CHAPTER 1

Why Growth? The Economist's Perspective

The growth of an economy has generally been seen as a good thing. Throughout history, nations have traded with each other and some have grown rich by exploiting their own natural resources and those of their neighbors or trading partners. The need to protect trade routes meant that from the Greeks and Romans right through to the British and the French empires, economies have grown hand in hand with military power. However, over the last half-century there has been a degree of rebalancing and a shift to create successful economic growth independent of 'empire.' Although the cases of oil and other mineral wealth may play against this, it is evident that when productivity improvements impact manufacturing and service-based economies at the same time as trading takes place, we experience economic growth.

Gross domestic product (GDP) is a widely adopted measure of national economic performance. Increases in GDP above and beyond what would be natural given population growth are believed to enable an increase in living standards for the population. Hence the interest in data such as GDP per capita both in real and relative terms. As wide-scale conflict between nations has been predominantly replaced by global trade, the post World War II decades have largely been focused on regions using growth to drive their economies forward, raise living standards, and increase influence. Over 30 years a growth rate of 2.5% of GDP per annum leads to a doubling of GDP. Growth of 8% per annum, as exhibited by many Asian economies in recent years, achieves this in a decade.

Pivotal technology breakthroughs have always enabled companies and countries to improve efficiency and so drive growth. The invention of the steam engine and processes for producing quality steel are often-quoted changes, but access to coal and oil and the 'invention' of electricity are also seen as inflection points.

So too we can consider that the creation of the train, the telephone, the car, the plane, the transistor, and the internet have all, over time, provided new platforms for growth.

The 18th-century economist Adam Smith is generally credited for shaping our views about how growth creates wealth, power, and stability. In *The Wealth of Nations*, published in 1776, Smith argued that 'productive capacity' was the engine of growth. Some 40 years later others such as David Ricardo with his theory of 'comparative advantage' saw that prowess in trade was the fundamental differentiator. In the mid-20th century Robert Solow and Trevor Swan contributed alternative theories – the neoclassical growth model – where the role of technological change is seen as significant as accumulation of capital and all countries eventually reach a steady state of growth. However, a decade earlier in 1942, Joseph Schumpeter made the connection between growth, innovation, and entrepreneurship upon which most companies and countries now base their respective economic policies. In his book, *Capitalism, Socialism, and Democracy*, Schumpeter saw an entrepreneur as someone who is able to convert a new idea into successful innovation. He popularized the idea of 'creative destruction' as creating new products, services, and business models across markets and so driving growth. It is this that is at the heart of successful long-term growth. The entrepreneur disturbs equilibrium and so causes economic development. Schumpeter argued that 'innovation is the critical dimension of change' and creates 'temporary monopolies that allow abnormal profits,' which are then competed away by rivals and imitators. These create new products and services that meet and drive demand and so improve profits and economic growth. Schumpeter also proposed that finance can have a positive impact on growth as a result of its effects on productivity and technological change. In recent years, many Asian economies have cited government-led investments as being a core catalyst for sustained economic growth. Back in the West, many see that Schumpeter's views stand firm and, for example, has had influence in such ambitions as the European Union's core development plan – the Lisbon Strategy.

Until recently it was generally assumed that growth is good for society. Indeed there is significant evidence to support this, for example the Cato Institute has

undertaken research which shows that, up to a level of around $15,000 per capita, happiness increases with higher GDP. If – and sometimes this is a big 'if' – appropriately shared across a community, the benefits of growth have direct impact on alleviating poverty and enabling people to access the next rung on the economic ladder. On the other hand there are increasing and multiple arguments which suggest that growth fosters excessive consumerism, resource depletion, and unsustainable ways of living. As a result some consider that 'well-being' is a better ambition than mere growth while others call for alternative measures to be implemented, such as gross domestic happiness, as measured in Bhutan. Many of these arguments are clear, compelling, and visionary. However, today in the greater scheme of things, they are unfortunately largely marginal. In a decade or so mainstream attitudes may well have shifted but right now the majority is still focused on creating growth as a priority with other issues in second place. Decoupling growth from resource use, for example, is a great concept but one which many organizations have yet to get their collective heads around. For the moment it seems that most companies and countries are still abiding by Schumpeter's view of growth via innovation and change driving progress.

