CEO advisory

Leadership and strategy in the news

Craig Henry

Craig Henry, *Strategy & Leadership's* intrepid media explorer, collected these examples of novel strategic management concepts and practices and impending environmental discontinuity from various news media. A marketing and strategy consultant based in Carlisle, Pennsylvania, he welcomes your contributions and suggestions (craig_henry@centurylink.net).

Of strategies and strategists

Herb Kelleher: "treat your employees like customers"

Southwest, which began in 1971 as a low-fare intrastate carrier serving three Texas cities – Houston, Dallas and San Antonio – grew into the behemoth that today carries more than 120 million passengers a year, making it the nation's most popular domestic airline.

Southwest employs more than 58,000 people and has been profitable every year since two years after it was founded. During CEO Herb Kelleher's tenure, the company never had a layoff, furlough or pay cut, despite being among the most unionized airlines in the world. . ..

By paying his employees well, avoiding layoffs and instilling a spirit of fun in the company's culture, Mr. Kelleher also set a tone for Southwest that translated into customer loyalty.

> "You have to treat your employees like customers," he told Fortune magazine in 2001. "When you treat them right, then they will treat your outside customers right. That has been a powerful competitive weapon for us."

What sounded like a business cliché translated into tremendous cost savings for Southwest. Its employee productivity levels were far higher than those of the competition, and even as salaries rose, the company managed to keep fares low and profits high. The company was a perennial choice for *Fortune's* "Most Admired Companies" list. . ..

Glenn Rifkin, "Herb Kelleher, Whose Southwest Airlines Reshaped the Industry, Dies at 87," *New York Times* 3 January 2019.

Could Honda disrupt the private jet market?

Honda, big well-known car company, coming out with a jet, a really innovative jet. My first thought was that with everything we know and have been taught about innovation, this isn't supposed to happen. A company like Honda is not supposed to come up with this sort of radical, transformational innovation. This is supposed to be the domain of startups, a kind of Tesla-like story. How did that happen and what did they do?

. . . These will be the smallest private jets or corporate jets, generally pretty cramped – about six people . . . The market is like $370 million, a tiny, tiny market, because realistically, $4.5 million doesn't buy you much when it comes to a jet. . . . Honda's view was that there's potential at the low end of the market to develop something that would really be quite attractive to use, and more comfortable. And that's where they had this notion of the Civic. . ..

The Civic, while still a sub-compact car, was a little roomier, kind of cooler, and more fun to drive. It transformed the sub-compact market. And so they said, "Could we do the same thing in the jet market? Could we create the Civic of light jets so it would be roomier, more comfortable,

DOI 10.1108/SL-03-2019-164

and a more interesting product?" That was their bet, to get a jet that's about $4.5 million, hold six passengers but comfortably, be quieter, and that could extend the market. If we actually had a much better product, does that market get bigger? . . .. So their argument is, can we create a product that is now effective for these smaller businesses to use that might never have thought about buying a private jet and say, "Look, the per hour costs are the same as flying first class".

Gary Pisano, "Honda Created a Civic for Very Light Jets. How High Will It Fly?", *HBS Cold Call Podcast*, 3 December 2018, https://hbswk.hbs.edu/item/honda-created-a-civic-for-very-light-jets-how-high-will-it-fly

Multiple lenses required for true strategic vision

Companies that hold no conviction about priorities too often spread resources evenly across multiple projects rather than targeting a few projects with the potential to win big. Those companies seeking to escape slowing growth in their core businesses sabotage themselves by chasing new markets without critically evaluating if or how they can win.

To avoid this fate, companies should examine their strategic choices through four critical, interdependent lenses – the company's financial performance, market opportunities, competitive advantage and operating model.

Executives tend to overemphasize the first two – viewing choices strictly in the context of financial and market opportunities – because those lenses represent critical inputs into the business case. But knowing what it will take to meet or beat financial expectations and which markets are profitable won't do much good if the company doesn't have the assets or capabilities required to win in those markets. Nor will it do much good if the company lacks the people, processes, and organizational structure to implement the proposed strategy successfully.

