**Chapter 2: Place the Customer at the Epicenter of the Business Model**

**Overview**

*From the start, our entire business—from design to manufacturing to sales—was oriented around listening to the customer.*

—MICHAEL DELL, founder & CEO, Dell Computer

*Being in touch with customer needs is ... always important. But perhaps more important when needs are changing—and generally that occurs during an economic downturn—you want to understand those better than any other company.*

—MICHAEL DELL

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**What Would Michael Dell Do?**

In the seat of the CEO: You are the CEO of a $30 million company that produces consumer products for the home. The company, founded by your father in the 1960s, was a pioneer in producing air-purifying products for home use. Two years ago your father retired, turning the business over to you. Your first moves involved modernizing the company by installing a state-of-the-art computer system (including a company web site) for both backroom operations and order procurement. As a result, today more than half the company's orders are processed via the Internet.

All went smoothly for the first 6 months. After that, though, things went downhill. Although the company's first products were air humidifiers and dehumidifiers, the firm's number one product for the past 4 years has been an airpurifier (the AirPure 4000). When the company first introduced the product, it was an instant hit. But new competitors have entered the market and are practically destroying you. If things continue at this pace, within 6 months you will have less than a quarter of the market share you enjoyed only a year ago. To make matters worse, you have a growing inventory problem, since demand has fallen so dramatically. If things don't turn around, you will have to write off more than a million dollars in excess inventory.

Since the product has not changed, you cannot understand what is going on. To counter the new competition, you followed your father's advice and launched a new marketing campaign. This effort included dozens of print and radio advertisements, as well as a huge promotional mailing of fliers offering unbelievable discounts. Already, the verdict on that campaign is clear: The new advertising and direct-mail campaigns were expensive, and they didn't work.

You're stumped. Your product is priced competitively and gets high grades on quality surveys. It even comes with a 100 percent guarantee. What do you do now? Is there any way to turn things around? What moves might you make to stop the plunge in market share of your number one product?

What would Michael Dell do?

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When Michael Dell was 12, he issued his first product catalog. It was called "Dell's Stamps," and he advertised it in a local trade journal. By going directly to the ultimate user, the young entrepreneur learned his first lesson about developing a direct relationship with the customer.

After spending a good part of his high school years fiddling with computers and hanging out at the local Radio Shack, Dell—like lots of other 19-year-olds—went off to college. But that's where his life stopped following the common path. Within months, Dell had turned his dorm room into a personal-computer laboratory. Before long, he was selling personal computers. In 1984, he made it official, registering his business as Dell Computer Corporation.

Just 4 years later, the company went public, raising $30 million in its initial public offering. At age 27, Michael Dell was the youngest CEO of a *Fortune* 500 company. Dell Computer Corporation emerged as a true phenomenon. It was the number one stock of the 1990s, soaring almost 90,000 percent. According to Michael Dell, the key to his company's success was the customer:

*From the start, our entire business—from design to manufacturing to sales—was oriented around listening to the customer, responding to the customer, and delivering what the customer wanted.*

While Dell's words sound almost like platitudes in today's competitive world, at that time building an entire business by placing the customer at the epicenter was anything but common. Dell's direct model is based on a one-to-one relationship between the company and the customer—there are no intermediaries, no middlemen. (On one occasion, Dell experimented with an indirect model—a product sold through computer stores—but the effort failed, and Dell vowed never again to waver from the company's original vision.) This was a case of philosophy converging with necessity:

*We started the company by building to the customer's order. And interestingly enough, we didn't do it because we saw some massive paradigm in the future. Basically, we just didn't have any capital [to mass-produce].*

Like other great success stories, Dell's direct model of "mass customization" was not born of any desire to revolutionize an industry. Instead, it was forged through a "bottom-up" strategy based on customers' needs and preferences. The lesson is clear: Managers hoping to create successful brands cannot do it by imposing their own views (or, worse, the management committee's views!) on the marketplace. Somehow, someway, there needs to be a mechanism in place whereby the company learns to make the products that its target customers actually want.

Dell says that while other companies *guess* what their customers want, his company *knows*. Through hundreds of thousands of calls, emails, and faxes from customers, the company gets vital information about the features that people will pay for in a computer and what capabilities they might be looking for (and, again, paying for) in the future. And this information is closely tied to the company's manufacturing strategy: Unlike its competitors, Dell does not even build the product until *after* the order comes in. In addition to heading off inventory backlogs and cash flow problems, this method has the advantage of ensuring that customers' needs are met *precisely*. In the mercilessly competitive computer industry, that knowledge advantage affords the company a decisive edge:

*As a natural extension of customer contact, the direct model allows us to take the pulse of whatever market we move into and provide the right technology for the right customers. The direct model has become the backbone of our company and the greatest tool in its growth. It all evolved from the basic idea of eliminating the middleman.*

With no middleman intervening, the company is able to get a constant flow of unfiltered information from its customer base. The lesson of the direct model is clear: To duplicate Dell's success, other companies must find ways to develop a relationship with the end users of their product, even if their business models do not resemble Dell's.

Here are three things that managers can do to cultivate closer relationships with end users while also garnering key information and product feedback:

* **SPEND MORE TIME WITH CUSTOMERS.** Whether you are a CEO, a director of sales, or an account manager, there is simply no substitute for frequent face-to-face meetings with customers. Many top CEOs report that they spend upwards of 50 percent of their time with customers, and they add that this is often the most important part of their day.
* **INVITE KEY CUSTOMERS IN TO SPEAK TO KEY UNITS.** An alternative to visiting customers is having customers visit you. Create a forum where they can speak with your key people, either publicly or in smaller groups. This will not only provide key information and insights, but also send an important message to those customers.
* **USE THE INTERNET AND OTHER NONINTERMEDIATED MEANS TO CREATE AN ONGOING CUSTOMER RELATIONSHIP.** While technology should not be used as the sole means of staying in contact with customers, sending email "blasts" to customers informing them of new product updates, etc., can be effective. Make sure, however, that the communication is not strictly one-way. Getting customers' feedback is a crucial step in the process.

