

**Record: 1**

How market leaders keep their EDGE. By: Treacy, Michael; Wiersema, Fred. Fortune. 2/6/1995, Vol. 131 Issue 2, p88-98. 6p. 4 Color Photographs. Abstract: Features an excerpt from the book, 'The Discipline of Market Leaders,' by the authors, management consultants at CSC Index. How successful companies must find the unique value that they alone can deliver to a chosen market; Three distinct value disciplines; Operational excellence; Product leadership; Customer intimacy; Examples from Price/Costco, Dell Computer, Johnson & Johnson and more. INSET: Which discipline should you choose?. (AN: 9501207678)

**Database:** Business Source Complete

**Section:** FORTUNE BOOK EXCERPT

## **HOW MARKET LEADERS KEEP THEIR EDGE**

**Instead of trying to do all things well, they pick just one discipline--best price, best product, or best solution--and execute like crazy.**

WHY CAN Casio sell a calculator more cheaply than Kellogg can sell a box of cornflakes? Does corn cost that much more than silicon?

- Why does it take only a few minutes and no paperwork to pick up or drop off a rental car at Hertz's #1 Club Gold, but twice that time and an annoying name/address form to check into a Hilton hotel? Are they afraid you'll steal the room?
- Why is it that Federal Express can "absolutely, positively" deliver a package overnight, but Delta, American, and United Airlines have trouble keeping your bags on your plane? Do they think you don't care?
- Why does Lands' End remember your last order and your family members' sizes, but after ten years of membership you are still being solicited by American Express to join? Don't the people at Amex know you're a customer?
- Why can you get patient help from a Home Depot clerk when selecting a \$2.70 package of screws, but you can't get any advice when purchasing a \$2,700 personal computer from IBM's direct-ordering service? Doesn't IBM think customer service is worth the time?

Why do some companies endear themselves to us while others just don't seem to know how to please? Don't the latter see what they are doing -- and not doing? How long do they think they can get away with it? No one goes to work in the morning intending to fail. But managers at a great many companies, for all practical purposes, have chosen failure. Don't they see that the world has changed?

Customers today want more of those things they value. If they value low cost, they want it lower. If they value convenience or speed when they buy, they want it easier and faster. If they look for state-of-the-art design, they want to see the art pushed forward. If they need expert advice, they want

companies to give them more depth, more time, and more of a feeling that they're the only customer. That's precisely why companies like Kellogg, Hilton, American Express, United, Delta, and IBM are on a slippery slope. One or more companies in their markets have increased the value offered to customers by improving products, cutting prices, or enhancing service. By raising the level of value that customers expect from everyone, leading companies are driving the market, and driving competitors downhill. Companies that can't hold their own will be pushed off a cliff.

Today's market leaders understand the battle they're in. They know they have to redefine value by raising customer expectations in the one component of value they choose to highlight. Casio, for instance, establishes new affordability levels for familiar products; Hertz makes car rental nearly as convenient as taking a cab; Lands' End shows individuals that they're not just a number; and Home Depot proves that old-fashioned, knowledgeable advice hasn't gone the way of trading stamps.

But wait a minute. These companies don't shine in every way. A successful company like Wal-Mart doesn't peddle haute couture; Lands' End doesn't sell clothing for the lowest possible cost; and Starbucks, the Seattle coffee chain, doesn't slide a cup of java under your nose any faster or more conveniently than anyone else. Yet all of these companies are thriving because they shine in a way their customers care most about. They have honed at least one component of value to a level of excellence that puts all competitors to shame.

OUR RESEARCH shows that no company can succeed today by trying to be all things to all people. It must instead find the unique value that it alone can deliver to a chosen market. We have identified three distinct value disciplines, so called because each discipline produces a different kind of customer value. Choosing one discipline to master does not mean that a company abandons the other two, only that it picks a dimension of value on which to stake its market reputation over the long term.