By viewing strategy choices through all four lenses, executives can identify and prioritize the big moves that will lead companies to new markets and growth opportunities, or the steps they can take to consolidate the core. . .

The financial lens can help them incorporate an outside view into these discussions and develop an objective baseline for assessing the feasibility of long-term targets.

The market lens provides a means by which companies can identify pockets of growth within existing segments and beyond, and assess them against strategic options. The critical factor here is granularity; executives should quantify and validate shifts in profit pools in relevant markets given trends that are visible now.

The competitive-advantage lens can help executives identify whether the company has what it will take to win in current markets and those going forward, or whether a big change is required to capture value. An honest assessment of current capabilities should inform how the company chooses to play in its markets, as well as partnerships or acquisitions that may be necessary.

The operating-model lens is essential for understanding whether the company is set up for future success. Indeed, a company's approach to resource allocation, talent management, organizational design, and performance management can either reinforce or defeat strategic objectives.

Kevin Laczkowski, Werner Rehm and Blair Warner, "Seeing your way to better strategy," *McKinsey Quarterly*, November 2018

How Dominoes remade itself for the digital age

For an example of digitally-enabled business model transformation, consider Domino's Pizza, which has experienced a massive turnaround since 2010. *Forbes* hailed it as a veritable case study "on how digital transformation leads to business value." That Dominos has undergone a transformation cannot be disputed – an investor who bought $1,000 worth of Dominos shares in 2008, when it was on the brink of bankruptcy, would be able to sell them for more than $80,000 today. By comparison, $1,000 of Chipotle stock purchased the same year and sold at its peak in 2015, before the e-coli scare, would have only been worth about $5,000.

Domino's improved its processes around ordering and delivery by bringing its e-commerce technology in-house. Today, more Domino's pizzas are ordered via digital devices than by phone. . ..

Building its own digital platform was a game-changer for Dominos, but it's not what changed its game. It did that by strengthening its CVP (adding more in the way of both convenience and fun), its Profit Formula (by increasing its volume and its resource velocity), and by upgrading the resources and processes that it needed to support them.

Any consumer or service company that doesn't have a digital component certainly should; this is 2018, after all. But the key to transformational growth is still a powerful and coherent business model.

Mark W. Johnson, "Digital Growth Depends More on Business Models than Technology," *Harvard Business Review*, December 2018

The crisis of trust

What is the cost of becoming known for doing things that don't match your words? To put a number on that, Tony Simons, a management professor at Cornell, took an unusually detailed look inside the hotel industry. In 1999, Simons and fellow-researcher Judi

McLean Parks interviewed employees at seventy-six Holiday Inn hotels in the United States and Canada. They surveyed more than seven thousand staff members. . .. They asked workers to score, on a scale of one to five, statements such as "My manager practices what he preaches." Those results allowed them to score each hotel on what Simons called "behavioral integrity."

Then, Simons and his team compared those results with the financial records of each Holiday Inn. "It turned out that trust had a huge impact on performance," Simons told me this week. Hotels with higher behavioral integrity scores were substantially more profitable than those with lower scores: an advantage of one-eighth of a point correlated to a 2.5 per cent advantage in revenues. Simons, who chronicled the hotel study and others in his 2008 book, "The Integrity Dividend," told me, "This is the single most powerful performance driver ever. It's more important than employee commitment and worker satisfaction.". . .

Evan Osnos, "How Much Trust Can Facebook Afford to Lose?" *New Yorker* 19 December 2019

Industry focus

Upending the received wisdom on branding

When Dollar Shave Club founder Michael Dubin launched his now famous YouTube video in 2012, no one imagined that it would cause earth-shaking tremors under razor behemoth Gillette. But it did. The tongue-in-cheek style video explaining the Club's many virtues had a seismic effect. The day it was released, the brand's website crashed from huge traffic. Within 48 hours, 12,000 orders were received. A few years later, Unilever bought the Club for $1 billion.