Delivering exactly what the customer wants is one of the ingredients of Dell's success. Price is the other. Dell became successful not only by fulfilling customer needs with high-quality products, but also by doing so at rock-bottom prices. With no distributors requiring their own margin, Dell is able to pass substantial savings on to its customers:

*We're in the business of dramatically reducing the cost of distributing technology. To do that, we are going to get closer and closer to our suppliers and our customers.*

This is an important lesson for companies that operate in ultra-competitive, price-sensitive markets. Whenever such an organization achieves some meaningful cost advantage, it does best when it passes at least a significant percentage of those savings on to consumers. This does not mean that a company should not maintain healthy profit margins, but squeezing every penny of profit out of a transaction may ultimately lead an otherwise healthy company to falter.

## Accelerating Market Share in *Bad* Times

One test of a corporate strategy is to see how well it performs in bad times. By that measure, Dell's direct distribution model has proved itself to be a solid success. In the recession that gripped the computer industry in the early 2000s, Dell continued to grow at a healthy rate. Despite industry retrenchment and consolidation, Dell continued to enjoy—in Michael Dell's phrase—"hefty profits." Why?

*It goes back to the structural cost advantage, which is very much at the root of our business model in terms of having a more efficient distribution. Eliminating dealers, middlemen, inventories; the Internet; all the efficiencies that we have been working so hard to drive have kind of kicked in the afterburners in the last 12 months.*

Additional evidence that this was a successful strategy is not hard to find. During the technology bust of 2001, for example, Dell cut the prices of its computers. This prompted at least one competitor to criticize Dell for allegedly igniting a price war, which this competitor described as a "dumb" move. Michael Dell shrugged off the salvo, responding, "If you don't have the real ability to differentiate, a price war is dumb." According to Dell, that was exactly the position his competitor was in—and it was no surprise, he added, that his rival was in the process of making a "very substantial exit" from that market.

Nor did Michael Dell express much concern about "the most rapid market consolidation ever" in his relatively young industry. Rather than threatening Dell's competitive position, all that consolidation and market churning actually *enhanced* Dell's competitive position:

*Essentially we have now taken on the number one share position on a worldwide basis. We have seen about a seven-point swing in market share in the United States on a year-by-year basis. So officially [rapid market consolidation] has accelerated in about four quarters what it normally has taken us about nine or ten quarters to do, in terms of a shift in market share.*

When consumers—companies and individuals alike—begin tightening their belts, the odds go up that the best product at the best price will win the day. So the company's countercyclical increase in market share during hard times grew directly out of its ability to gauge demand, produce a superior product, and ultimately deliver better value than its rivals.

The real takeaway from this episode is probably self-evident. The pieces of the puzzle have to fit together in a mutually reinforcing way. Unless your firm is able to achieve genuine differentiation—through quality of product, a better price, superior service, ease of use, etc.—then price wars alone are unlikely to address your firm's competitive woes. On the other hand, if you are able to truly differentiate your product or service and then deliver it at a lower (and profitable) price, you can sustain a genuine competitive advantage.

## The "Demand Side" of the Dell Strategy

Obviously, the direct model is an unusual approach to distribution that wouldn't meet the needs of most businesses. Still, other organizations can incorporate vital elements of Dell's model into their own operations. For example, Dell stresses that during tough economic times, it is especially important to understand and anticipate customer demand—a crucial element of Dell's strategic advantage. The problem, says Dell, is that most companies don't really know how to accurately forecast demand:

*First, if you just step back from whether it's direct or indirect and you just look at the way business works ... it's based on the assumption that you don't really know when and how the demand is going to occur.*

Although gauging customer demand became somewhat easier for some companies once Internet technology transformed assumptions and business models, it continues to be a difficult undertaking for most companies. Again, the evidence abounds: If forecasting demand were easy, the business news would include far fewer stories of excess inventory and multibillion-dollar write-offs. [1]

Nimbleness is a critical ingredient. Dell says it is imperative that companies "be prepared for all possible ... instances of demand whenever and wherever they may occur." Of course, that's relatively easy for a company like Dell, with its "made to order" mentality and model. But Michael Dell argues that, to a large extent, the key to enhancing productivity and profitability for companies without a direct model is the correct use of technology, and in particular, the Internet.

He admits that the Internet was tailor-made for his company, allowing the firm to gauge demand more accurately than ever before. In early 2002, Dell was raking in between $60 and $70 million of sales over the Internet on a *daily* basis, and Dell is hoping to boost this number substantially within a couple of years. Again, the way he plans to get there has implications for many kinds of businesses:

*There are goals to have 100 percent of our sales on line ... that's the only correct goal for us as far as we're concerned...so we keep* *driving in that direction .... Evolution follows a couple of different paths. One is machine-to-machine communication.*

Another part of the formula is *automation*, especially in the order process. The goal is to get machines talking to machines. A machine at a client company places an order with a machine at Dell. That triggers the entire made-to-order process, which then becomes more or less automatic. "Over 90 percent of our supply-chain transactions are machine-to-machine transactions," Dell says with obvious satisfaction. Of course, "you have to put some sort of human framework in there. But if all transactions were non-Internet individual purchases [that is, individual orders placed over the phone], the expense would be just enormous."

Based on Michael Dell's experience, there are several things that any organization should keep in mind in order to maximize sales opportunities and keep costs down:

* **FIND BETTER WAYS TO GAUGE DEMAND.** The basis of the Dell model is an incredibly firm grasp on demand. Other companies, regardless of their size, can help their own cause by doing a better job of forecasting demand and, in Michael Dell's words, being "prepared for all possible instances of demand, whenever and wherever they may occur."
* **MOVE AS MUCH BUSINESS AS POSSIBLE ONTO THE INTERNET, AND INCREASE THE PERCENTAGE OF "MACHINE-TO-MACHINE" BUSINESS.** Dell may never reach his goal of garnering 100 percent of his sales online. But remember that 90 percent of his supply-chain transactions are machine-to-machine. This may be unrealistic for many companies, but moving in this direction can lower transaction costs, while freeing up employees to get more involved with knowledge-based activities that can help the company in other ways.

