

Leadership and strategy in the news

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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).

Technology and disruption

Will software eat the world?

Just the announcement that Jeff Bezos, Warren Buffett, and Jaime Dimon will be entering the health care space has sent shock waves for industry incumbents such as CVS, Cigna, and UnitedHealth. It also puts a fundamental question back on the agendas of CEOs in other industries: Will software eat the world, as Marc Andreessen famously quipped? Is this a warning shot that signals that other legacy industrial companies, such as Ford, Deere and Rolls Royce are also at increased risk of being disrupted?

To start to answer that question, let's tally up the score. There are three types of products today. Digital natives (Amazon, Google, Facebook, Microsoft, IBM) have gained competitive advantage in the first two, and the jury is still out on the third:

Type 1: These are "pure" information goods, where digital natives rule. An example would be Google in search, or Facebook in social networking. Their business models benefit from internet connectivity and they enjoy tremendous network effects.

Type 2: These are once-analog products that have now been converted into digital products, such as photography, books, and music. Here too, digital natives dominate. These products are typically sold as a service via digital distribution platforms (Audible.com for books, Spotify for music, Netflix for movies).

Type 3: Then there are products where input-output efficiency and reliability of the physical components are still critical but digital is becoming an integral part of the product itself (in effect, computers are being put inside products). This is the world of the Internet of Things (IOT) and the Industrial Internet

The Challenges for Digital Natives Value will no doubt be created in the era of smart, connected machines. We don't expect Amazon or Microsoft or IBM to design, make, and market agricultural tractors, aircraft engines, or MR scanners. The question really is: Can digital natives develop software-enabled solutions that siphon off significant value from industrial hardware? The answer is "yes." But it won't be easy.

1. The physics of the hardware. Companies like Rolls Royce design and manufacture jet engines. These are very complicated machines. There is hard science behind these machines. That's much different than digital natives like Airbnb where marketing is more important than technical expertise.
2. Customer intimacy. Industrial giants have well-established brands, built strong customer relationships, and signed long-term service contracts. They've won the customer's trust, which is why customers are willing to share data.
3. Difficulty in sharing risks. Industrial incumbents have product

knowledge, customer relationships, and field engineers on customer sites. Companies like Rolls Royce can, therefore, offer outcome deals where they guarantee customer outcomes (examples: zero downtime, higher speed, more fuel efficiency, zero operator error, greater reliability) and share risks and rewards with customers. It would be very hard for Amazon or Google to guarantee customer outcomes and take risks with businesses whose operations they know little about.

Vijay Govindarajan, "Can anyone stop Amazon from winning the industrial internet?," *Harvard Business Review*, February 2018.

The end of the shopping mall?

Retailers are bracing for a fresh wave of store closings in 2018 that is expected to eclipse the rash of closings that rocked the industry last year.

"Landlords are panicking," said Larry Perkins, the CEO and founder of the advisory firm SierraConstellation Partners. "The last year was pretty apocalyptic from a retail standpoint, and the macro issues haven't changed. There will continue to be a high degree of bankruptcies and store closures."

2017 was a record year for both store closings and retail bankruptcies. Dozens of retailers including Macy's, Sears and J.C. Penney shuttered an estimated 9,000 stores – far exceeding recessionary levels – and 50 chains filed for bankruptcy. . . .

The commercial real estate firm CoStar has estimated that nearly a quarter of malls in the US, or roughly 310 of the nation's 1,300 shopping malls, are at high risk of losing an anchor tenant. . . . The loss of even one anchor tenant can trigger a multi-decade downward spiral for mall owners.

That's because the malls don't only lose the income and shopper traffic from that store's business; such closings often trigger clauses that allow the remaining mall tenants to exercise their right to terminate their leases or renegotiate the terms, typically with a period of lower rents, until another retailer moves into the vacant anchor space.

