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).

Airlines and their discontents

The Southwestern difference

Domestic airlines have been in the spotlight for the past few weeks based on their treatment of customers, starting with United Airlines booting passengers off a flight, followed by an American Airlines flight attendant getting into a spat with a mother, and Delta Airlines kicking off a family.

Though Southwest Airlines' customer service hasn't been the subject of viral videos caught on smartphones, it was cause for concern at the annual shareholders meeting. "In light of all the social media issues that have taken place over the last several weeks, do we have any specific initiatives in place to make sure we're not being smeared?" a shareholder asked Southwest CEO and Chairman Gary Kelly. Southwest Airlines gets the fewest complaints of any major carrier.

Kelly pointed to Southwest's reputation for customer service: "I don't think we're lumped in with the rest of the industry," Kelly told shareholders. "I was a little surprised that others didn't follow suit when we stopped the practice of overbooking."

"I am worried our broader society has become less and less civilized, so what we want to try to do at Southwest is stand for civility stand for hospitality and make that a key focus with all of our people every single day", he told shareholders.

Steven Totten, "Southwest Airlines CEO Gary Kelly on passenger turbulence: 'I am worried our broader society is less civilized'" *Phoenix Business Journal*, 18 May 2017

. . . and it's partly the customers' fault

As Seth Meyers noted while looking back at 40 years of government deregulation of the airline industry, people will just take whichever flight is the cheapest. "Let's be honest," Meyers said. "The main reason airline travel is so awful is that we the customers are okay with it being awful, as long as the ticket prices are low enough. If there was an airline that offered $50 round-trip tickets to any destination in America as long as the pilot could open-hand slap one passenger of his choosing in the face, that airline would never have an empty seat."

"Seth Meyers skillfully explains how airline deregulation led to the travel dystopia we all barely tolerate," *Fast* Company 3 May 2017 https://news.fastcompany.com/seth-meyers-skillfully-explains-how-airline-deregulation-led-to-the-travel-dystopia-we-all-barely-tolerate-4036523

Do the headlines miss the big picture?

The recent scandals that have plagued United States airlines didn't deter passengers from being happy overall to travel by air. A recent study showed that satisfaction

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among passengers with regards to air travel is on the rise.

According to a report from *CNN*, the J.D Power 2017 North America Airline Satisfaction Study shows that this will be the fifth year in a row that passengers are satisfied with American airlines. This is considered a record high, measuring 756 points on a scale of 1,000 – a 30-point increase from the 2016 results.

Michael Taylor, a travel practice lead at J.D Power, said that some of the factors that contributed to the increase in passenger satisfaction are "cheaper airfares, better on-time performance," and "an all-time low bump rate." He adds that passengers also liked that there are fewer "mishandled bags."

The company surveyed 11,000 people regarding their experiences in the past year with airlines and Taylor said that the passengers, on average, had a better experience than the previous year.

"Passengers Still Happy With US Airlines Despite Latest Incidents, Airlines Satisfaction Ratings Up Again," *Travelers Today*, 15 May 2017 www.travelerstoday.com/articles/47052/20170515/passengers-still-happy-with-us-airlines-despite-latest-incidents-airlines-satisfaction-ratings-up-again.htm

Of strategists and strategies

Transformation as a dual path strategy

Many firms that have tried to transform have failed. A common reason why is that leaders approach the change as one monolithic process, during which the old company becomes a new one. That doesn't work for a host of practical reasons. An organization that grew up producing newspapers, for instance, not only lacks key skills to build a digital content company but also might actively resist embracing the new in order to protect the business it knows and loves.

Success requires repositioning the core business while actively investing in the new growth business. . .. While Amazon has expanded its core retailing platform into new categories, such as food and streaming content, in parallel it has built the world's largest cloud computing enterprise. Amazon Web Services CEO Andy Jassy has been with the effort since it began as an internal challenge to scale IT infrastructure. Established as a separate division in 2006, AWS ultimately addressed a long-standing analyst complaint about Amazon – that its core was only barely profitable. Today AWS accounts for just 10% of Amazon's $150 billion in revenue, but generates close to $1 billion in quarterly operating profit.