[1]The great NASDAQ meltdown of 2000–2002 occurred in part because companies built up excessive inventories on the assumption that the voracious demand for technology of the late 1990s would continue into the new century. When demand failed to materialize, companies missed earnings and sales targets by wide margins, and hundreds of billions of dollars disappeared from the stock market as the vast majority of technology stocks plummeted. Dell was not immune; its market capitalization also dropped. In essence, the market reevaluated the true worth of all technology stocks. This took the air out of the NASDAQ bubble, which was caused, in large part, by the exaggerated valuation of Internet stocks.

## Involve Customers *First* to Avoid Disasters

Even great companies make mistakes, and Michael Dell admits that his company is no exception. In 1989, Dell introduced a new family of products, code-named Olympic. Olympic was a line of desktop and workstation computers that were able to perform a wide array of tasks. The product introduction—Dell's biggest ever—turned out to be the company's biggest-ever flop. While the products were impressive from a technology standpoint, customers just didn't *need* such complex products with that much technological firepower. The failure of Olympic delivered a powerful lesson to the relatively young company, and it was one that Michael Dell would not soon forget:

*We had gone ahead and created a product that was, for all intents and purposes, technology for technology's sake, rather than technology for the customer's sake. If we had consulted our customers first about what they needed ... we could have saved ourselves a lot of aggravation.*

Michael Dell urges all companies to involve their customers earlier in the process. He feels that failed products are often the result of companies' launching new products without sufficient knowledge of their customers. He believes that it is incumbent upon organizations to provide useful information up and down the supply chain. He warns that companies that ignore this advice do so at their own peril:

*If your business isn't enabled by customers and suppliers having more information and being able to use it, you're probably already in trouble. The Internet is like a weapon sitting on a table ready to be picked up by either you or your competitors.*

## Involve *Everyone* in Creating Value for the Customer

The company obviously gleaned important lessons from its mistake. After Olympic, Dell started talking about "relevant technology," meaning only those technologies that are important to its customers. But Olympic also taught Michael Dell that just about everyone needs to be involved in serving customers—even engineers and technicians. It would have been easy to blame Olympic on the engineers, but Michael Dell felt that it wasn't their fault. Why? Because, for structural reasons, *they didn't know the company's* *customers*. What to do? The company began to encourage its engineers to spend more time with sales teams and get more involved in product planning. While some resisted, many welcomed the chance to play a more prominent role in the entire process:

*Teaching bright technical people to think beyond the technology and in terms of what people really want—and what makes for good* *business—isn't always easy. It can take time, but it can best be done by immersing them in the buying process and involving them in the strategy and logic that go in deciding what creates value for customers.*

The lessons Michael Dell learned from the failure of Olympic are relevant to the vast majority of organizations, and are worth noting here:

* **ORGANIZATIONS AND PRODUCT MANAGERS CANNOT, AND SHOULD NOT, IMPOSE THEIR VIEWS ON THE MARKETPLACE.** Don't assume that just because you make a product—even one that you and your co-managers believe is spectacular—it will sell. Customers will always have the final say, and customers have a way of surprising you.
* **INVOLVE CUSTOMERS AS EARLY IN THE PROCESS AS POSSIBLE.** If you ignore customers during the product-development process, you do so at your own peril. Involve customers as early as possible—and then *keep* them involved in the process.
* **GET AS MANY PEOPLE AS POSSIBLE INSIDE THE COMPANY INVOLVED IN SATISFYING CUSTOMERS.** Silos in organizations tend to develop over time. Functional areas like R&D and engineering tend to get insulated and isolated over time. The challenge for management is to involve as many individuals and departments as possible in determining the preferences and needs of core customers.

**Structure the Organization Around the Customer (How Dell Acts Small While Getting Bigger)**

In the late 1990s, Michael Dell took customer focus one step further by *structuring the organization around the customer*. He had become convinced that organizing by product alone would not ensure the high-quality customer relationships he hoped to achieve. (If the company organizes only by product, says Dell, there is an assumption that the leaders of those divisions know everything about their target customers—not only domestically, but also around the globe.) Instead, he decided to segment by *both* product and customer. This way, product teams would have the information they need in order to satisfy specific customer segments.

First, Dell created several distinct sales organizations, each focused on serving the needs of a particular customer segment. As the company got bigger, he split the segments even further:

* Large and medium-sized companies
* Educational and government organizations
* Small businesses and consumers

This degree of segmentation not only reinforces Dell's commitment to satisfying customer's needs, but also ensures that the accountability for satisfying customers is shared throughout Dell's ranks. But Dell didn't stop there. He further extended the customer segmentation model, creating complete business units organized around different customer types, each with its own sales, service, finance, IT, technical support, and manufacturing pieces. He credits the company's segmentation with supporting and reinforcing the direct approach:

*Segmentation takes the closed feedback loop and makes it even smaller and more intimate. It refines our relationship with our customers.*

As the company has grown, it has spun off some of these groups focused on customer segments into de facto small companies, each with its own organization team. That model enables Dell—today a huge company by almost any measure—to act with the spirit and responsiveness of dozens of small companies. Without a doubt, it gives Dell a decided edge in the marketplace.

What can other companies learn from the way Dell is organized? Here are some ideas that can prove useful in almost any organization:

* **ORGANIZE AROUND THE CUSTOMER.** The key is to get as many people in your organization as possible involved in satisfying the customer. Review the organizational chart with a fresh eye, and determine whether the way you are organized achieves this important goal.
* **IF POSSIBLE, SEGMENT THE FIRM BY BOTH PRODUCT AND CUSTOMER, OR CREATE CROSS-FUNCTIONAL TEAMS THAT CAN DO SO.** The key is to make sure that as many people in your organization as possible *know the* *customers*—their needs, desires, preferences, and so on. If you can't organize the company in that manner for some reason, consider creating ad hoc cross-functional teams or task forces designed around specific customer groups or clusters.
* **GET YOUR COMPANY TO MOVE WITH THE RESPONSIVENESS OF A SMALL COMPANY.** Most large companies eventually get mired in bureaucracy, and when they do, it is the customer who suffers. One key to winning in the marketplace is to make sure that your firm is streamlined in a way that does not penalize the customer for your mistakes. In other words, get the people in your organization to adopt a small-company mind-set. Get them to move faster, respond more quickly, and anticipate customer needs more effectively. Get them to be more proactive, so that they won't have to play catchup later.