Most analyses of the Dollar Shave Club's success conclude that it accomplished this feat because of millennials' obsession with direct delivery, the founder's comedic flair, or its bargain basement prices. We say it was something much deeper. In fact, Dollar Shave Club rose to prominence because it employed the formula we have discovered to be the key to changing subconscious brand preference: the expansion of a brand's positive associations in customers' memories to the point that it becomes an automatic, involuntary choice.

. . .In fact, every brand has a host of interconnected associations – an ecosystem of multi-dimensional, accumulated memories that dictate which brand you instinctively favor and buy most often. The more positive associations your brand has, the healthier it is and the greater its growth. So, a dogmatic pursuit of a single brand concept may be detrimental to success.

The biggest key to the Dollar Shave Club's success was not that it communicated a single-minded idea, but rather that it rapidly stood for many, including good value, high quality, practicality, direct delivery, job creation and an understanding of what you need (and what you don't).

"Cracking the Code on Brand Growth," *Knowledge@Wharton*, 7 January 2019. http://knowledge.wharton.upenn.edu/article/cracking-code-brand-growth/

Toward a more nuanced view of network effects and business success

Recent battles for platform market share have shown that some technology platforms are better than others. More specifically, some platforms seem both more durable and more lucrative than others due to important characteristics of the platform and its users. . ..

These cases suggest that successful platform strategy is not just about the size or structure of the platform, but also the specific nature of interactions among users.

Traditionally, when we think of "network effects," we're focusing on the value we get from other users on a given platform. . .Yet while network effects exist across a wide spectrum of markets, they play out differently across different contexts and use cases. . ..

For example, for users of online auction sites, a consumer will almost certainly be drawn to the platform with the largest current user base, as the brunt of value comes from the ability to sell to or buy from a large network of users. Similarly, in deciding which video game console platform to join, a person may evaluate which platform currently seems most popular in the marketplace, as part of the fun is the opportunity to interact with other users. However, the same person might also give equal weight to criteria outside of the user base, such as the availability of a particular game title or the quality of graphics on the console.

These seemingly subtle differences in the strength or intensity of network effects have important implications for optimal platform strategies. At a basic level, the fundamental distinction in platform-based markets is no longer whether there are network effects or not, but rather the extent and type of network value that can be created and leveraged by platform companies.

David McIntyre, "Beyond a 'Winner-Takes-All' Strategy for Platforms," *Sloan Management Review* January 2019

Technology and disruption

Bricks, mortar, and big data

Some stores act as showrooms where consumers can have items shipped to their homes. Some stores are only

around for a short time and are more about gathering consumer data than selling inventory. Still others are creating products only after a consumer has opted to make a purchase, a practice known as "pretail."

"I think all of the major retailers are trying to figure it out," said Ari Lightman, a professor at Carnegie Mellon University's Heinz College. Lightman said that since so much spending has shifted to online, many retailers are rethinking how to use their existing space. Ideally, brick and mortar will be an extension of the online and mobile experience, a place where the retailer recognizes you and can anticipate what you want to buy next. . ..

The top U.S. retail chains reported a net increase of 4,000 store openings last year and are planning a further net increase of more than 5,500 new stores in 2018, according to Scott Clarke, Chief Digital Officer at Cognizant. Online retail may get more attention but will still only garner 20% of all transactions by 2025. . ..

The stores that dominate the next era will often be online-based and willing to take risks. Retailers will also look at their physical locations as sources of data that validate or disprove their hypotheses.

In the digital age, retail floor space is a black hole. For the most part, merchants have no idea what shoppers are looking at and which layouts and products they find most interesting. As Lightman notes, that's why the biggest e-commerce players have recently opened brick-and-mortar stores. "Data that you can collect in a physical location is different than data that you're collecting online, in terms of purchasing patterns," he said.

. . .Samsung's rentable pop-up solution, for instance, tracks customers from entrance to exit. The solution uses Samsung Nexshop software, its cloud-based digital store platform that uses real-time behavioral sensing, IP cameras, and Samsung mobile devices.

"Brick and Mortar 2.0: From Retail to Pretail" *Wired* November 2018, www.wired.com/brandlab/2018/11/brick-mortar-2-0-retail-pretail

Innovation myths and realities

Ever since Clayton Christensen published *The Innovator's Dilemma*, the concept of disruptive innovation has become the buzziest of buzzwords. The process he described, a seemingly marginal player upending industry incumbents by creating a shift in the basis of competition, is at once both seductive and terrifying.

