

Rethinking where to compete: An interview with the CEO of Pentair

The US manufacturer has reinvented itself by switching out of power tools and into water and other resource-based businesses.

Few large, established companies anywhere in the world effectively reinvent themselves overnight. But Minneapolis-based Pentair did just that. A decade ago, the company sold its core power-tools businesses—42 percent of group sales—and reinvested the proceeds in Wicor Industries, the water-systems subsidiary of Wisconsin Energy. In March 2012, Pentair made another big bet, roughly doubling its size to \$8 billion by acquiring Tyco International's flow-control business. Randall Hogan, chairman and chief executive officer and the man who led the transition, talked recently with McKinsey's Rik Kirkland about strategy, capital reallocation, the importance of getting the board's buy-in, and the vital art of thinking "right to left."

The Quarterly: *How do you approach strategy?*

Randall Hogan: Before joining Pentair, in 1998, I had worked for GE and United Technologies. Both companies were in a lot of different and seemingly unrelated businesses, but the experience taught me that successful conglomerates exist because they're good at moving capital, talent, and processes around. United Technologies, in particular, brought substantive operating discipline—using the Toyota Motor production system, for example—to its assets. That just threw a switch inside me; here, I thought, is a powerful way of running a diverse company. And it shaped my view that there had to be something more to Pentair than just a holding company—a set of common principles and common beliefs, for instance.

The Quarterly: *Was it a difficult decision to exit power tools?*

Randall Hogan: The power-tools group was our largest business when I became CEO, in 2001, but I don't think the board was surprised when I told them I thought it had the dimmest prospects. We didn't control our own destiny. Lowe's and Home Depot, the retail outlets which stocked our professional niche tools and helped drive growth in the 1990s, accounted for 55 percent of sales, and we were dependent upon them. Water, on the other hand, was looking interesting to a lot of people; its growth prospects were strong, its M&A potential was bright, and its industry dynamics—channel power, innovation, pricing fundamentals—seemed attractive. It was clear that we had to reduce our dependence on power tools and double down on at least one of our other businesses, maybe both.

The Quarterly: *So, was the timing of the water acquisition a coincidence?*

Randall Hogan: The purpose of the CEO, the leader of the company, is to create a brighter future. And that's why I often talk about thinking "right to left." Left is where you are now. The right-hand point is the goal—in our case, not just getting out of power tools but developing a water strategy. Even before we sold power tools and bought Wicor Industries, we were identifying interesting spaces and people in the water sector and making a number of small acquisitions. Our focus wasn't just on the sale, it was on the buy—with the commitment and understanding that we would do the sell. In February 2004, we announced the purchase of Wicor, and then we had an auction to sell the power-tools business. It was hairy at times, but for a net difference of \$75 million, the result was that we upgraded our entire portfolio, the stock price jumped, and as investors saw the promise of it, we were rewarded with a better multiple.

The Quarterly: *How did the board react to the change of direction?*

Randall Hogan: It was very important that the board was in on the discussions early—they were fully aligned on the "right point" of our strategy. I'm sure that this was easier to do 10 or 15 years ago than it is today, when many boards are a bit more focused on governance. Yet engaging in strategy and resource allocation is really where boards can help the most to create value. That said, plenty of people in the know at the time argued that our move was too radical.

They pointed out that all our power-tools know-how was irrelevant to the water business and that there was a lot about the water business that we didn't know. The role of the CEO is not to let those little voices carry the day. Listen to them, by all means, and understand them, but keep that point to the right in mind. And stick to it.

The Quarterly: *Does the end goal of strategy have to be fully baked?*

Randall Hogan: It's really best to think of it as a destination with an infinite number of ways to get there. We knew we had to get out of power tools but initially we had no idea how. Most companies, in my experience, don't have a destination; they just want to keep doing what they're already doing, at an incremental pace.

The Quarterly: *Was the financial crisis of 2007–08 a big test of nerve?*

Randall Hogan: We actually got hit earlier than that, in 2006, because the water business we built was 50 percent residential and we had deliberately stayed small in municipal, where the margins are low. Between 2006 and 2008, Wall Street told us we were the dumbest people in the world. It was quite an education. The board wasn't always easy when things were going badly: miss a few quarters and you're going to hear about it. But luckily, I had enough of a relationship with them that we drew together a little tighter, and they stuck with us. Even then, we were still focused on that right-hand point—what is the long game?

The Quarterly: *What prompted the Tyco deal?*

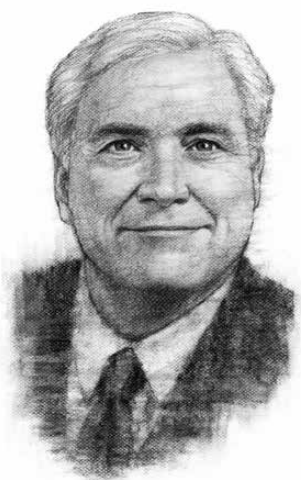
Randall Hogan: We had taken the actions to get us through the financial crisis, but after that the target was to become a \$10 billion company. We knew that we had to be bigger to control our own destiny. And the opportunity was there in what we call the “new—new world,” four billion middle-class people demanding energy, water, and food.