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**Don't Forget about *Potential* Customers**

Peter Drucker, the ageless management author, makes a critical point about customers that is worth repeating here. He urges companies not to forget about the customers who don't currently use their products—in other words, those who have the *potential* to become customers. After all, says Drucker, even the best companies don't have a lock on the whole market, and far too many companies forget about this crucial constituency.

As an example of what can go wrong when a business forgets about potential customers, Drucker cites a case far removed from Dell's world of computers—the fall of the big-city department stores:

*Marketing starts with all customers in the market rather than with our customers. Even a powerful business rarely has a market share much larger than 30 percent. This means that 70 percent of the customers buy from someone else. Yet most businesses or industries pay no more attention to this 70 percent than the department stores did.*

Drucker implores managers to pay attention to the inherent changes in demography that may transform the markets in which their business operates. These changes should be viewed not as threats, but as sources of new business, for the shifting environment changes the customer landscape of many businesses. He also points out that customers define markets, and that potential customers offer organizations the best opportunities with the least amount of risk. But market knowledge can go only so far in helping a business to snare new customers. It is not knowledge, cautions Drucker, but *actions* that will ultimately determine a company's success.

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**What Would Michael Dell Do?**

Let's return now to the scenario at the beginning of the chapter—in which, you'll recall, you are the CEO of a $30 million consumer-products manufacturer that has fallen on hard times. I hope that, based on a review of how Michael Dell has built his company, the answer to the question posed is reasonably obvious.

First, you'll have to agree that it is unlikely that Michael Dell would have gotten into such a jam. Why? Because once the company's web site was constructed—remember, you launched it shortly after taking over—he would have used the site to garner as much information as possible from his customers.

Your major problem is that you don't know *why* your number one product is hemorrhaging market share. Let's back up 18 months, to when the AirPure 4000 started to lose market share. Faced with that situation, Michael Dell would have used all means possible to find out why. He would probably have arranged for a customer questionnaire to be prominently featured on the web site (perhaps rewarding respondents with cash-off coupons). Had he done so, he most likely would have discovered the key to the entire problem: The AirPure 4000 was not designed to clean mold spores from the air! During the last 2 years, air allergens and mold spores have become your customers' chief concern, but you had no idea about this. Your top competitor has been taking away your core customers by featuring this product benefit.

Next, he would have found a way to hold off producing the product until the order came in. Obviously, this would have prevented the inventory backlog that is adding to the company's red ink. Perhaps he would have found a way to let customers choose the features that were most important to them. For example, perhaps some buyers of the AirPure 4000 were interested only in cleaning pet dander from the air, while others were interested in eliminating smoke.

And finally, he would have worked to increase the percentage of sales that come in via the Internet. Remember, Michael Dell's own goal is to secure 100 percent of the company's sales from the Web. (Those sales save the company money!) Right now, you are at 50 percent—not bad by most measures, but probably a long way from where you could be if you offered additional incentives for buyers.

## Assessing Your CEO Quotient

1. How effectively has your organization incorporated the needs and desires of your customers into the everyday running of your business?
2. How often do senior managers of your company meet with customers?
3. Do you feel that your organization gets sufficient feedback directly from your customers? How could you learn more about your customers' specific needs and desires as they relate to your product or service?
4. Is your organization's product-development model built around the customer? If not, think about how you can involve the customer earlier on in the development model.
5. What does your organization do to ensure that the technical teams (e.g., engineers, scientists, computer scientists) better understand the needs of the customers? Do they participate in the product-development process?
6. Has not involving the customer in your strategic planning and/or product development led to product failures? Could those blunders been avoided?
7. What are you doing to learn more about potential customers? How can increased customer knowledge turn potential customers into actual customers?

## More Lessons From the CEO

The Dell direct model is a complex business model that is obviously difficult to duplicate. Still, there are many ways in which your company can become more customer-focused. Here are a few ideas.

1. **MAKE A COMMITMENT TO LEARN MORE ABOUT YOUR CUSTOMERS.** Meet with key customers as often as it makes sense to do so, and make sure that all the people in your division do the same. Incorporate this sort of behavior into the regular culture of the business.
2. **WHEN MEETING WITH CUSTOMERS, MAKE SURE TO USE THE TIME WISELY BY GETTING SPECIFIC FEEDBACK ABOUT THEIR NEEDS, PREFERENCES, ETC.** Prepare for the meeting ahead of time by writing a short list of questions. (Remember: Customers will appreciate your interest, and they will appreciate it even more if you respect their time.)
3. **IF YOUR COMPANY DOESN'T ALREADY DO SO, PLAN ON CONDUCTING AT LEAST ONE CUSTOMER SURVEY EACH YEAR IN AN AREA THAT WOULD BENEFIT FROM INCREASED CUSTOMER KNOWLEDGE.** Once the results are in, make sure that you use the information by incorporating this feedback into the appropriate parts of the company. If your company uses the Internet to elicit company feedback, and if you're confident that this approach paints a reasonably accurate picture, then an annual survey may not be necessary.
4. **KEEPING THE DELL MODEL IN MIND, TARGET AREAS THAT WOULD MOST BENEFIT FROM INCREASED CUSTOMER INVOLVEMENT.** Some examples are strategic planning, product development, and promotional planning. Focus on key products, key customer groups, and so on. Also, keeping Drucker's ideas in mind, you may want to devote resources to potential customers and customer groups in order to increase your market share in new areas.
5. **ONCE YOU DECIDE WHICH AREAS YOU WANT TO FOCUS ON, WRITE A BRIEF PLAN INCORPORATING YOUR IDEAS FOR INCREASING CUSTOMER INVOLVEMENT.** Share it with your manager and appropriate colleagues, and secure their commitment to executing the plan within a specified time frame.