German steel maker ThyssenKrupp, facing pricing pressure from Asian competitors, likewise embraced a dual transformation strategy. In 2011 the board selected as the new CEO one of its own members, Heinrich Hiesinger, a Siemens executive with experience supplying technology to many industries. From day one, Hiesinger began executing a plan for repositioning the declining core of steel manufacturing by divesting less profitable product lines, focusing on higher-margin custom manufacturing, and even opening 3D printing centers to fashion components such as parts for wind turbines. For new growth areas that now make up 47% of sales, it moved into industrial solutions and digital services, creating systems such as internet-connected elevators.

Scott Anthony, Evan I. Schwartz "What the Best Transformational Leaders Do," *Harvard Business Review* May 2017

Amazon's secret weapon: the market acid test

I believe that Amazon is the most defensible company on earth, and we haven't even begun to grasp the scale of its dominance over competitors. Amazon's lead will only grow over the coming decade, and I don't think there is much that any other retailer can do to stop it.

The reason is . . . that each piece of Amazon is being built with a service-oriented architecture, and Amazon is using that architecture to successively turn every single piece of the company into a separate platform – and thus opening each piece to outside competition.

Amazon has been systematically rebuilding each of its internal tools as an externally consumable service. A recent example is AWS's Amazon Connect – a self-service, cloud-based contact center platform that is based on the same technology used in Amazon's own call centers. Again, the "extra revenue" here is great – but the real value is in honing Amazon's internal tools.

If Amazon Connect is a complete commercial failure, Amazon's management will have a quantifiable indicator (revenue, or lack thereof) that suggests their internal tools are significantly lagging behind the competition. Amazon has replaced useless, time-intensive bureaucracy like internal surveys and audits with a feedback loop that generates cash when it works – and quickly identifies problems when it doesn't. They say that money earned is a reasonable approximation of the value you're creating for the world, and Amazon has figured out a way to measure its own value in dozens of previously invisible areas.

Zach Kanter, "Why Amazon is eating the world," *TechCrunch* 14 May 2017 https://techcrunch.com/2017/

05/14/why-amazon-is-eating-the-world/

Strategy, complexity and execution

Decide to cut out the extras and focus on what you can deliver and what the customer really wants. How many companies can truthfully say that they have made that decision? Herb Kelleher at Southwest Airlines can. Kelleher proved that differentiation is a CEO-level issue. "It is still the low-cost airline by which all others are judged," notes the Financial Times.

Yet, if you look at the basics, Southwest doesn't appear to have a lot going for it. Its product is, from a business person's perspective, plainly inferior. There is no first class, no seat assignment. This is the kind of thing that matters to harried business people anxious to finish a report on their laptop during the flight. Yet, Southwest still captures a reasonable share of business traffic. Its services are high frequency, punctual, and passengers have shorter ground journeys as Southwest flies to alternative airports. The value of this higher certainty and shorter overall door-to-door time is immeasurable to many business travellers.

Turnaround times tend to be quicker than those of competitors – often 20 minutes – because staff work together. There is a similar win-win in the company's use of a standardized fleet of Boeing 737s. A single plane means a single inventory of spare parts. It invented a new channel – low thrills, low cost, high service . . . Others have, inevitably, boarded the bandwagon. But, such strategic clarity is easier said than done. The lesson from Southwest is to keep it simple. Strategy needs to be compellingly straightforward in order for it to be understood and executed effectively.

Stuart Crainer and Des Dearlove, "Simply Strategy," *Thinker 50 blog*, 12 April 2017 http://thinkers50.com/blog/simply-strategy/

How dominant brands fail

Few brands have imagined their worlds as completely as J. Crew. J. Crew exercised an unparalleled influence over the way affluent Americans dressed, especially at work . . . [But] sales at J. Crew have fallen for two years. The company is two billion dollars in debt, putting it in danger of bankruptcy.. . .

J. Crew has faced fundamental problems beyond its control. Earlier this year, in an article for the magazine *The Business of Fashion*, Chantal Fernandez explained why "America's most beloved mall brands" – J. Crew, Gap, The Limited, and Abercrombie & Fitch – are all in crisis. (The Limited filed for Chapter 11 in January, and has closed all of its stores.) The short answer is the Internet. Millennials tend to spend money on gadgets, rather than clothes, and rarely go to the mall; savvier customers have learned to wait for coupon codes. The middle of the market has disappeared: while aimless, open-minded shoppers are happy to haunt Zara and H & M, discerning ones turn every purchase into a research project, gravitating toward Web-centric brands such as the California fashion startups Reformation and Everlane, which are more transparent about sizing and manufacturing. Then there is Amazon, which accounts, by itself, for more than half of all growth in online retail, according to the market-research company Slice Intelligence. By allowing customers to search across brands, it devalues branding in general, reducing the potency of the world-building in which companies like J. Crew have invested so much.