The first value discipline we call operational excellence. Companies that pursue this are not primarily product or service innovators, nor do they cultivate deep, one-to-one relationships with customers. Instead, operationally excellent companies provide middle-of-the-market products at the best price with the least inconvenience. Their proposition to customers is simple: low price or hassle-free service, or both. Wal-Mart, Price/Costco, and Dell Computer epitomize this kind of company.

The second value discipline we call product leadership. Its practitioners concentrate on offering products that push performance boundaries. Their proposition to customers is an offer of the best product, period. Moreover, product leaders don't build their positions with just one innovation; they continue to innovate year after year, product cycle after product cycle. Johnson & Johnson, for instance, is a product leader in the medical equipment field. With Nike, the superior value does not reside just in its athletic footwear, but also in the comfort customers can take from knowing that whatever product they buy from Nike will represent the hottest style and technology on the market. For these product leaders, competition is not about price or customer service (though those can't be ignored), it's about product performance.

The third value discipline we have named customer intimacy. Its adherents focus on delivering not what the market wants but what specific customers want. Customer-intimate companies do not

pursue one-time transactions; they cultivate relationships. They specialize in satisfying unique needs, which often only they recognize, through a close relationship with -- and intimate knowledge of -- the customer. Their proposition to the customer: We have the best solution for you, and we provide all the support you need to achieve optimum results, or value, or both, from whatever products you buy. Long-distance telephone carrier Cable & Wireless, for example, practices customer intimacy with a vengeance, achieving success in a highly competitive market by consistently going the extra mile for its selectively chosen, small-business customers.

Note well: Choosing to pursue a value discipline is not the same as choosing a strategic goal. A value discipline can't be grafted onto or integrated into a company's normal operating philosophy. It is not a marketing plan, a public relations campaign, or a way to chat up stockholders. The selection of a value discipline is a central act that shapes every subsequent plan and decision a company makes, coloring the entire organization, from its competencies to its culture (see table). The choice of value discipline, in effect, defines what a company does and therefore what it is.

Such thinking leads to ideas that will surprise you. They seem out of step with the current, widely held notion that to identify core competencies and to reengineer a company's business processes is to assure its competitive future. Sick or not, if a company is going to achieve and sustain dominance, it must first decide where it will stake its claim in the marketplace and what kind of value it will offer to customers. Then it can identify core competencies and reengineer the processes that make up the operating model required to get the job done. The success of these exercises depends entirely on whether and how well they are channeled toward the pivotal issue of increasing customer value, year after year.

### Winning Through Cost

- Operationally excellent companies deliver a combination of quality, price, and ease of purchase that no one else in their market can match. They are not product or service innovators, nor do they cultivate one-to-one relationships with customers. They execute extraordinarily well, and their proposition to customers is guaranteed low price or hassle-free service, or both.

Price/Costco, the chain of warehouse club stores, doesn't provide a particularly rich selection of merchandise -- only 3,500 items, vs. 50,000 or more in competing stores. But as a customer, you don't have to spend much time deliberating over what brand of coffee or home appliance to select. Price/Costco saves you that hassle by choosing for you. The company's Consumer Reports mentality leads to rigorous evaluation of leading brands and shrewd purchasing of just the one brand in each category that represents the best value. To add excitement to the shopping experience -- that is, to get the customer to come again and again -- new items are constantly sprinkled into the assortment to build anticipation and a value-of-the-week atmosphere, while the on-premise bakery wafts a delicious smell of fresh bread and pastry.

Behind the scenes, Price/Costco follows an operating model in which it buys larger quantities and negotiates better prices than competing stores. It carries only items that sell well. The company's information systems track product movement -- and move it does. These data drive stocking

decisions that optimize floor space usage. The place hums. It runs like a well-oiled machine, and customers love it.

Dell Computer is another master of operational excellence. Dell has shown PC buyers that they do not have to sacrifice quality or state-of-the-art technology to buy personal computers easily and inexpensively. In the mid-1980s, while Compaq concentrated on making its PCs cheaper and faster than IBM's, college student Michael Dell saw a chance to outdo both companies by focusing not on the product but on the delivery system. Out of a dorm room in Austin, Texas, Dell burst onto the scene with a radically different and far more efficient model for operational excellence.