# Chapter 5: Prepare the Organization for *Drastic* Change

## Overview

*Most companies don't die because they are wrong; most die because they don't commit themselves. They fritter away their momentum and their valuable resources while attempting to make a decision. The greater danger is in standing still.*

—ANDY GROVE, cofounder and former CEO, Intel

*I submit that all businesses, whether they are bricks origin or clicks origin, are today at a point of choice, such as a strategic inflection point and, depending on their embrace of the two elements.... They'll either write new competitive strategies or they'll be marginalized.*

—ANDY GROVE

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**What Would Andy Grove Do?**

In the seat of the CEO: You are the CEO of a midsized, publicly traded pharmaceutical maker based in the Midwest. While your firm produces more than 100 different drugs, it has become increasingly dependent on its runaway best-selling product, one of the top cholesterol-reducing drugs in the industry.

The drug, which last year enjoyed a 60 percent market share, is responsible for 80 percent of the company's profits. However, its share has fallen dramatically, as has investor confidence in your firm. The firm's stock price has plummeted approximately 50 percent from its recent highs, and with the stock slide, you have gone from hero to goat. Half a dozen Wall Street analysts have downgraded your stock, and the board is all over you, demanding to know what you intend to do about it.

What's behind the precipitous drop in market share? A supplement manufacturer (a company that was not even on your competitive radar screen) has produced a new supplement that has threatened your hold on the market. The new supplement contains antioxidants, garlic, ginger, and other curative herbs, and it appears to reduce cholesterol in middle-aged men and women without the side effects of drugs. To make matters worse, the retail price of the supplement is less than half the price of your fading star, and it requires no prescription.

Although you had heard talk about the therapeutic effects of herbs in reducing cholesterol, your key researchers advised you not to "concern yourself" with such alternatives. They agreed (as did your key managers) that garlic, supplements, and other such "mumbo jumbo" were nonsense, and would never catch on as viable competitors. The sole dissenting voice in your firm was a junior researcher, but no one took him seriously enough to listen to him, despite his MIT degree.

The judgment of your management team appeared to be correct—until about 6 months ago, that is, when the supplement started to steal market share from your drug. Thanks to a two-page story in a national magazine (as well as Internet chat rooms that talked up the new "medical breakthrough"), the supplement took off. After the competing product reduced your market share by a third, you did some research of your own, and you discovered that, incredibly, there are more than 10,000 web sites devoted to cholesterol and its effect on health (including tips for reducing cholesterol, drug therapy, etc.).

Your new-product pipeline is relatively empty, and there certainly is nothing in it that can replace the lost revenue. Unless you are able to turn things around, you will report the worst financial quarter in the company's history. This will probably mean that the company will have to close plants and lay off thousands of workers. Where did you do wrong? Could this have been prevented? If so, how might it have been? And what do you do now?

What would Andy Grove do?

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Few individuals have overcome more adversity than the Hungarian Jew Andras Grof. After nearly dying of scarlet fever and barely escaping the Nazis in World War II, he fled to the United States when the Red Army invaded his homeland. He taught himself English and worked his way through college in the United States, graduating from Berkeley.

In the late 1960s, he cofounded a small high-tech company named Intel. In 1997, *Time* magazine named him Person of the Year for his role in fueling the computer revolution. His personal mantra, "only the paranoid survive," helped him to survive and prosper throughout his career. Ironically, it just might have been Andras Grof's paranoid perspective that gave Andy Grove the foresight that he needed in order to help create an industry.

There is much to be learned from Grove's tumultuous journey toward building what would become the world's largest chipmaker. Along the way, his company confronted several crises of massive proportions. This reinforced and helps to explain his paranoid perspective. He once said, "Success breeds complacency. Complacency breeds failure." During his three-decade-plus career, Grove never had the luxury of complacency.

At least twice during his tenure, Intel faced challenges that could have crippled or destroyed the company. By clearing these hurdles successfully, Grove not only made his organization stronger and more resilient, but also contributed to the body of leadership knowledge, advancing a management construct that showed other managers how to deal with drastic change.

## The Dual Levers of Success: Execution and Strategy

It all started in 1968, when Grove teamed up with two other people who shared his vision for a new business. Andy Grove, Bob Noyce, and Gordon Moore thought they could own the world. They had discovered that they could store ever-increasing numbers of transistors on a single chip without noticeably increasing the costs. More transistors meant faster performance and more utility for computers (and, of course, for any other gizmo that used the chips). By creating chips that could store an ever-increasing amount of information, they could boost the computer's memory and functionality in an enormously cost-effective manner. Intel was born. And one of the most important things that it had going for it was Grove's common-sense wisdom:

*I have a rule in my business: to see what can happen in the next ten years, look at what has happened in the last ten years.*

Grove was not the only Intel manager with prescience. In 1975, Gordon Moore made a critical prediction of his own: He declared that the power of the computer chip would double every 18 months. That prediction, now called Moore's law, has proved remarkably accurate.

