This Quarter’s Results Are Not Enough
Culture Matters

Turquality Vision Seminar
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Don Peppers
No matter how innovative your product is...

...in a few years it will still be a commodity
The velocity of change is increasing

- Economist Paul Romer estimates human beings are on average 30 times wealthier today than just 200 years ago
  - Despite having many times more people dividing up the same quantity of earthly resources
- Re-arranging our finite physical resources to create value requires two tasks:
  - Discovering new “instructions” for how to arrange resources
  - Carrying out those instructions

New ideas, changes, and innovations have their own “network effect”
Shorter business horizons

- A study of 6800 companies in 40 industries spanning 25 years showed:
  - Periods of persistent superior economic performance are declining in duration, over time
  - Hyper-competition not limited to tech sector
  - Successful companies now string together short-lived competitive advantages to sustain their success
  - Neither a large market share nor a concentrated industry correlate with sustainable success

- Other studies show similar results

Source: Wiggins and Ruefli study, 2001
Companies are at greater risk of failing

- Individual equity stocks are now more volatile than before
  - But market as a whole is no more or less volatile

- Average life of a company in the S&P 500 list in the 1950’s was 25 to 35 years

- Today, it is 10 to 15 years
Creative destruction at Intel

Andy Grove to Gordon Moore:

“If we got kicked out and they brought in a new CEO, what do you think he would do?”

“Why shouldn’t you and I walk out that door, come back in, and do it ourselves?”

Source: Creative Destruction, Foster and Kaplan, 2001
Last year Darwin’s turtle Harriet passed away

It is not the strongest of the species that survives, not the most intelligent, but the one most responsive to change.

Charles Darwin

1835 - 2006
Wake up, everyone: The World is Flat

- Technology, interactivity, work-flow software
- Deregulation, democracy, free markets, consumer demand
- Outsourcing, off-shoring, supply-chaining, insourcing

Internationally, change is faster, and it’s even more critical to be able to adapt
Change is the only way to create value

- **The old-fashioned way:**
  - New products and services conceived by an elite staff from research, engineering and (sometimes) marketing

- **21st Century:**
  - Open-source contributions, market-based evaluation
  - Autonomous players working together

- To remain successful your company must have a resilient, innovative, trusting *culture*
R&D spending isn’t necessarily the answer

- Research shows little correlation between increased R&D spending and profit improvement
  - Levi Strauss, Polaroid, Maytag – all spent heavily on R&D as profits continued to plunge

- Last ten years saw a 7% CAGR of new products introduced in the US – 32,000 in 2004
  - But corporate sales increased just 3% annually

- Booz, Allen study shows top innovators tend to spend less on R&D relative to sales!
99% of inventions are failures

Portable office necktie
99% of inventions are failures

Hay fever hat
99% of inventions are failures

Cockroach-swatting slippers
99% of inventions are failures

Vertigo-reducing eyeglasses
99% of inventions are failures

Solar-powered cigarette lighter
99% of inventions are failures

Fresh oxygen mask
99% of inventions are failures

Ten-in-one gardening tool
99% of inventions are failures

Discount hearse
99% of inventions are failures

Eye-drop funnels
But some innovations do succeed. Why?
Three factors in “sustainable innovation”

1. Demand
2. Design
3. Do-ability

Each of these factors requires a firm to develop a *culture of trust*
1. Demand: If you build it, will they come?

- Getting “insight” from customers does not ensure success
  - There is no customer demand for products
  - The only demand customers make is to solve their problems, or meet their needs

- *Listening* to customers is not the same thing as being *directed* by them

- Focus groups and traditional market research methods usually won’t uncover big opportunities
  - “People can’t know what they don’t know”
As Henry Ford reported…

“If I had listened to what people said they wanted, I would have designed a faster horse.”
So back up from the product you sell…

- Ask yourself what the customer’s problem actually is
  - What is his motivation?
  - What does he need?
- Now: What portion of the customer’s problem can you help solve?
Taking the customer’s perspective

Maximize the value created by each customer

Share of customer

Maximize the value created by each product

Customer Needs Satisfied

Customer Centric

Product Centric

Market share

Customers Reached
But what exactly is *share of customer*?

- Other products, across the whole organization
- Ancillary services
- Additional sales, over time
- Referrals of colleagues, family, friends
- Related problems and issues

*Share of customer = share of need*
Acting on the customer’s need

- Go to an ATM for ING Bank
  - Ask to withdraw cash
  - Suppose the ATM notifies you that you don’t have enough money in your account for this...
- If this happens, and you are creditworthy, ING mails you a credit line offer within a few days

Response rate greater than 50%!