Dell realized that he could outperform PC computer dealers by cutting them out of the distribution process. By selling to customers directly, building to order rather than to inventory, integrating his company's logistics with its suppliers', and creating a disciplined, extremely low-cost culture, Dell undercut Compaq and other PC makers in price while providing high-quality products and services.

Businesses like Price/Costco and Dell Computer, which have vigorously pursued a strategy of operational excellence, have built an operating model based on four distinct features:

- Supply chains and basic services that have been optimized and streamlined to minimize costs and hassle.
- Operations that are standardized, simplified, tightly controlled, and centrally planned, leaving few decisions to the discretion of rank-and-file employees.
- Management systems that focus on integrated, reliable, high-speed transactions and compliance to norms.
- A culture that abhors waste and rewards efficiency.

### Winning With Great Products

- Companies pursuing product leadership continually push products into the realm of the unknown, the untried, or the highly desirable. Reaching that goal requires that they challenge themselves in three ways. First, they must be creative. More than anything else, being creative means recognizing and embracing ideas that may originate anywhere -- inside the company or out. Second, they must commercialize their ideas quickly. To do so, all their business and management processes are engineered for speed. Third and most important, they must relentlessly pursue ways to leapfrog their own latest product or service. If anyone is going to render their technology obsolete, they prefer to do it themselves. Product leaders do not stop for self-congratulation. They are too busy raising the bar.

Johnson & Johnson meets all three of these challenges. It brings in new ideas, develops them quickly, and then looks for ways to improve them. The president of J&J's Vistakon, a maker of specialty contact lenses, heard in 1983 about a Copenhagen ophthalmologist who had conceived a way of manufacturing disposable contact lenses inexpensively. At the time, Vistakon generated only \$20 million in annual sales, primarily from a single product, a contact lens for people with astigmatism.

Vistakon's president got his tip by telephone from a J&J employee who worked for Janssen Pharmaceutical, a Belgian drug subsidiary. Instead of dismissing the ophthalmologist as a mere tinkerer, these two executives speedily bought the rights to the technology, assembled a management team to oversee development, and built a state-of-the-art facility in Florida to manufacture disposable contact lenses called Acuvue.

By the summer of 1987, Acuvue was ready for test-marketing. In less than a year, Vistakon rolled out the product across the U.S. with a high-visibility ad campaign. Vistakon -- and its parent, J&J -- were willing to incur high manufacturing and inventory costs before a single lens was sold. Vistakon's high-speed production facility helped give the company a six-month head start over would-be rivals such as Bausch & Lomb and Ciba-Geigy. Caught off guard, the competition never caught up. Vistakon also took advantage of the benefits of decentralization -- autonomous management, speed, and flexibility -- without having to give up the resources, financial and otherwise, that only a giant corporation could provide.

Vistakon's sales topped \$225 million worldwide in 1991, and the division had captured 25% of the U.S. contact lens market. This success resulted partly from directing much of the marketing effort to eye-care professionals to explain how they would profit if they prescribed the new lenses. In other words, Vistakon did not market just to consumers. It said, in effect, that it's not enough to come up with a new product; you have to come up with a new way to go to market as well.

J&J, like other product leaders, works hard at developing open-mindedness to new ideas. Vistakon continues to investigate new materials that would extend the wearability of the contact lenses and even some technologies that would make the lenses obsolete. Product leaders create and maintain an environment that encourages employees to bring ideas into the company and, just as important, to listen to and consider these ideas, however unconventional. Where others see glitches in their marketing plans or threats to their product lines, companies that focus on product leadership see opportunity and rush to capitalize on it.

Companies excelling in product leadership do not plan for every possible contingency, nor do they spend much time on detailed analysis. Their strength lies in reacting to situations as they occur. Fast reaction times are an advantage when dealing with the unknown. Vistakon's managers, for example, were quick to order changes to the Acuvue marketing program when early market tests were not as successful as they had expected. They also responded quickly when competitors challenged the safety of the lenses. They distributed data combating the charges, via Federal Express, to some 17,000 eye-care professionals. Vistakon's speedy response engendered goodwill in the marketplace.

