# Introduction

# Resilience in Turbulent Markets

## *From Inside-out to Outside-in*

MANAGERS EVERYWHERE FACE the most turbulent market conditions since the Great Depression. Global competition has accelerated, and excess capacity worldwide will likely persist as desperate competitors slug it out for increasingly demanding customers who treat goods and services as commodities where price is the only differentiator.

If you face maturing markets and shrinking product life cycles, then your traditional avenues for winning through product or service innovation are receding. You might try to control the purchase equation while cutting costs for short-term relief. Simultaneously, you might curb investment in innovation as product life cycles shorten. But these measures can't effectively tackle a market where customers have more choices, more information, and are themselves being squeezed in a challenging market. Faced by eroding pricing power, managers find themselves in a vicious cycle of declining output, prices, and profits.

What's more, in a marketplace where price erosion seems the norm, the goal of driving volume and margin growth simultaneously is almost inevitably elusive. To grow margin, firms must cut costs and maintain, or even increase, prices. However, a strategy of raising prices risks growing per-unit margins at the expense of reduced sales volume. When firms cut prices to gain top-line growth, growth often comes directly at the expense of margins, which can erode rapidly. All in all, it's a "growth trap" that companies today are desperate to avoid.

This monumental market adversity has triggered survival instincts in most firms. The lofty goals of yesterday to grow and expand businesses have been replaced by efforts to stabilize sales and price declines while at the same time make draconian cuts in costs. The natural response of most business leaders is to look at such turbulence as a period of shakeout in which some will survive and others not and the key differentiator will be those who have honed their survival instincts and acted upon them most effectively. A recent study I conducted with a colleague found some interesting trends that cut across the last three recessions: approximately 60 percent of companies survive through drastic downturns while the remaining 40 percent don't, with some variation across different recessions.[1] Furthermore, the survivors themselves come in two very distinct forms. The first are those that set their sights on survival as their primary goal. They hunker down, conserve resources, slash costs drastically, and wait for the storm to pass before surfacing from their bunkers to pick up where they left off. All endeavors to drive growth are shelved and the focus is on conservation and preservation. They expect to come out of the economic downturn albeit with a nasty hangover from which they anticipate they will recover. The second group, constituting 5 to 10 percent (variance across recessions) out of the survivors, came out of adverse markets not only mere survivors, but actually having leveraged adverse markets to catapult themselves far ahead of their competitors. These firms find ways to embrace downturns that turn adversity into opportunity: they survive and thrive at the same time.

My research uncovered that some companies have circumnavigated the challenges posed by turbulent markets. Few traditional businesses are prospering as I write, but some smart ones are holding their own—even as they nicely position themselves for breakaway success when the roiling seas finally recede. How have they managed it?

By looking at company strategies starting in the last downturn in 2000 and continuing into this one, I found that those companies built around an *inside-out* mind-set—those pushing out products and services to the marketplace based on a narrow viewpoint of their customers that looks at them only through the narrow lens of their products—are less resilient in turbulent times than those organized around an *outside-in* mind-set that starts with the marketplace, then looks to deliver creatively on market opportunities. Outside-in orientation maximizes *customer* value—and produces more supple organizations.[2]

Embracing an *outside-in* perspective—focusing on creatively delivering something of value to customers instead of obsessing over pushing your product portfolio—builds an inherent flexibility into organizations. While this perspective is beneficial under all market conditions, its advantages become particularly acute in adverse and turbulent markets, making you inherently more responsive to market shifts, a competence that's especially important in markets where firms must radically alter what they produce, what they sell, and how they sell it. Rallying around customer problems thus results in the resilience that protects businesses from economic storms.

A recent study by Richard Ellsworth offers even broader evidence of the bottom- and top-line power of fostering resilience through a customer-centered outside-in approach. While the study primarily compared organizations that shared a common purpose with those that didn't, it also examined whether the actual purpose they pursued mattered. Among purpose-driven companies, *customer-driven* companies were significantly more successful than *shareholder-driven* ones, providing a 36 percent advantage in shareholder returns, compared with their industry median; shareholder-aligned organizations provided only a 17 percent advantage.[3] In sports terms, that's a rout.