The reality, however, is that true disruption is incredibly rare. It may happen to your industry once in a decade and even then it's usually not nearly as disruptive as pundits say it's going to be. We still have newspapers and many of them make money. Last year, sales of paper books surged, while those of e-books fell.

What makes disruptive innovation so dangerous is not that they create technologies that are necessarily better, but that they initiate a shift in business models, which makes it hard for incumbents to compete without killing their cash cows. So we should view disruptive innovation as a means to an end rather than an end in itself.

Consider Uber or AirBnB. Both launched with standard technologies, but disrupted more established firms because they undermined those business models. In effect, they did not invent new technologies to solve a problem, but found a new problem for existing technology to solve.

While disruptive innovation is widely praised, incremental innovation is often sneered at. Why merely tweak at the edges when you can do something really radical? Many innovation gurus proudly say that they don't even consider incremental innovation "real" innovation because it doesn't move the needle fast enough.

They often point to Steve Jobs and Apple as a prime example. When MP3 manufacturers were making incremental improvements in their devices, Jobs completely reimagined the possibilities with the iPod. When mobile phone companies were making mild improvements, he blew away the competition with the iPhone. How inspiring!

Yet what made Jobs's innovations possible were decades of incremental improvements in processors and other technologies. In a similar vein, what made Elon Musk's success at Tesla possible was decades of incremental improvements in lithium-ion batteries. Sure, everyone would rather hit home runs, but the game is more often won with singles and doubles.

Greg Satell, "Innovation 'Gurus' Love To Talk About These 4 Myths – None Of Them Are True," *Innovation Excellence* 24 December 2018, www.innovationexcellence.com/blog/2018/12/24/innovation-gurus-love-to-talk-about-these-4-myths-none-of-them-are-true/

A wider view

The case against stock buybacks

The Wall Street Journal reports Thursday that the shares Apple purchased are now worth $9 billion less than when they bought them. Wells Fargo and Citigroup also repurchased shares that have declined in value by billions.*

This usefully illustrates one of the problems with share repurchases: Companies have a nasty habit of purchasing their own stocks at the top of the market.

When companies buy back their stock, they increase its value by reducing the number of shares outstanding on the market. The

practice was effectively barred as a form of market manipulation until a rule change by Ronald Reagan's Securities and Exchange Commission in 1982. Since then, buybacks have gradually become the primary way corporations reward their investors, far outstripping dividends in most recent years.

Shareholders are generally just fine with this arrangement, since buybacks offer a nice jolt of instant financial gratification. You can either sell your shares and take a profit, or hold on to them and watch your net brokerage account fatten up without having to pay any capital gains taxes.

But buybacks also have their critics, a group that's unofficially led by William Lazonick, an economist at the University of Massachusetts – Lowell. One line of argument says that buybacks are both a symptom and a cause of a business culture in which CEOs strip their companies bare by lavishing cash upon shareholders instead of investing in their operations or workers – what Lazonick calls "the legalized looting of the U.S. industrial corporation." The idea is that buybacks both make it easier to send money back to shareholders instead of invest, and – unlike regular quarterly dividends – tend to reward short-term investors who want the stock to pop quickly so they can make a quick buck selling it. Because CEOs are rewarded partly based on whether they hit certain stock price targets and are often compensated largely in stock options, there are also incentives for them to spend more on buybacks than they might on normal dividends.

But then there's a second line of anti-buyback argument, which is basically that companies have a habit of doing them at the wrong time. In theory, companies ought to purchase their stock when it's undervalued – buy low, sell high. But some CEO's may be tempted to execute buybacks at times that maximize the value of their stock options, whether or not it's actually a good deal for the company.

Jordan Weissmann, "Apple Blew $9 Billion Buying Back Its Own Stock. There's a Lesson Here," *Slate* 27 December 2018

Corresponding author

Craig Henry can be contacted at: craig_henry@centurylink.net