Product leaders have a vested interest in protecting the entrepreneurial environment that they have created. To that end, they hire, recruit, and train employees in their own mold. When it is time for Vistakon to hire new salespeople, for example, its managers do not look for people experienced in selling contact lenses; they look for people who will fit in with J&J's culture. That means their first question isn't about a candidate's related experience; it's more likely to be, "Could you work cooperatively in teams?" or "How open are you to criticism?"

Product leaders are their own fiercest competitors. They no sooner cross a frontier than they are scouting the next. They must be adept at rendering obsolete the products and services they have created. They realize that if they don't develop a successor, another company will. J&J, Nike, and other innovators are willing to take the long view of profitability, recognizing that extracting the full profit potential from an existing product or service is less important than maintaining product leadership and momentum. These companies are never blinded by their own successes.

Not surprisingly, the operating model of the product leader is very different from that of a company like Price/Costco or Dell that's focused on cost. Its main features include:

- A focus on the core processes of invention, product development, and market exploitation.
- A business structure that is loosely knit, ad hoc, and ever-changing to adjust to the entrepreneurial initiatives and redirections that characterize working in unexplored territory.
- Management systems that are results-driven, that measure and reward new product success, and that don't punish the experimentation needed to get there.
- A culture that encourages individual imagination, accomplishment, out-of-the-box thinking, and a mind-set driven by the desire to create the future.

### Winning Through Customer Intimacy

- A company that delivers value via customer intimacy builds bonds with customers like those between good neighbors. Customer-intimate companies don't deliver what the market wants but what a specific customer wants. The customer-intimate company makes a business of knowing the people it sells to and the products and services they need. It continually tailors its products and services and does so at reasonable prices. Its proposition is: "We take care of you and all your needs," or "We get you the best total solution." The customer-intimate company's greatest asset is its customers' loyalty.

Customers don't have to be resold through expensive advertising and promotion. Customer-intimate companies don't pursue transactions; they cultivate relationships. They are adept at giving the customer more than he or she expects. By constantly upgrading offerings, customer-intimate companies stay ahead of customers' rising expectations -- expectations that, by the way, they themselves create. Cable & Wireless, a long-distance carrier, is a good example of a company that is better than most at building relationships that pay off in repeat sales from loyal customers.

Cable & Wireless Communications, based in Vienna, Virginia, has worked for years to become a customer-intimate organization. It is a subsidiary of Britain's Cable & Wireless, and focuses principally on business clients. The company attributes its 20% annual growth rate in number of long-distance customer minutes to its striving continuously to serve customers better than bigger competitors, such as MCI.

Company executives knew long ago that their long-distance operation couldn't compete on price with the Big Three, AT&T, MCI, and Sprint. So they sought to differentiate themselves by providing the best customer support in the industry, along with direct sales consultation that gives salespeople

intimate knowledge of what makes its customers successful. The result is that Cable & Wireless has turned itself from a mundane commodity business peddling long-distance service into a sophisticated telemanager, a partner with its customers. Does the customer need an 800 service that routes calls, blocks calls, or captures data? Cable & Wireless supplies the expertise and information systems. "The product is conceived at the customer's office," says the president and chief operating officer, Gabriel Battista.

Cable & Wireless pins its success on choosing the customers it can serve best -- small to medium-size businesses with monthly billings of \$500 to \$15,000. In such small businesses, Cable & Wireless's 500 U.S. salespeople, working out of 36 regional offices, can act like telecommunications managers. Corporations too small to hire their own telecom gurus value the advice and expertise Cable & Wireless people can offer.

The key is to segment the market vertically. This enables the company to pitch specific customers with specialized services that no other company can begin to provide. Example: One customer segment is the legal profession. Cable & Wireless is developing features and functions that have tremendous appeal to lawyers, such as innovative ways to track and segment billing of calls linked to specific client accounts. "We want to sell products that fit the legal industry like a glove," says Battista.