The Nature of Growth

Before exploring some examples of successful growth, it is useful to consider the nature of growth, how it occurs, and what some of the implications are. Taking the macro view, some see that economic growth and prosperity result from interaction at different levels ranging from the organization to the sector and then the national and international level. Growth within each of these can be supported or constrained by a number of factors such as the development of technology platforms, environmental fluctuations, political, economic or societal change, and regulatory changes that introduce new laws and standards at an industry or national level. Growth is driven by a complex amalgam of multiple issues – some of which are internal to a company or sector and can be more easily managed or stimulated, but there are also external influences which have to be accommodated as they unfold.

In order to try and gain some control of the changes that influence growth, the business of 'management' has evolved. New approaches, tools, and models have been created to help us be more effective in how we deploy available resources. These processes are often static 'command and control' methods that seek to impose order, hierarchies, and rules onto systems that are by their very nature complex, interconnected, evolutionary, and constantly shifting. One reason for this is that management theory has been largely dominated by thinking from the United States and based on large manufacturing businesses, where business models, underpinned by economic thinking, gained both relevance and resonance with business leaders. For example Alfred Chandler, Igor Ansoff, Peter Drucker, and Michael Porter arguably all used the U.S. manufacturer as a common reference point. Even 'Blue Ocean Strategy,' one of the most popular post-millennium models to have emerged from INSEAD, is grounded in product-based economics (see Kim and Mauborgne's book). Times have changed, however, and the problem is that in today's world this approach doesn't stack up. For a start, many of the high-growth businesses that have emerged in the last decade – think Google, Netflix, Facebook – don't play by the same rules as product manufacturers. In addition, the recent financial crisis demonstrates that, for many, the analytical models that were put in place to manage financial and economic systems simply don't work.

In truth growth cannot be rigorously controlled. As many now recognize there are levers that organizations, either corporate or governmental, can pull at different levels but, in an ever more interconnected world, most are nudges at best. Whichever metaphor you think of, from nurturing a growing plant to navigating an oil tanker, there are things we think we can do to improve efficiency and optimize the process but there also other factors – disease, hurricanes and the like, not to mention the caprices of human nature itself – that will inevitably occur from time to time and are outside our control. We will do our best to see them coming and have plans to deal with them, but we can't direct the what, where, or when.

However, we are where we are and know what we know. So, acknowledging the gaps, what can we learn from past economic thinking to help us see growth opportunities more clearly? For a start, we can see patterns that let us recognize

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The Growth Challenge

and categorize what type of growth is taking place and we can understand some of the key characteristics. This can be done at both the national/regional and organizational company levels.

National/international economic growth

The economic view of growth is that increases in productivity lead to increased levels of economic prosperity. So, it follows that more competitive economies tend to be able to produce higher levels of income for their companies and citizens, not to mention higher returns on investment and hence increases in the national growth potential. The World Economic Forum's 'Global Competitiveness Report' provides an analysis of many of the drivers that enable national economies to achieve sustained growth and long-term prosperity. It divides countries into three different stages, which are consistent with general economic development theory:

- Stage 1 'factor' driven economies, where countries compete primarily on the use of unskilled labor and natural resources and companies compete on the basis of price as they buy and sell basic products or commodities.
- Stage 2 'efficiency' driven economies, where growth is based on the development of more efficient production processes and increased product quality.
- Stage 3 'innovation' driven economies, where companies compete by producing and delivering new and different products and services by using the most sophisticated processes.

So looking at the BRIC (Brazil, Russia, India, and China) countries, as of 2011, India is largely still in stage 1, while Brazil, China, and Russia are stage 2. Most of the developed world is in stage 3 for now, but, just as the performance of many European countries is starting to plateau, China's competiveness is way ahead of other developing economies and it is moving fast toward becoming a stage 3 economy. Although just one point of view, many see that this type of grouping is helpful in understanding what levers, regulatory or industry led, can be applied to different economies.