We first identified Tyco's flow-control business in 2009 as a way to gain scale, diversify beyond residential consumers, and gain greater global coverage. We had no idea if it would ever be an option,

but the point of thinking right to left is to imagine where you'd like the company to be, and then to be open to the opportunities as they present themselves. You create the future you imagine.

When Tyco decided to spin off its flow-control business, they recognized that it needed some common operating disciplines and that we already had a corporate office we could leverage. Secondly, we had a strategic road map of how the businesses would fit together. Thanks to those operating disciplines, we've been able to

Randall Hogan



Vital statistics

Born in 1955, in Framingham, Massachusetts

Education

Attended the US Coast Guard Academy from 1973 to 1975

Graduated with a BS in civil engineering in 1977 from the Massachusetts Institute of Technology and an MBA in 1981 from the University of Texas at Austin

Career highlights

Pentair (1998–present)

Chairman (2002–present)

CEO (2001–present)

President and COO (1999–2000)

Executive vice president and president of Electrical and Electronic Enclosures Group (1998–99)

United Technologies (1994–97)

President, Carrier Transicold Division (1995–97)

GE (1988–94)

Various executive positions

McKinsey & Company (1981–87)

Consultant

Fast facts

Received Ernst & Young's Entrepreneur of the Year Lifetime Achievement Award (2013)

Serves as deputy chair of the board of the Federal Reserve Bank of Minneapolis

Sits on the board of trustees of American Public Media Group

Is a member of the board of directors for the Guthrie Theater, in Minneapolis

Is a member of the board of directors for Covidien

extract the necessary synergies to pay the bills. It was what we call a “Goldilocks” deal—the combination and price were just right.

The Quarterly: *How do you routinely allocate capital to the best businesses?*

Randall Hogan: Rarely do the business units have the altitude or the amplitude to think big. So it’s the job of the corporate center to say what’s next.

But the decisions on nurturing and pruning do happen inside the business units, and we try to encourage a dialogue around that. In the old days, we used to call the capital-allocation model “first pig to the trough,” and the biggest pig usually won. I’m not sure we’re totally weaned off that, but the process now starts with the 33 platforms we’ve identified across Pentair—platforms with a little *p* that could be anything from a \$600 million product line to just an idea. We take a look at all the opportunities. Some are cash cows, and some need more resources put into them.

What we’re trying to do is to turn what’s been predominantly a budgeting process into a more strategic allocation of capital. My big focus right now is getting the business culturally ready for that. We have seven global business units run by really talented people who all want to run their own show. My challenge is to encourage the notion that they are part of Pentair, as opposed to running a Pentair division. In organizations, there is always deep inertia, a reluctance to change things. You have to introduce energy in a radical way to change the corporate gyro.

The Quarterly: *How have you tried to change people’s thinking?*

Randall Hogan: We’ve set questions at the outset of the planning process, listened to their ideas, provided feedback, and attempted to get them to think more nonlinearly—challenging them about markets that are not growing or ones where there is a clear mismatch of resources. How do you run a market with 25 percent of your sales but only 15 percent of your sales people? We’re not saying, “Do it.” We’re saying, “How would you do the thought exercise?” They may be big in the United States and Western Europe, but the opportunities are in Indonesia and Brazil.

For five years, I've been saying we need more talent in the fast-growth markets and our best talent against our best opportunities. At our global leadership meeting, one or two global business units sent 30 people, but only one of them came from Asia, despite the region's representing 50 percent of their opportunities for growth. That doesn't make sense.

The Quarterly: *What's next for Pentair?*

Randall Hogan: We have been through a huge shift in the last few years, from 20 percent to 60 percent of our sales outside North America, and from \$1 billion to more than \$12 billion in market cap; from being the largest unknown company in Minnesota to one with a much higher, global profile. In the future, we're going to be even bigger outside North America, because growth rates elsewhere will be higher. Our aim will be to grow faster organically in these markets. Although that doesn't mean that we won't do more acquisitions, we now really have to develop our organic-growth genes. Strategically, we're interested in the food space and we're really interested in energy.

A language of performance is important—our lean enterprise, process improvement, and talent-management principles are all about that. But we're also working hard to clarify the underlying purpose of the company—improving the quality of life for people around the world—and to be the next great industrial company. Our values are about “winning right,” and we're going through a process right now to tie that philosophy to our operating principles. I want to get 30,000 people all heading in the same direction, or, as Lee Walton, an old McKinsey mentor with Texas roots, said to me, “You know, management is about getting everyone roughly heading west.” And I would modify that with these words: “as long as west is the direction you want to go.” ◉

This interview was conducted by **Rik Kirkland**, senior managing editor of McKinsey Publishing, based in McKinsey's New York office.