Next Cable & Wireless fine-tunes its services to each customer. If that means something as simple as printing its bills on both sides of the paper, Cable & Wireless obliges. The company wants customers to feel they're getting the support of not just the sales force but of the entire company. Top management empowers all employees who work with customers to make sophisticated decisions. Pricing was once the domain of corporate pricing gurus. No longer. Now it's in the hands of the 50 local managers. The same thing goes for promotional, advertising, and trade-show money. Local managers allocate it as they see fit, preparing budgets and sending them up the corporate ladder to keep supervisors informed.

Do managers run amok with so much authority? It can happen, executives concede. But they figure the occasional screw-up is worth it. Executives go on to audit all decisions and practices to catch blunders and help the front lines learn from them.

All these practices help Cable & Wireless people build tight relationships with customers. The result is extremely high customer-retention rates: Cable & Wireless loses only 2% of long-distance minutes billed each month, vs. an industry standard of 3% to 5%.

The company holds out a big carrot to keep everyone focused on customer retention: It pays salespeople based on how long a customer remains with the company. Salespeople thus don't hesitate to suggest that customers switch to more appropriate services, even if these bring in less money. Result: happier, more loyal customers.

Again, the operating model of the customer-intimate company is quite different from that of businesses pursuing other disciplines. Its features include:

- An obsession with helping the customer understand exactly what's needed and ensuring the solution gets implemented properly.
- A business structure that delegates decision-making to employees who are close to the customer.
- Management systems that are geared toward creating results for carefully selected and nurtured clients.
- A culture that embraces specific rather than general solutions and thrives on deep and lasting client relationships.

DESPITE the specialization required of market leaders, we regularly come across managers who don't buy the idea of having to narrow their operational focus. "What you're saying about making hard choices doesn't apply to us," they say. "We're good at all three disciplines."

Yet when we look at these managers' businesses, we invariably find companies that don't excel but are merely mediocre in the three disciplines. Sure, as the ante has risen in their markets, they've improved their cost structure and become more aware of their customers. They've added new products and line extensions over the years. They've kept up with rising parity levels to stay in the game. What they haven't done is create a breakthrough in any one dimension to reach new heights of performance. They have not traveled past competence to reach excellence. To these managers we say that if you decide to play an average game, to dabble in all areas, don't expect to become a market leader. Choosing a discipline is the choice of winners.

#### ILLUSTRATION

PHOTO: Low prices and smart merchandising help Price/Costco attract customers to its warehouse stores. (ROBBIE MCCLARAN)

PHOTO: Shoemaker Nike competes not on price but on product. (ROBBIE MCCLARAN)

PHOTO: Cable & Wireless's Battista wins through customer intimacy. (KATHERINE LAMBERT)

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By Michael Treacy and Fred Wiersema

This article is adapted from *The Discipline of Market Leaders*, a new book by Michael Treacy and Fred Wiersema, management consultants at CSC Index.

#### **WHICH DISCIPLINE SHOULD YOU CHOOSE?**

**Market Leaders pick one of these disciplines and then build their organizations around it in the following ways.**

#### **Disciplines**

|                |                           |                       |                      |
|----------------|---------------------------|-----------------------|----------------------|
| Company Traits | Operational<br>Excellence | Product<br>Leadership | Customer<br>Intimacy |
|----------------|---------------------------|-----------------------|----------------------|

|                                 |                                                                  |                                                                         |                                                                             |
|---------------------------------|------------------------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| Core business processes that... | Sharpen distribution systems and provide no-hassle service       | Nurture ideas, translate them into products, and market them skillfully | Provide solutions and help customers run their businesses                   |
| Structure that...               | Has strong, central authority and a finite level of empowerment. | Acts inn an ad hoc, organic, loosely-knit, and ever-changing way        | Pushes empowerment close to customer contact                                |
| Management systems that...      | Maintain standard operating procedures                           | Reward individuals' innovative capacity and new product success         | Measure the cost of providing service and of maintain- ing customer loyalty |
| Culture that...                 | Acts predictably and believes "one size fits all"                | Experiments and thinks "out-of-the-box"                                 | Is flexible and thinks "have it your way"                                   |

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