Company growth

Broadly speaking companies also grow across three dimensions:

- Dimension 1: 'existing market growth' – Once established a firm can expand by increasing existing market share through price and other sources of competitive advantage.
- Dimension 2: 'customer-driven market growth' – A business grows by helping to create new customers for existing offerings.
- Dimension 3: 'innovation-driven products and services growth' – This occurs when companies create new markets by offering innovative products, services, or business models.

Within each of these dimensions, different techniques to drive growth and improve efficiency have been used by organizations in order to win. It's what Michael Porter describes as competitive rivalry in the industry. High-growth companies excel across one or more of these dimensions. This means that they achieve disproportionate shares of growth.

Linking the national and company views together, it is clear that because high-growth firms contribute a disproportionate amount to employment levels and/or have higher productivity than their peers, they are also responsible for a significant proportion of economic growth. High-growth companies are attractive because they are more successful within a sector, but also help make a country more economically competitive on a global scale. Therefore they become the heroes – not just because they are the organizations people want to work for, but also because they are the companies that countries either want to nurture or to attract.

Established Growth Successes

Reviewing the varied archives of *The Economist*, the *Financial Times*, *Business Week*, and the *Wall Street Journal*, large companies have clearly been the main drivers of sustained growth over the last 50 years or so. The likes of Exxon,

General Motors, General Electric, IBM, Boeing, Procter & Gamble, United Technologies, AT&T, and Caterpillar in the United States; Tata and Reliance in India; and BP, Shell, Rolls-Royce, Ericsson, Bosch, Fiat, Novartis, and Volkswagen in Europe have all played a pivotal role. Big companies like these have grown in both scope and scale, increased incomes, employed more people, paid more dividends to shareholders, and taxes to governments. However, we argue that continued large company-led growth is no longer a certain bet. As new organizations are formed to tackle emerging challenges, the old models that supported large companies in the past are being replaced by new ones.

Taking a U.S.-centric view: of the top 100 companies in the *Fortune 500* in 1955, only 11 can be found in the same group 50 years later. Although oil companies still dominate, many leading firms from the 1950s were absorbed into larger entities or have died out to be replaced by banks, retailers, and a host of new technology companies: 10 years ago Amazon and Google were not even in the top 500. However, just looking at brand names can be deceptive and gives an inaccurate view of reality. A relatively recent UK study by the Department for Business Enterprise & Regulatory Reform on high-growth firms looked at a number of international factors that drive success. One interesting finding relates to the average age of the successful organization. Perhaps surprisingly many of the largest firms in the UK and the United States are over 100 years old and at least half of the firms in both countries can be tracked back to origins prior to 1900. So, presumably something has been going right?

Whilst some of the growth successes of today have been around for many years, many innovative companies, such as those highlighted by the likes of *Fast Company*, are relatively new: Groupon and Zynga are both in the *Fast Company* top 10 innovative companies for 2011 and neither existed five years ago. Alongside Google, other top 10 ranked companies such as Netflix and Epocrates can both trace their roots back to the late 1990s. There are evident growth successes from the past few decades that, all being well, will continue to prosper in the future. However, they are likely to be joined by newcomers ready to ride the next innovation wave. Just as Facebook, Twitter, and LinkedIn are driving high valuations today, so in the next decade we may see others of greater influence emerge from start-ups addressing new opportunities.

Such perspectives on successful growth companies also apply to nations. Countries such as Singapore, India, and China have all grown at twice the world average over the past 20 years. While many see China and India's growth being at the forefront of the rise of the BRIC economies, Singapore is seen as the leading example of government-influenced growth of an established economy. It is therefore the country that others seek to emulate: From Dubai and Qatar to Thailand and the Philippines, Singapore, with the pivotal roles of Temasek – its industrial investment vehicle – and the Economic Development Board – its catalyst for inward investment – is widely admired. Over the past 30 years or so, Temasek, 100% owned by the Singapore government, has placed some good bets: It has invested in markets and resources and supported companies – often financing strategic expansions – to such a consistent extent that it now has over $130 billion of assets for use by the nation. It is, by far, the most successful Sovereign Wealth Fund that links corporate growth and wealth creation to the assets of the nation, and hence the population.

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