Grove built on Moore's law with a prophecy of his own: *The world will never stop finding new applications for* *these powerful chips*. With every new generation of computers, more powerful chips would be needed, and Intel would be the company that supplied them. Years later, Grove used a metaphor to describe how technology, manufacturing, and marketing provided the foundation for Intel's success:

*The essence of a company like Intel is execution and strategy. Intel, looked at in another way, is a three-legged stool. One leg is technology—design and silicon technology—another leg is manufacturing, and the third leg is marketing. Whenever Intel did well* *it was because the three legs were equal. Whenever one of those legs was shorter than the others, we wobbled.*

## The First Crisis: Intel Gets Beaten at its Own Game

In the early 1980s, Intel's three-legged stool almost came crashing down. When the company first started, it had nearly a 100 percent share of the memory market. New competitors appeared in the 1970s, but it was not until the 1980s that the Japanese broke Intel's rock-solid hold on this market. They did so by producing chips that were not only superior in quality, but also lower in cost. Intel tried everything it could think of to battle the Japanese, but nothing worked. Grove later identified several factors that had contributed to Intel's misfortunes: The company had been late to market with several generations of products, and it hadn't invested in new factories early enough. Ultimately, though, the cause of the problem came down to the wrong strategy and poor execution:

*You execute on the wrong strategy, you sink. You don't execute on the right strategy, you sink.... Actually, there's a perfect example of this: our performance in memory in the early '80s. Our execution and our strategy were faulty.*

Intel had to do something to stop the bleeding. The company was losing money hand over fist, as demand for Intel's memory chips was in free fall. Grove felt the pressure: "The need for a different memory strategy, one that would stop the hemorrhage, was growing urgent."

Then one day in 1985, after Intel's problems had been raging for nearly a year, Grove found himself discussing the company's woes with Gordon Moore, then Intel's CEO. In that conversation, which was detailed in Grove's leadership memoir *Only the Paranoid Survive,* Grove asked Moore a question:

*"If we got kicked out and the board brought in a new CEO, what do you think he would do?" Gordon answered without hesitation, "He would get us out of memories." I stared at him, numb, then said, "Why shouldn't you and I walk out the door, come back and do it ourselves?"*

This story has become an industry legend, and it is vintage Grove. He recognized that the Japanese competition was no ordinary threat. In fact, it was potent enough to put his company out of business. Even though Intel was built on a foundation of memory chips, the company really had no choice but to get out of this market. It simply could not continue on its current path. But Grove knew that abandoning the company's legacy would mean a long and difficult change process, almost certainly filled with pain, plant closings, and layoffs.

*We had become marginalized by our Japanese competitors. There really was no viable option for us to work our way out....The defining business of the company had not hit a pothole but an ultimate wall, and we had to make a very desperate move.*

The reality was that bad, and worse. (Grove later said that when it was all over, about one-third of the company had been shut down or laid off.) The process took three terrible years. As the company got out of the memory market, however, it put much of its resources into a new technology: microprocessors. While memory chips only stored memory, microprocessors were the *thinking* part of a computer—the part that actually performed calculations. Certainly, this new realm looked promising. But Grove admits that departing from his company's chipmaking past was one of the hardest decisions his management team ever made:

*For us senior managers, it took the crisis of an economic cycle and the sight of unrelenting red ink before we could summon up the gumption needed to execute a dramatic departure from our past.*

By getting out of the memory business and focusing the company on the riskier microprocessor business, Grove was planting the seeds that would help the company grow into the mightiest in its new industry. A decade later, Grove would face a very different crisis that shared some elements with this first crisis. But before we turn to that other episode, let's sum up what can be learned from Grove's early experiences at Intel:

* **DEVELOP AN OUTSIDER'S PERSPECTIVE.** To truly study your organization—warts and all—look at your company as an outsider might. This is the perspective you need in order to make critical decisions. When Grove asked Moore what an outside CEO would do to deal with their crisis, he was applying this tenet to Intel— a kind of dispassion and detachment that ultimately saved the company and led it to even greater heights.
* **NEVER INSULATE THE COMPANY SO MUCH THAT IT CANNOT BELIEVE IN ITS OWN UNDOING.** Grove believes that a certain amount of paranoia is good for a company. Guard against incursions by competitors by keeping managers and employees on their toes. This does not mean paralyzing them with fear; rather, it means instilling a healthy amount of skepticism into the organization, so that everyone is focused on keeping the company on track.

## Strategic Inflection Points Defined: A 10X Change

When Andy Grove arrived at his office one December morning in 1994, he had no idea that his world was about to be turned upside down once again. Intel was then in the midst of launching its latest-generation microprocessor, the Pentium processor. Some weeks earlier, a "minor design error" had been discovered in the chip, and reports of the problem began circulating online. However, the situation seemed to be under control, since testing showed that the problem was likely to occur only once in every 27,000 years of use.

But that fateful morning, everything changed. Grove was informed that IBM had stopped shipment of all Pentium-based computers. Intel's credibility—and, by extension, the entire company—was threatened as anxiety about the "bug" spun out of control in the business community. Grove faced a crucial decision: Try to reassure the world that the chip was sound, or replace every chip, which would cost Intel about *half a billion* dollars. He decided on the latter course of action. For the second time in a decade, the company was facing chaos, and possibly extinction. No matter what the outcome, Grove wrote later, nothing would ever be the same again:

*Something has changed, something big, something significant, even if it's not entirely clear what that something is.*

What had happened? According to Grove, the rules that had governed his business for decades were no longer valid. Suddenly, what Intel thought—about quality, about reliability—*no longer mattered*. For the first time, computer *users,* who were not even Intel's direct customers, were demanding that an Intel product be replaced. Intel had reached what Grove calls a "strategic inflection point"—a point at which a company comes face to face with a massive change, one that is powerful enough to threaten the life of the enterprise.

Strategic inflection points, Grove later concluded, tend to arise following a long period of unbroken success. It is at these junctures, when the managers of the enterprise can't imagine anything but continued success, that the organization is most vulnerable. Grove has won wide acclaim for his seminal work on this topic, which was the main subject of his aforementioned book.

To Grove, the difference between ordinary change and a strategic inflection point (SIP) is the *magnitude* of the potential effect on the business:

*We managers like to talk about change, so much that embracing change has become a cliché of management. But a strategic inflection* *point is not just any change. It compares to change the way Class VI rapids on a river, the kind of deadly and turbulent rapids that even professional rafters approach gingerly, compare to ordinary waters.*

Grove even quantified a strategic inflection point by calling it a "10x change," meaning that the magnitude of the change is 10 times that of the changes that the business has been accustomed to. He noted that strategic inflection points are not restricted to technological changes. Almost anything can precipitate a strategic inflection point, including new or shifting competition, a change in regulation, a new channel of distribution, and so on. Strategic inflection points seldom announce themselves, and they can affect a single company or an entire industry.