## Is Your Company Resilient? The Four Levels of Organizational Resilience

All organizations like to think of themselves as resilient. They want to see the world as their customers see it, to partner with customers to solve their problems, which in turn allows them to be nimble and responsive to market shifts. Such customer-centricity that is a key enabler of organizational resilience is, however, easier said than done. The vast bulk of enterprises talk the customer talk while failing consistently to walk the customer walk. This failure results from not only how companies understand (or don't understand) customers externally, but also—far more importantly—how they *structure their internal organization*. Without organizational flexibility, a company will never be truly resilient, a grave risk in turbulent times. Which is your enterprise—resilient or rigid?

In my research, I've observed what I call the four levels of organizational resilience. Where does your business fit in?

### *Level 1*

Level 1 firms are quick to assure customers that they are the center of the universe, but they guarantee a high level of rigidity by continuing to view the marketplace entirely through the lens of their own goods and services. The motto of level 1 companies is simple: we make, you take. For some, the customers become incidental to the entire enterprise. That's how many GE executives described a stagnant GE when Jack Welch took over as CEO in 1981: "[GE is a company] . . . with its face to the CEO and its ass to the customer."[4]

### *Level 2*

Level 2 firms have more than a veneer of pliancy. They systematically gather customer information and channel it to the appropriate units. They thoroughly understand their heterogeneous customer base, and can thus distinguish precise customer segments and needs and can tailor their products accordingly.

Intellectually and emotionally, though, level 2 enterprises step only partially toward resiliency. Though they understand customer needs, they still focus on their products, viewing their customers through the lens of the company's offerings, focusing on customers' experience with their purchase while ignoring the larger problems that customers may be trying to solve. Structurally, level 2 enterprises remain organized by product or geography, and gaining insight into customers remains the province of separate staff units like marketing. These firms will bend in a storm, but only so far.

### *Level 3*

Level 3 firms are a quantum leap beyond their level 2 competitors when it comes to pliancy. They focus first on the problems their customers are trying to solve, and only then turn to their products, configuring their offerings to address those problems. Further, they conserve resources by allocating them only to those tasks that will help customers most. Whether premium providers of a differentiated offering or low-cost leaders, level 3 firms filter all resource allocation decisions through the lens of deep customer awareness, turning encounters with select customers from transactional to relational. Authentic empathy with customers and their issues becomes paramount as these firms continually evolve their offerings to meet those issues.

Intellectually, level 3 firms have achieved resilience at the highest plane. Moreover, they have the structural elements to become, in Zen terms, one with their customers. They have mechanisms to foster greater integration between their disparate units. Sometimes they even bust those units apart, replacing them with structures more closely aligned with their customers.

What, then, holds level 3 back from maximum resilience? Two things: At an emotional level, these firms are not yet ready to sever the final ties to their old product- or service-centric corporate identity. While they see through the prism of customer problems, they continue trying to match what customers want with what they themselves produce. Hence, their evolution to full resilience remains incomplete. More important, at a structural level, they are unwilling to eradicate the final rigidity that holds them back: their own borders. They think outside the box but live inside one.

### *Level 4*

The most resilient companies—level 4 firms—go well beyond their competitors in attuning goods or services to customers' needs and even beyond redefining themselves in terms of the customer problems they want to solve. A level 4 firm is more attached to producing solutions to those problems than it is to the products and services it offers. This intellectual, structural, *and* emotional transition means that it is no longer concerned whether the inputs it uses to solve customers' problems are its own or assembled through a network of partners.

Successfully dealing with their own organizational barriers ultimately differentiates level 4 firms. Unlike lower-level peers, they understand that they cannot become deeply and profitably resilient without an organizational architecture that enables and encourages the entire company to understand and respond to customer needs. The entire firm reorients around a common axis: the customer. Without these fundamental organizational adjustments, all the other activities to improve customer understanding—market research, activating and monitoring customer communities, open innovation, and more—will never deliver their full potential.

Structurally, level 4 firms foster permeable boundaries not only between their disparate internal units, but also between themselves and external partners that may now produce key elements of their offering. Level 4 firms might have stumbled their way into authentic resilience, but once they get there, they embrace living inside their customers' wants and needs and make that part of their deliberate strategy. Their borders are their customers' borders, even if that means that some boundaries are dissolved into partnerships and third-party arrangements.

Apple's phenomenally successful iPhone is a case in point. Apple partnered with AT&T, granting the carrier five years of exclusivity as the only iPhone-compatible U.S. carrier, approximately 10 percent of iPhone sales in AT&T stores, and a small piece of Apple's iTunes revenues.[5] In return, AT&T developed iPhone features like visual voice mail, which provides enhanced information about received messages and a touch-screen interface for calling back or deleting them, and streamlined the in-store sign-up process. And while Apple wrote its own operating system, it partnered with multiple firms to produce a wide range of applications. Some are free, like the preloaded Google Maps; others are sold through its online store. Other partners produce a vast array of accessories, sold in Apple and other retail stores.