Source: SPSS Netherlands
Backing up from the product

Many “green house” customers

Remote monitors for complete environment
Different customers need different things

Quarterly mailing goes out to eleven million customers in five million versions!

- Response rates generally 25% to 30%
- £100 million incremental sales annually
What do these businesses have in common?

They each focus on the customer’s problem to be solved, rather than the product to be sold.

By doing this, they are maximizing the value created by each customer.
And consider how customers create value

First, they generate current profits, today

But also, the customer’s experience, today, affects what *share of customer* you can expect

Suppose a valuable customer calls you to make a complaint...
Balancing between short term and long term

Attempts to increase current income affect a customer’s lifetime value, and vice versa

- Marketing too aggressively could damage the future value a customer might give you, while
- Improving service to boost future value costs money in the present

Taking a balanced approach is critical
The “Goldfish Principle”

Some species of tropical fish have no capacity for territorial memory.

Businesses focused only on current period earnings often have no *customer* memories.

But with no memory of a customer’s past and no regard for the future, their decisions are *unbalanced*. 
Out of balance

- Highly profitable bank
  - FY 2003 net income of nearly $18b, five-year CAGR of 9.5%
  - Market cap in Sept 2004 of $240b

- But then: All Citi’s private banking in Japan was closed by regulatory authorities
  - Selling complicated derivatives clients didn’t understand
  - Requiring purchase of securities as a condition for loan
  - Passing off second-rate art works as premium art
  - Tolerating stock manipulation and possibly even laundering
Short-term gain, long-term loss

- According to the Wall Street Journal, Citigroup
  
  “…tolerated lax practices …as long as aggressive business targets were met.”

- Merrill Lynch downgraded Citigroup’s stock, because:
  
  “Citigroup might lack something that poses a threat to its future growth: a sense of right and wrong.”

Citigroup’s stock price was doing well, and then...

$15 billion of lost value
Nor is Citigroup particularly unique…

Would you give up real economic value to make this quarter’s numbers?

What portion of American public-company CFOs answer “yes” to this question?

*In a recent survey, nearly 4 out of 5!*
Will businesses be consumed by short-termism?

Short-term thinking does genuine financial damage to a firm
### Market share vs. Share of customer

<table>
<thead>
<tr>
<th>Market share</th>
<th>Share of customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product point of view</td>
<td>Customer point of view</td>
</tr>
<tr>
<td>Current-period metric</td>
<td>Long-term metric</td>
</tr>
<tr>
<td>Adversarial</td>
<td>Collaborative</td>
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Taking a collaborative approach

- Orica, based in Australia, sells chemicals, paints, fertilizers, and commercial explosives
  - One of the world’s very largest explosives manufacturers

- Explosives customers are mostly mining companies and quarry operators
  - They want rocks broken into optimal size
  - Too large or too small means extra cost and time required

- Up to 20 variables must be considered in calibrating an explosive blast, including type of rock structure
  - But each individual quarry has limited opportunity to experiment with these variables
Database of blast parameters

- Orica collects blast input and output parameters from customers all around the world

- Orica sells customers a service contract for crushed rock, taking charge of blast management itself
  - Customers minimise risk of poorly executed blasts
  - They now have a “floor price” for correctly broken up rock

- What makes it possible is Orica’s knowledge gained from many customers
  - And the customers themselves are collaborating with Orica to provide this service
Seek out feedback from customers
Why customers choose you

Two Canadian marketing professors asked thousands of business executives this question over a four-year period.

Answers in all industries are remarkably similar.

“...trust, confidence, strength of customer relationships...”
Think about your customer value proposition

A customer creates the most value for you when you create the most value for him

But when does this happen?

Maximizing the value customers create requires you to earn their trust
Four ingredients of customer trust

- Credibility
- Reliability
- Intimacy
- Self-orientation

-- Charles Green, 
*Trusted Advisor*

-- Steven M. R. Covey, 
*The Speed of Trust*
What humans and vampire bats have in common

Except for humans and some other primates, only vampire bats are capable of trusting non-relatives

*Trust involves balancing an uncertain long-term benefit against a known short-term cost*
Customer trust implies customer advocacy

“Treat the customer the way you would want to be treated if you were the customer.”

