 2010

**Rebound but Not Yet Recovery**  
An article by The Boston Consulting Group, March 2010

**After the Storm**  
The 2010 Creating Value in Banking Report, February 2010

**Time to Engage—or Fade Away: What All Owners Should Learn from the Shakeout in Private Equity**  
BCG White Paper, published with the IESE Business School of the University of Navarra, February 2010

**M&A: Ready for Liftoff? A Survey of European Companies’ Merger and Acquisition Plans for 2010**  
BCG White Paper, published with UBS Investment Bank, December 2009

**Lessons from Consistent Value Creators in the Consumer Industry**  
The 2009 Value Creators Report for Consumer Companies, November 2009

**Searching for Sustainability: Value Creation in an Era of Diminished Expectations**  
The 2009 Value Creators Report, October 2009

**Be Daring When Others Are Fearful: Seizing M&A Opportunities While They Last**  
A report by The Boston Consulting Group, September 2009

**Fixing What's Wrong with Executive Compensation**  
BCG White Paper, June 2009

**Real-World PMI: Learning from Company Experiences**  
A Focus by The Boston Consulting Group, June 2009

**The Clock Is Ticking: Preparing to Seize M&A Opportunities While They Last**  
BCG White Paper, May 2009

**Thriving Under Adversity: Strategies for Growth in the Crisis and Beyond**  
BCG White Paper, May 2009

**Collateral Damage: Function Focus; Valuation Advantage—How Investors Want Companies to Respond to the Downturn**  
BCG White Paper, April 2009
Note to the Reader

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For Further Contact
For further information about the report or to learn more about BCG’s capabilities in corporate development and value management, you may contact the authors.

Marcus Bokkerink
Senior Partner and Managing Director
BCG London
+44 207 753 5353
bokkerink.marcus@bcg.com

Patrick Ducasse
Senior Partner and Managing Director
BCG Paris
+33 1 40 17 10 10
ducasse.patrick@bcg.com

Jeff Gell
Partner and Managing Director
BCG Chicago
+1 312 993 3300
gell.jeff@bcg.com

Eric Olsen
Senior Partner and Managing Director
BCG Chicago
+1 312 993 3300
olsen.eric@bcg.com

Frank Plaschke
Partner and Managing Director
BCG Munich
+49 89 23 17 40
plaschke.frank@bcg.com

Daniel Stelter
Senior Partner and Managing Director
BCG Berlin
+49 30 28 87 10
stelter.daniel@bcg.com
For a complete list of BCG publications and information about how to obtain copies, please visit our website at www.bcg.com/publications.

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