That partnering is only on the outside. When industry analyst iSuppli Corporation examined the iPhone's innards, it found a global catalog of third-party companies. German semiconductor producer Infineon supplied much of the phone's core communication capability; National Semiconductor provided the chip that connects the display to the graphics controller; Balda AG provided the display module. The touch screen included components from Epson Imaging Devices, Sharp, and Toshiba Matsushita Display Technology. Samsung provided at least three crucial components, and a host of other suppliers for other components were also represented.[6] iSuppli estimated the cost of these inputs and calculated that the margins for Apple likely exceeded 50 percent.

Take note—not all companies must emulate Apple or, for that matter, can gain by enhancing their resilience from level 3 to level 4. Apple itself is now trying to pull some of its outsourcing back in-house. The level to aspire to is largely determined by how exposed a company is to the raging commoditization wars and other market dynamics. What's important to keep in mind is that achieving full organizational resilience requires a companywide commitment—because the process is likely to reveal that the company itself is the biggest impediment on this journey.

## How Can You Become Resilient?

Over the last decade, long before economic circumstances made resilience such a vital survival skill, I have interviewed over five hundred executives, from CEOs to division heads and line managers, and analyzed close to a dozen enterprises, searching for the secrets of resilient organizations. I began my research during the 1999–2000 recession, when I was looking at strategies companies used to survive and thrive, and have continued to track the same firms and some others through the post-2000 upswing until the present. My research has revealed a four-part path that many of these companies are following.

- First, they have changed the conversation with their customers from one that focuses only on product specifications and price—the underpinning for inside-out thinking—to one that is more outside-in, focused on how they can help address customer-articulated needs. They have also sought to discover customer needs that may not be fully articulated.

- Second, they no longer conceive of themselves as *selling to* customers, but rather as *solving problems with and for* customers. Their corporate souls are shaped not by *making* or even *being* but by *solving*. Developing real and deep customer empathy has become a key imperative.

- Third, many have developed a salutary indifference to whether their own key inputs or even outputs are produced by themselves or someone else. As customer-centric companies focus on the set of customer problems they want to solve, they become less concerned with the means and more focused on the ends. Thus, these resilient enterprises are defined not by the stalwartness of their boundaries but rather by their permeability. Where once corporate boundaries were marked by defensive fortifications, these firms are strong enough to invite their former enemies inside.

- Finally, and most important, for these resilient firms, *customer centricity* and related outside-in thinking isn't a shopworn mantra; it's their way of life. Their CEOs and top management see the business from the outside in—immersed in the broad customer experience, not constricted to the narrow lens of product or service—and build an organizational architecture that preserves that perspective and allows the company to bend the customers' way—the more so, the worse the economic climate. Under dire commoditization pressures, these companies have hacked down not costs but the old structures that held them in a product-centric world. They have not simply sharpened or redefined their strategy—the normal nostrums—nor was effective marketing alone the key.

Most managers understand *why* they need to be resilient, and many have figured out *what* customers want and *what* their companies should offer, but few appreciate the huge *organizational* barriers that prevent them from delivering on the suppleness they so fervently desire. While building customer centricity and outside-in thinking can make for great mission statements, most companies find it also spawns operational chaos and job confusion because they are not set up to execute on the promise.

Virtually all organizations have traditionally been built around stand-alone "silos" that revolve around a set of functions, products, services, or geographies, guarded by fortified boundaries that resist the intellectual, structural, and emotional changes that cooperation and coordination around a customer axis require. This organizational architecture has dictated strategic focus, which was by necessity inside-out (*from* the product or service *to* the customer), and, in turn, the customer interface, which was oriented toward selling products or services rather than toward customers and the problems they are trying to solve with those products or services.

These legacy boundaries are the final and often most resistant barrier to organizational elasticity. Even in a networked age, organizational boundaries have an extraordinary and endemic capacity to impede new growth initiatives by creating blind spots to fresh opportunities that may reside between silos or that can only come about through cross-silo collaboration. Altering such core elements is not easy—but it can be done. In fact, as readers will discover, some companies have done so very successfully, and many more could.[7]

Building resilience into an organization can involve a complete restructuring, or require the bridging of existing product, geographic, or functional lines, and processes that have created barriers. But busting up organizational silos does not always equal obliteration, nor should it. Boundaries are often crucial to innovation and the development of deep product and marketing expertise—not to mention corporate identity—so managers must find ways to maintain those benefits while harnessing the aggregate strengths of the company's silos to develop and improve customer-centric offerings.