The senior managers' earlier battle with the Japanese— and themselves—was a textbook strategic inflection point, and it had clarified Grove's thinking on the subject. What used to work now no longer works. Chaos, or at least a sense of being out of control, predominates. We had "lost our bearings," declared Grove. "We were wandering in the valley of death."

But as Grove had already discovered once—and was about to prove again—strategic inflection points don't necessarily mean institutional death. If managed skillfully, they can also breathe life into an organization.

## Strategic Inflections Points Can Strengthen Organizations

Not all strategic inflection points spell disaster for an organization and its managers. Says Grove:

*Strategic inflection points offer promises as well as threats. It is at such times of fundamental change that the cliché "adapt or die" takes on its true meaning.*

How can this be? Because companies that adapt in response to profound pressures often reinvent themselves, adding important new skills and competencies as they adjust to the external change. In most cases, *early detection of* *the strategic inflection point is key*. By acting before the potential damage inherent in the SIP occurs, organizations can not only fend off the near-term threat, but also develop an inner strength that can help them through difficult times for years to come:

*Businesses are about creating change for other businesses. Competition is about creating change; technology is about creating change....So the ability to recognize that the winds have shifted and to take appropriate action before you wreck your boat is crucial to the future of an enterprise.*

As the organization approaches and comes to terms with an SIP, it's the corporate mind-set that counts. And, as stated earlier, *complacency* is the worst possible mind-set. It is much better to be fearful, says Grove, for fear keeps companies skeptical, sharp-edged, and on their toes. Therefore, when Grove was CEO at Intel, he worked to instill a healthy amount of paranoia into the organization, in the conviction that vigilance was one of the ingredients of the company's success:

*I attribute Intel's ability to sustain success to being constantly on the alert for threats, either technological or competitive in nature.* *The word paranoia is meant to suggest that attitude, an attitude that constantly looks over the horizon for threats to your success.*

And *prompt action*, once vigilance has served its purpose, is equally important. Says Grove:

*It is best when senior management recognizes and accepts the inevitability of a strategic inflection point early on and acts before the vitality of the business has been sapped by the "10x" forces affecting it.*

## Dealing with a Strategic Inflection Point: A Manager's Primer

According to Grove, there are three warning signs that companies must heed in order to recognize a possible 10x force. Monitoring these signs may be an organization's best weapon against the sneak attack of a strategic inflection point.

1. **YOUR KEY COMPETITOR IS ABOUT TO CHANGE.** The organization that you have long viewed as your primary competitor may no longer be the one that you should fear most. This may be an early warning that things are being shaken up and that significant change is in the offing.
2. **YOUR PRIMARY "COMPLEMENTOR" IS ABOUT TO CHANGE.** The company that has long been your most important ally may no longer be as important—in the marketplace or to you. If something is happening that is changing the competitive position of a supplier or strategic partner and that supplier or partner's importance to your company, it's possible that the same train is headed toward you.
3. **MANAGEMENT'S ABILITY TO "GET IT" IS CHANGING.** If members of the management team—including you—feel that they are out of touch with what is really going on out there, this is a clue that things out there may be changing at a faster rate than you anticipated.

## Preparing Your Organization for a Strategic Inflection Point

Obviously, the advent of a strategic inflection point is not under one's control. So what sort of actions does Grove recommend in order to ready the organization for such a massive change? First, says Grove, the CEO has to adopt and promote a "guardian" attitude:

*The prime responsibility of a manager is to guard constantly against other people's attacks and to inculcate this guardian attitude in the people under his or her management.*

So how can a CEO and other senior manager make sure that they are properly guarding against attacks? There are several ways:

1. **LISTEN TO ALARMISTS.** Grove calls them "helpful Cassandras"—those folks who are always proclaiming that the sky is falling. They are often middle managers (for example, sales managers), who may be less focused on strategic issues, but are closer to the marketplace than most senior executives, and thus are in a better position to detect sea changes and paradigm shifts. Pay close attention to what they are saying, and encourage "Cassandra communications" from employees and managers the world over. Emails are a perfect medium for this kind of communication.
2. **ENCOURAGE RIGOROUS DISCUSSION AND DEBATE.** Only by thrashing out the possible implications of what appears to be a strategic inflection point—a debate that should involve different managers at several levels—can an organization determine whether it is truly facing a 10x change.
3. **EXAMINE—AND BE SKEPTICAL ABOUT—THE DATA.** There is often no substitute for cold, hard facts. But in making the call regarding a strategic inflection point, you may need to discount the data and put more faith in your instincts, since strategic inflection points are mostly about the *future*, which in all likelihood is not yet measurable.

There is a very definite progression of events involved in getting through a strategic inflection point, says Grove, who speaks from experience:

*Getting through the strategic inflection point required enduring a period of confusion, experimentation, and chaos, followed by a period of single-minded determination to pursue a new direction toward an initially nebulous goal. It required listening to Cassandras, deliber**ately fostering debates and constantly articulating the new direction, at first tentatively but more clearly with each repetition.*

**Let Chaos Reign: Experiment Early—And Often**

Once you have identified a strategic inflection point, the key to dealing with it effectively is to "let chaos reign," says Grove. It is important for organizations to experiment in multiple directions so that they have the power to respond to a strategic inflection point. To put it in more dire terms, if you're not already trying *all kinds of new things all of the* *time*, it may be too late to start when the 10x change hits you. So it is essential that you experiment constantly with new products, new technologies, and so on:

*The dilemma is that you can't suddenly start experimenting when you realize you're in trouble unless you've been experimenting all along. It's too late to do things once things have changed your core business. Ideally, you should have experimented with new products, technologies, channels, promotions, and new customers all along.*

If an organization builds experimentation into its everyday business, it will have options available when a 10x change occurs. This is particularly important now, Grove asserts, as the Internet is emerging as *everybody's* strategic inflection point.