Joshua Rothman, "Why J. Crew's Vision of Preppy America Failed," *The New Yorker* 3 May 2017

How the best CEOs take charge

In our earlier research, we found that on average, CEOs who are hired externally tend to pull more strategic levers than those who come from within and outperform their internal counterparts. Our research on exceptional CEOs reinforced this finding: these CEOs are twice as likely to have been hired from outside the company as the average CEO in our data set and roughly 1.5 times as likely to have been external hires as the other top-quintile CEOs.

Still, 55 percent of the exceptional CEOs were internal hires. Clearly, insiders can move aggressively and achieve outstanding results. Doing so often means cultivating an outsider's point of view to challenge the company's culture with greater objectivity and overcome the organizational inertia that sometimes limits an insider's span of action.

Strategic actions

The findings offered additional insights on how CEOs may gain a clear-eyed perspective for action. CEO's joining low-performing companies derived the biggest benefits from conducting a strategic review. Our exceptional CEOs did not join struggling companies in disproportionate numbers, but they were significantly (about 60 percent) more likely to conduct a strategic review in their first two years on the job versus the average CEO in our sample.

Informed by this view of the company's past – and potential future – performance, this elite group was bolder than other top-quintile CEOs, far surpassing them in the average number of strategic moves they made in their first year. Changing strategic direction typically requires freeing up resources, often in part by cutting costs in lower-priority parts of the company. While cost-reduction programs are, according to our earlier research, a no-regrets move for all CEOs, the exceptional CEOs were significantly more likely to launch such initiatives than the average CEO, thereby building strategic momentum.

Michael Birshan, Thomas Meakin, and Kurt Strovink, "What makes a CEO 'exceptional'?" *McKinsey Quarterly* April 2017

Culture and innovation

Becoming digital

There are myriad ways to achieve a digital culture, and the path each company chooses will be unique. . .. Here we describe some that reinforce three particular traits of high-performing digital companies – customer-centricity, collaboration, and comfort with (calculated) risk-taking.

Customer-centricity: Customer-centric companies expand the framework for decision making, putting the customer's point of view among their top considerations. A question on the table should always be, "How does this create value for the customer?"

At Amazon, for example, internal presentations addressing business problems are known as "working backwards documents." They start by identifying how a proposed solution would help improve the customer experience, be it a better price, improvement in service, or increased selection. Only then does the presenter work backwards to present the business case. It is a mind-set that some insurance incumbents are endeavoring to enforce. . . ..

Collaboration: Collaboration is key not only because it improves customer understanding and decision making, but also because it does so quickly. Our research shows that more than 70 percent of insurers take from six months to more than a year to move a digital initiative from idea to implementation. That is too slow. Scott Simony, head of industry at Google, explains why. "Insurance is a highly regulated industry and it is not easy to move quickly – but the fact is consumers are moving at exceptional rates. So I'd say that the companies that will stand out are the ones that are going to find ways to move a bit faster, at the pace of the people they're insuring."

The way to achieve this pace and cut development time dramatically is to set up small, cross-functional teams that take an agile approach to their work.

Risk taking: On the subject of experimentation, the inventor Thomas Edison is reputed to have said, "I haven't failed, I've just found 10,000 ways that won't work." In a digital age, insurers need the same mind-set. . . .. United Services Automobile Association, a US-based insurer, now tests some 8,000 ideas each year, generating roughly 250 patents. Yet a culture that understands the value of calculated risk-taking is one that also accepts failure, and learns from setbacks. Some organizations openly celebrate the lessons learned in order to encourage their employees to take risks.

Tanguy Catlin and Julie Goran, "Building momentum for cultural change," McKinsey *Insights*

www.mckinsey.com/industries/financial-services/our-insights/building-momentum-for-cultural-change

Innovation: the ecosystem defeats the hierarchy

Once you start thinking in terms of networks rather than hierarchies, it becomes clear that we must change how we do things; and not just within organizations, but also in how we approach a competitive marketplace. As it turns out, firms that seek to strengthen industrial networks have a big advantage over those that seek to preserve hierarchies.