## How This Book Evolved

This book grows out of a decade of research. The role of outside-in thinking and action in fostering resilience is exemplified by

FIGURE I-1

**Firms included in study**

| Business-to-consumer (B2C) | Business-to-consumer (B2C) and Business-to-business (B2B) | Business-to-business (B2B) |
|---|---|---|
| Harley-Davidson | Tribune | Jones Lang LaSalle |
| Starbucks | Best Buy | Lafarge |
| Target | Cisco | GE Healthcare |

the nine companies I tracked over the course of this study (see figure I-1).[8] The companies include firms that sell products, services, and both (GE Healthcare). Some are large multinational corporations (e.g., Lafarge). Some are technology intensive (Cisco), and some are not (Starbucks). One (the Tribune Company) ultimately stumbled—though for reasons that had to do with external industry factors, not its thinking.

What all nine companies had in common when I picked them in 1999 and 2000 was their passion and commitment to look for innovative ways to survive and thrive through a recession. All had focused on achieving authentic resilience as a key to their success and made a serious effort to achieve that goal, and collectively, they strongly outperformed the S&P 500. Their total shareholder return over the 2001–2007 time frame of my study was a whopping 150 percent, compared with the S&P 500 at 14 percent. Only two companies in my sample, Tribune and Cisco, underperformed the S&P composite, mirroring problems in their specific industries. Over the same time period, these nine companies, which worked so diligently to achieve deep and meaningful resiliency, reported an astonishing average increase of 134 percent in sales growth, compared with a 53 percent average increase for the S&P 500.

What makes their stories even more significant is that the relatively good news has continued into the current sharp downturn that began in early 2008. While most of them have suffered along with others in their sectors, most have done better than their immediate competitors. Over the twelve-month period starting January 31, 2008, Best Buy's major rival, Circuit City, filed for bankruptcy first and then, ultimately, liquidation. During the same time period, Jones Lang LaSalle gained ground on its major rival, CB Richard Ellis, which is reflected in its relative market capitalization: CB Richard Ellis's market capitalization has gone from being 2.2 times that of Jones Lang LaSalle to 1.6 times at the end of January 2009. Similarly, Lafarge's market capitalization is down 1 percent in this time period, while that of its major rival, Cemex, has dropped 22 percent.[9]

I also relied on a number of other sources for some of the ideas that went into this book. Before I began my fieldwork, I conducted an exploratory survey-based study of *Fortune* 500 CEOs to explore their key strategic and organizational challenges coming out of the last recession in 2000.

A final source of data was my MBA and executive MBA students to whom I was teaching the cases I'd written on these companies. As a teaching device, I also asked several hundred of my executive MBA students from North America, Europe, and Asia to discover and document cases of companies that had faced the kinds of implementation challenges associated with becoming customer centric in turbulent markets. These stories further sharpened my thinking.

## *The Path of This Book*

This book is primarily about implementation: the managerial processes that firms use to build resilient organizations by prying open the internal boundaries that separate the firm's units and the external boundaries that separate the organization and its partners. The many pitfalls on the road to resilience will be covered at length throughout this book, but so too will the pathways, as I explore the underpinnings of success and failure in firms' quest for the deep customer centricity that is so crucial today. I will also demonstrate the importance of companies' making their internal and external boundaries more permeable and adaptive. Getting there, I will show, requires turning the inside-out mind-set and organizational architecture outside in.

Chapter 1 starts off by addressing the question of *how* an organization can recognize and shift internal barriers to move toward resiliency, tracing one company's journey to customer centricity as an example. This chapter also introduces the five levers—coordination, cooperation, clout, capability, and connection. Used together, these key organizational levers carry a company from *why* to *what* and *how*, and lead it to building a resilient organization. Chapters 2 through 6 examine each of these levers in depth, providing a tool kit that you can use to dissolve silos and replace them with a resilient organizational architecture. Finally, the conclusion considers these five levers in the context of the four levels of resilience, and describes the way these can work together to achieve the truly supple organization, one that dances with its customers rather than dictating to them.

Now let's start on our journey.