Hayley Peterson, "A tsunami of store closings is about to hit the US – and it's expected to eclipse the retail carnage of 2017," *SF Gate*, 1 January 2018.

Why Amazon wants physical stores

Even before it opened, Amazon Go began drawing deep skepticism over whether it could possibly work. Would Amazon be able to create a convenience store in which shoppers gathered their goods and walked out the door having been automatically charged for their purchases? The technology behind it – like driverless cars – has captured the public's imagination. . . .

But as shoppers gauge the gee-whiz aspects of the store and convenience of not having to wait in line, Amazon is sharply focused on the shopper. The company is always watching. More than 100 cameras in the 1,800-square-foot store are capturing shoppers' every move to total up the purchase, but that's just the start.

Amazon isn't saying what its plans are for Amazon Go – whether the company will roll out dozens more soon, or exactly how the store serves a greater corporate strategy. But many say that by recording shopper behavior at such a detailed level and being able to analyze it, Amazon is hot on the trail of the Holy Grail of retail: really understanding why shoppers do what they do.

"The big enigma has always been why does a customer buy; what causes someone to pick something

off the shelf, put it in their basket and pay for it?" says Marshall L. Fisher, Wharton professor of operations, information and decisions. "That's the number-one issue in retailing. One obvious step is directing traffic to the store or website. But then once you've got the customer in your crosshairs, how do you get them to buy?"

The Amazon Go store samples in physical form the online realm from which Amazon has been able to extract increasingly detailed information about how customers behave. Says Wharton marketing professor Peter Fader: "To the extent that it revolutionizes retail, the idea here is knowing who is buying without relying on loyalty programs. But in addition to knowing who is looking at what, who is picking an item off the shelf and in what sequence – that idea of really seeing everything could have dramatic implications." It could change the way stores are laid out, he notes, and it could change where a concierge person comes in. "I think that the data part of it could be the big breakthrough, but at this point it's still icing on the cake."

"Will Amazon go capture the holy grail of retail?," *Knowledge@Wharton*, 9 February 2018, available at: <http://knowledge.wharton.upenn.edu/article/amazon-go-game-changer/>

Competition in the era of tech giants

Big tech platforms, particularly Facebook, Google and Amazon, do indeed raise a worry about fair competition. . . . Increasingly, they are the market itself, providing the infrastructure (or "platforms") for much of the digital economy. . . . Powerful though they already are, their huge stock market valuations suggest that investors are counting on them to double or even triple in size in the next decade. . . . By some estimates, Amazon captures over 40% of online shopping in America. With more than two billion monthly

users, Facebook holds sway over the media industry. Firms cannot do without Google, which in some countries processes more than 90% of web searches. Facebook and Google control two-thirds of America's online ad revenues.

America's trustbusters have given tech giants the benefit of the doubt. They look for consumer harm, which is hard to establish when prices are falling and services are "free". The firms themselves stress that a giant-killing startup is just a click away and that they could be toppled by a new technology, such as the blockchain. Before Google and Facebook, Alta Vista and MySpace were the bee's knees. Who remembers them?

However, the barriers to entry are rising. Facebook not only owns the world's largest pool of personal data, but also its biggest "social graph" – the list of its members and how they are connected. Amazon has more pricing information than any other firm. Voice assistants, such as Amazon's Alexa and Google's Assistant, will give them even more control over how people experience the internet. China's tech firms have the heft to compete, but are not about to get unfettered access to Western consumers.

If this trend runs its course, consumers will suffer as the tech industry becomes less vibrant. Less money will go into startups, most good ideas will be bought up by the titans and, one way or another, the profits will be captured by the giants.

The early signs are already visible. The European Commission has accused Google of using control of Android, its mobile operating system, to give its own apps a leg up. Facebook keeps buying firms which could one day lure users away: first Instagram, then WhatsApp and most recently tbh, an app that lets teenagers send each other compliments anonymously. Although Amazon is still increasing competition

in aggregate, as industries from groceries to television can attest, it can also spot rivals and squeeze them from the market.