To see what I mean, let's look at the Route 128 corridor outside Boston. In the 1980's, with firms like DEC and Apollo Computer, as well as world-class research universities like MIT and Harvard, it seemed poised to dominate the technology industry. Yet by the 1990's, it was clear that the baton had passed to Silicon Valley.

In her book *Regional Advantage*, AnnaLee Saxenian explains why. While DEC and Apollo were vertically integrated firms that bound employees through non-compete contracts, their Silicon Valley competitors such as Hewlett-Packard and Sun Microsystems embraced open technologies, built alliances and allowed their people to job hop.

From the standpoint of a hierarchy, the strategies of the Route 128 companies made a lot of sense. They were protecting proprietary technology and building a stable, high-skilled workforce. However, from a network perspective, they effectively disabled valuable linkages and were restricting the information flows that make innovation possible.

What Saxenian found in Silicon Valley is not specific to the technology industry, but can be seen just about anywhere. Studies have found similar patterns in the German auto industry, among currency traders and even in Broadway plays. Small, tight clusters of people, loosely connected through more distant ties, can dramatically increase information flow and enhance innovation.

Greg Satell, "Why We Must Change Our Mental Models from Hierarchies to Networks," *Innovation Excellence* 20 April 2017

http://innovationexcellence.com/blog/2017/04/20/why-we-must-change-our-mental-models-from-hierarchies-to-networks/

A wider perspective

Anti-trust in the era of Big Data

A new commodity spawns a lucrative, fast-growing industry, prompting antitrust regulators to step in to restrain those who control its flow. A century ago, the resource in question was oil. Now similar concerns are being raised by the giants that deal in data, the oil of the digital era. These titans – Alphabet (Google's parent company), Amazon, Apple, Facebook and Microsoft – look unstoppable. They are the five most valuable listed firms in the world. Amazon captures half of all dollars spent online in America. Google and Facebook accounted for almost all the revenue growth in digital advertising in America last year. . ..

The giants' success has benefited consumers. Few want to live without Google's search engine, Amazon's one-day delivery or Facebook's newsfeed. Nor do these firms raise the alarm when standard antitrust tests are applied. Far from gouging consumers, many of their services are free (users pay, in effect, by handing over yet more data). Take account of offline rivals, and their market shares look less worrying. And the emergence of upstarts like Snapchat suggests that new entrants can still make waves.

But there is cause for concern. Internet companies' control of data gives them enormous power. Old ways of thinking about competition, devised in the era of oil, look outdated in what has come to be called the "data economy" A new approach is needed.

Quantity has a quality all its own

What has changed? Smartphones and the internet have made data abundant, ubiquitous and far more valuable. . ..This abundance of data changes the nature of competition. Technology giants have always benefited from network effects: the more users Facebook signs up, the more attractive signing up becomes for others. With data there are extra network effects. By collecting more data, a firm has more scope to improve its products, which attracts more users, generating even more data, and so on. The more data Tesla gathers from its self-driving cars, the better it can make them at driving themselves – part of the reason the firm, which sold only 25,000 cars in the first quarter, is now worth more than GM, which sold 2.3 million. Vast pools of data can thus act as protective moats.

"Regulating the internet giants," *Economist* 6 May 2017

Economics: explaining the irrational

Prevailing economic theory states that financial markets behave in a rational and efficient way, but a new book from MIT Sloan Finance Professor Andrew Lo suggests that the principles of evolutionary biology offer a more complete explanation. After all, a crowd of people making a bank run during an economic panic doesn't look all that different than a herd of gazelles surrounding the savannah's lone watering hole. . ..

Q: What are the limits to the efficient markets hypothesis?

Professor Lo: The theory is not wrong, it's just incomplete.. . .We need a hypothesis to explain abnormal times, and to build alternatives and other financial models.

Financial markets are more like complex ecosystems, with different species that are competing, evolving, innovating, and adapting. The rules of biology, which govern living organisms, are more relevant for understanding market dynamics than the rules of physics, which govern inanimate objects. The existing paradigm doesn't capture the full picture – especially the financial crisis and the aftermath.

"Why Financial Markets Behave like Living Organisms" MIT Sloan Business School, 26 April 2017
http://mitsloan.mit.edu/newsroom/articles/why-financial-markets-behave-like-living-organisms/

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