When an SIP arises, it is up to management to choose a clear path and take decisive action. This means (1) exhibiting an unwavering commitment to righting the ship, and (2) providing sufficient resources to accomplish that end. Under Grove's leadership, as noted, Intel's "ship" was righted on more than one occasion, and the company returned the resources invested in it many times over. By the time Grove stepped down as CEO in 1998, Intel was a $26 billion juggernaut delivering more than $6 billion in annual profits.

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Here are some historic examples of events that have presented a strategic inflection point to one or more industries:

* **THE INVENTION OF THE MASS-PRODUCED AUTOMOBILE.** When Henry Ford's first Model T rolled off his revolutionary "assembly line," it presented a strategic inflection point not only to the horse-and-buggy business, but also to the coach makers who were still making "horseless carriages" more or less by hand.
* **THE BIRTH OF AIR FLIGHT.** The Wright brothers' invention led to airmail and air travel, siphoning off first mail and later passengers from the railroads.
* **A NEW COMPETITOR.** Amazon.com went live in 1995, taking a significant bite out of the market share of traditional bricks-and-mortar bookstore chains like Barnes & Noble.
* **THE ARRIVAL OF ONLINE TRADING.** In the late 1990s, online brokers such as E\*Trade and Ameritrade offered investors the chance to trade stocks at a fraction of the cost of traditional brokers like Merrill Lynch, turning the brokerage industry upside down.

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**What Would Andy Grove Do?**

Returning to the case that opened the chapter, it should now be clear that your company was faced with a strategic inflection point when the supplement manufacturer started to steal market share. There are several similarities between this case and Intel's battle with the Japanese in the memory market in 1984. In both instances, the CEO underestimated the competition. None of the senior managers at Intel felt that the Japanese could marginalize Intel's memory business, and the same is true in this case. You didn't take the supplement manufacturer seriously, nor did you prepare the organization for the decline in its lead product.

So what do you do now? What would Andy Grove do? In this particular example, unfortunately, it may be a case of too little too late. Andy Grove would never have allowed the firm to become so vulnerable. He would have made sure that the company was experimenting with new types of drugs all along, keeping the drug pipeline full. He would have canvassed people lower down in the organization, knowing that the senior managers are often the last to know something. He would have listened to the "helpful Cassandras," who in your organization would have included the young researcher out of MIT. He would have encouraged vigorous debate, and he probably would not have dismissed the supplement alternative so quickly.

Had the company taken these measures, it would probably have more options than it does now. At this point, it appears almost too late to turn things around. Since your core business is fading, your only hope is to take the company in a new direction. Somehow, some way, you have to chart a new course for the company.

And there's always hope. Says Grove:

When you are in a strategic transformation, you get kind of lost. Part of you wants to retreat back to doing what you know how to do, because it's familiar.... But your intellect tells you that's not really where you want to be. So you strike out in a new direction....You have to feign more confidence than you feel, and you have to be convincing enough and courageous enough that you can affect the rest of the organization to follow you. You can course-correct as you go.

Most likely, your best chance of following Grove's model is to come up with a new drug or series of drugs that may prove to be your equivalent of the microprocessor. Keep in mind that Grove himself did not believe in the microprocessor in its early years. (In fact, he called it a nuisance.) If your firm has many "hooks in the water," perhaps it will come up with something that will turn things around. But discovery, development, refinement, and ultimate FDA approval take *years,* not months, and this will make it very difficult for your company to find its way out of the valley of death.

## Assessing Your CEO Quotient

1. How have you dealt with massive change? Do you and your employees roll with the punches?
2. Can you identify the last time you or your company encountered a 10x force? What happened? How well did your company cope with the change?
3. Do you feel that your organization is well positioned to detect the early warning signals of a strategic inflection point?
4. Has your organization developed an effective business strategy that combines a traditional bricks-and-mortar capability with an online component?
5. Do you make it a habit to listen to those Cassandras in your organization who are likely to identify a strategic inflection point before you do?
6. Does your organization routinely experiment with new products, processes, and technologies?

## More Lessons From the CEO

1. **TO MAKE SURE THAT YOUR ORGANIZATION IS PREPARED FOR MASSIVE CHANGE, YOU MUST INSTILL A CULTURE THAT DESPISES COMPLACENCY.** Hold regular managers' meetings to discuss possible forces that threaten your organization, and encourage rigorous debate. Make sure that this debate filters down into the organization.
2. **TO ACHIEVE STEP 1, INSTILL A HEALTHY AMOUNT OF FEAR INTO THE ORGANIZATION.** Grove feels that this is key to making sure that complacency never infects your organization. Grove's embrace of paranoia may be off-putting to some, but it is difficult to argue with his results. Keeping everyone on their toes will help the company sniff out new threats before those threats become insurmountable.
3. **MAKE SURE THAT MANAGERS THROUGHOUT THE WORLD CAN COMMUNICATE WITH YOU DIRECTLY.** (Email is probably the best way.) Remember that those managers who are closer to the customers are often aware of change before you are. It is imperative that you have a pipeline to those who are closer to the customer, so that you can get wind of any key shifts in your business context.
4. **MAKE EXPERIMENTATION WITH NEW PRODUCTS A REGULAR PART OF THE PRODUCT DEVELOPMENT PROCESS, EVEN IF THE REVENUES SEEM INSIGNIFICANT.** Remember that a new product at the right time may be what saves your company when it faces a massive threat. Had Intel not been experimenting with microprocessors, its prospects as it got out of the memory market—or stayed in that losing game—would have been very dim.
5. **IF APPROPRIATE TO YOUR INDUSTRY, MAKE SURE THAT YOUR COMPANY'S BUSINESS STRATEGY INCLUDES A UNIQUE ONLINE COMPONENT.** Grove regards the Internet as a strategic inflection point that *everyone* must face. Tomorrow's winners will be those companies that leverage the unique advantages of the Internet in a way their competitors have not yet thought of.