"How to tame the tech titans," *Economist*, 18 January 2018.

Big Data at work

Industries such as life sciences, while newer to data management, possess vast repositories of scientific and patient data that have gone largely untapped relative to the potential for insight. . . . Now, many of these mainstream companies are facing threats from data-driven competitors that have no legacy processes and have built highly agile data cultures. Companies like Amazon, Google, Facebook and Apple are among the most prominent disruptive threats to these traditional industry leaders. As mainstream companies increase their investment in big data and AI initiatives, they face a range of issues and challenges as they seek to organize to compete against data-driven competitors. This concern is highlighted in the 2018 survey results.

A clear majority (79.4%) of executives report that they fear the threat of disruption and potential displacement from these advancing competitors. In response to the threat of disruption, companies are increasing their investment in big data and AI initiatives. In the 2018 survey, 71.8% of executives indicate that investments in AI will have the greatest impact on their ability to stave off disruption (in the next decade). . . .

Executives indicate that investments in big data and AI are beginning to yield meaningful results. Nearly three-fourths of executives surveyed (73.2%) report that their organizations are now achieving measurable results from their big data and AI investments. In particular, executives report notable successes in initiatives to improve decision-making through

advanced analytics – with a 69% success rate – and through expense reduction, with a 60.9% success rate. Businesses are also using big data and AI investments to accelerate time-to-market for new products and services (54.1% success rate) and to improve customer service (53.4% success rate). Yet, just over one-fourth (27.3%) of executives report success thus far in monetizing their big data and AI investments. This remains an elusive goal for most organizations.

Randy Bean, "How big data and AI are driving business innovation in 2018," *Improvisations*, 5 February 2018, available at: <https://sloanreview.mit.edu/article/how-big-data-and-ai-are-driving-business-innovation-in-2018/>

Getting digital right

Only eight percent of companies we surveyed recently said their current business model would remain economically viable if their industry keeps digitizing at its current course and speed.

How can this be, at a moment when virtually every company in the world is worried about its digital future? In other words, why are so many digital strategies failing? The five issues that, in our experience, are particularly problematic. . . .

Pitfall 1: Fuzzy definitions

Lacking a clear definition of digital, companies struggle to connect digital strategy to their business, leaving them adrift in the fast-churning waters of digital adoption and change.

Pitfall 2: Misunderstanding the economics of digital

Digital is confounding the best-laid plans to capture surplus by creating – on average – more value for customers than for firms. This is big and scary news for companies and industries hoping to convert digital forces into economic advantage.

Instead, they find digital unbundling profitable product and service offerings, freeing customers to buy only what they need. Digital also renders distribution intermediaries obsolete (how healthy is your nearest big-box store?), with limitless choice and price transparency. And digital offerings can be reproduced almost freely, instantly and perfectly, shifting value to hyperscale players while driving marginal costs to zero and compressing prices.

Pitfall 3: Overlooking ecosystems

Digital means that strategies developed solely in the context of a company's industry are likely to face severe challenges... Platforms that allow digital players to move easily across industry and sector borders are destroying the traditional model with its familiar lines of sight. Grocery stores in the United States, for example, now need to aim their strategies toward the moves of Amazon's platform, not just the chain down the street, thanks to the Whole Foods acquisition.

Pitfall 4: Overindexing on the 'usual suspects'

Most companies worry about the threats posed by digital natives, whose moves get most of the attention – and the disruptive nature of their innovative business models certainly merits some anxiety. Excessive focus on the usual suspects is perilous, though, because incumbents, too, are digitizing and shaking up competitive dynamics. And the consumer orientation of many digital leaders makes it easy to overlook the growing importance of digital in business-to-business (B2B) markets.

Pitfall 5: Missing the duality of digital

The most common response to digital threats we encounter is the following: "If I'm going to be disrupted, then I need to create something completely new." Understandably, that becomes the driving impetus for strategy. Yet for most companies, the pace of

disruption is uneven, and they can't just walk away from existing businesses. They need to digitize their current businesses and innovate new models.

Jacques Bughin, Tanguy Catlin, Martin Hirt, and Paul Willmott, "Why digital strategies fail," *McKinsey Quarterly*, January 2018.

The keys to successful transformation

Our analysis also revealed that companies with the most severe downturns – a two-year TSR [Total Shareholder Return] deterioration of 20+ percentage points – were especially unlikely to succeed at transformation. More than 95% of these organizations failed to return to their prior level of performance; instead, they became stuck at a lower level or continued to decline still further. This pattern suggests that leaders must recognize performance deterioration early and act quickly, because if they wait for a point of deep crisis, their company may never recover

Five Evidence-Based Factors in Transformation Success

Considering the increasing pace of technological change and volatility in many industries, the patterns suggest that the need for transformation is rising, while the chance of successfully achieving it is falling. On the positive side, our empirical research also reveals a number of factors that can help large companies beat the odds.

1. . . . organizations that successfully recovered from severe TSR deterioration relied on cost-cutting as a principal driver during the first year of their turnaround effort. But more surprisingly, investor expectations (as measured by company valuation relative to earnings) were a slightly stronger

driver of short-run TSR recovery than costs, accounting for 37% of outperformance.

2. . . . but revenue growth is the primary driver of long-run success. While cost-cutting and investor expectations are necessary to ensure transformation viability in the short term, after year one of a transformation. . . revenue growth becomes an increasingly important driver of TSR success. By year five, it outweighs each of the initial primary drivers of success.
3. Long-term strategy and research and development (R&D) investment support transformation success, especially in turbulent environments. . . companies with above-average R&D spending perform substantially better.
4. New, external leadership improves the odds of transformation success. . . but it is surprising that more than three-quarters of troubled companies stuck with their current leaders in this era of increasing investor activism and performance pressure. Nevertheless, the long-term effect of changing CEOs in transforming companies was positive. New CEOs increased TSR by 9.2 percentage points over a five-year span, compared to 4.6 percentage points for incumbents.
5. Formalized transformation programs are helpful, as long as they have sufficient scope and scale. . . . More than half (57%) of the companies launched a formal transformation within one year of experiencing a severe TSR deterioration. Furthermore, their programs increased their odds of transformation success in the short and long run.

Martin Reeves, Lars Fæste, Kevin Whitaker, and Fabien Hassan, "The truth about corporate transformation,"

The bright side of robotics

The arrival of the robotic arm was not a happy affair at Professional Finishing in Richmond, California. . . . this robot was meant to work right alongside humans, delicately sanding and painting things like speaker cases or cabinets for medical devices. Which sounded a lot like a first step toward replacing the company's workers altogether.

"We did have one employee tell us, 'Hey let me know when the robot's up and running and I'll just quit,'" says Professional Finishing co-owner Dawn White. "We said, just bear with us. Watch what happens. Help us and everybody will keep their jobs."

Everyone did indeed keep their jobs. Today, three of these machines from Universal Robots handle the brute sanding and painting, while humans handle more complicated tasks like assembly. Some of these workers even turned into robot technicians. It's called collaborative robotics, and it's popping up all over the place, thanks to advanced machines that sense when they've contacted a person and stop, as opposed to launching them across the room.

Like many companies, Professional Finishing moved into robotics as a matter of economics. . . . So 10 months after purchasing the company, the Whites hired their first robot painter, which increased the productivity of the human laborers by a factor of four. And bonus: those humans' jobs got a lot easier. "The operator would have to do a lot of bending, crouching, lifting the part, twisting, just all day long," says Chad. "The robot now does all that for them. And now the operators who used to paint these parts are now actually running the robot."

You are more likely to work with a robot than have one replace you in

the near future. Because while robots are great at repetitive tasks, humans still beat them at delicate, complex jobs. "We think more jobs will change their activities than completely disappear, and so we'll see more of these collaborations between machines and people," says Michael Chui, a partner at McKinsey Global Institute and co-author of a recent report on automation. "When you actually have a robot next to a person or artificial intelligence next to a person and they work better together to produce higher quality products than any one of them working alone."

Matt Simon, "The tale of the painting Robot that didn't steal anyone's job," *Wired*, 8 February 2018.

Culture and transformation

Making Agile pay

The subject of Strategic Agility is important because it's central to the key business issue: how to make money from Agile? If the Agile movement is only about creating great workplaces for software developers (also important!) but doesn't generate better business outcomes, its life expectancy won't be long. . . .

Strategic Agility vs. Operational Agility

What I am embracing is a distinction between on the one hand operational Agility – i.e. making the existing products better, faster, cheaper and so on for existing customers – and on the other hand Strategic Agility – i.e. creating new markets with new products that reach new customers, i.e. market-creating innovation. . . . On this subject, I am indebted to Clayton Christensen, and to Professors Kim and Mauborgne in their books on Blue Ocean Strategy.

To illustrate the distinction:

While firms like Nokia, and Blackberry were pursuing Operational Agility in the mid-2000s by developing better mobile phones, Apple exhibited Strategic Agility by developing multi-functional device – the iPhone – that appealed to a much larger array of customers.

While some firms were improving DVDs (Operational Agility), Netflix pioneered web-based streaming of movies (Strategic Agility). While Google has been steadily improving keyboard-based search (Operational Agility), Amazon's Echo pioneered voice-activated search (Strategic Agility).. . .

If a firm wants to make a lot of money today, it will usually need to be pursuing market-creating innovations, i.e. Strategic Agility.

Steve Denning, "What is strategic agility," *Forbes*, 28 January 2016.

A wider view

Capitalism: beyond the earnings report

Larry Fink recently created a shockwave. As cofounder, chairman, and CEO of BlackRock, one of the world's largest global asset management firms, in an open letter to CEOs he caught the attention of financial markets and beyond by insisting on the importance of companies serving a social as well as financial purpose.

Because BlackRock manages more than \$6 trillion in assets, Mr. Fink's announcement has the potential to help change companies' behaviors in big ways. But this will happen only if BlackRock and other large asset managers add social performance to their evaluations of companies. To do so, investment funds will need to collect new data.

The good news is that over the past decades, many initiatives have contributed to developing standards to assess companies' social

performance. The Sustainability Accounting Standards Board, Global Reporting Initiative, and B Lab are examples of initiatives that provide assessment tools companies and investors can use in their efforts to achieve both financial and social goals. In this light, Mr. Fink's announcement did not come out of the blue. It is in part a result of the long and hard work of these initiatives and many others around the world to help change the face of capitalism by making it more socially conscious. . . .

What is at stake is reshaping the face of capitalism as we know it. Historically, the corporate sector has focused mostly on profit maximization, and we as a society have paid a cost for such blind pursuit regardless of the social and environmental consequences, as

the 2008 financial crisis and increasing inequalities have made clear.

This kind of systemic change, however, does not sit only on the shoulders of CEOs. Today, corporations that attempt to incorporate a social purpose frequently have to deal with competing market demands that still push them to focus exclusively on financial performance. We must take action to create an ecosystem within which companies are encouraged to pursue social goals along with profit. We all have a role to play, both in creating the demand – as consumers, shareholders, investors, policymakers, and activists – and in making the environment more conducive by agreeing on industry measurement

standards, providing templates for supportive organizational processes and systems, training business leaders on why and how to pursue social goals along financial ones, and addressing legal limitations wherever they exist. The transformation of capitalism will not happen overnight, but there are actions that we can all take to make it possible.

Julie Battilana, "How to heed black rock's call for corporate social responsibility," *HBS Working Knowledge* 3, February 2018.

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