- Forrester survey rated USAA highest in “customer advocacy”
  “the perception by customers that a firm is doing what’s best for them and not just for the firm’s bottom line”

- According to Forrester, customer advocacy is…
  “…the best indicator of whether financial services companies are able to achieve cross-sell success to a customer base”
  “Firms that score highest, such as USAA, are considered the most for future purchases of products and services.”
The organizational benefit of trust

- Groups, teams, companies all need to cooperate in order to achieve goals
  - Reducing travel expenses, winning an account, or launching a new product on time and within budget
- An individual group member’s own interests often conflict with the group’s goal
- Trusting other members of a group is what makes the group effective

*Trust is a prerequisite to effective innovation*
The social role of trust

- Playing the ultimatum game
- “Strong reciprocity” – willingness to punish those thought to be guilty of unfair dealings
- Robert Axelrod’s description of how members behave in a productive society:
  
  “…nice, forgiving, and retaliatory”

- In the ultimatum game:
  - People from market-oriented economies make higher offers and exhibit strong reciprocity
Internet means trust is more important than ever

- Reputation can now be spread online
- Abuse one customer and thousands of others may soon learn of it
- Far from inhibiting businesses, the need for trust has eliminated economic friction
- Consider E-Bay’s business model, among others
  - Hundreds of thousands of new businesses that would not have been able to exist before
Customer trust can serve as the basis for culture
Networking together creates the most value
Complex adaptive systems innovate to persist

They use a balance of exploitation and exploration

- Ants leave chemical trails, and honey bees do a dance
- But in addition to exploiting known food sources, ants and bees also explore to find new food sources
  - Bees will find any new food source within 2 km of the hive
- *Exploitation* helps social insects survive the short-term, while *exploration* ensures long-term persistence

Source: *Swarm Intelligence*, Kennedy and Eberhart, 2001
Companies are complex adaptive systems, too

- Complex adaptive systems involve both positive and negative feedback mechanisms
  - Composed of “agents” acting independently, but also in response to other agents
- Employees, channel partners, and customers will be interacting and adapting to one another
  - This will produce results that are better than even the best single employee or channel member could produce
  - Complex systems are able to generate highly variable outcomes by applying a few simple rules

Source: *More Than You Know*, Mauboussin, 2006
Simple rules are required

- Chess grandmasters follow simple rules
  - Don’t look too far ahead
  - Develop and continuously revise your options
  - Know your competition
  - Seek small advantages

- Five varieties of rules for business strategy
  - How-to rules
  - Boundary rules
  - Priority rules
  - Timing rules
  - Exit rules

Simple rules define your corporate culture

“How things get done around here…”

Some questions to help define your company’s culture

- What activities are “out of bounds” for your company?
- What do you value most and what do you value least in a customer or client?
- Are there any customers you would choose not to serve?
- How fast do you make decisions and take actions?
- What criteria are applied in making decisions?
- Is dissent discouraged, tolerated, or actively encouraged?
A healthy culture involves a sense of purpose

- Employees (and others) must be bound together with an over-riding common purpose
  - A healthy mission will go far beyond profit or shareholder value
- Creative innovation and problem-solving occur best when employees have a mission
  - Purpose-driven employees work at overcoming obstacles and removing barriers to the mission
- Culture perpetuates itself through: Imitation
When people are free to do as they please, they usually imitate others

Eric Hoffer
Companies are less efficient than beehives

- Bees and ants are programmed to make decisions for the benefit of the community
  - But employees often act out of self-interest

- To maximize your company’s capacity to innovate
  - You need metrics and incentives for behaving in the corporation’s broader interest
  - Then take advantage of the human impulse to imitate by relying on a unifying employee culture

- Your goal: self-organizing employees
But your culture must involve the *right* purpose

- A strong but misdirected purpose will simply lead to faster failure
  - Enron employees had a strong sense of purpose…
- …and now “the smartest guys in the room” have become “the smartest guys in the prison”
However, if your culture involves customer trust

• Then think about the kind of work place you are offering to your employees…

• Now imagine how difficult it will be to get an employee to deceive others

  • Customers, investors, regulators

• Would an Enron or Worldcom deception even be possible for a customer-oriented enterprise?

• How might Citigroup’s private banking operation in Japan have been run differently?
“At Sony, we assume that all our competitors’ products have basically the same technology, price, performance, and features. **Design** is the only thing that differentiates one product from another.”

– Norio Ohga, former chairman
Everyone wants to be a designer

- Number of graphic designers in the US has increased ten-fold in a decade
  - There are now four times as many designers as there are chemical engineers
- Design involves more than just the physical composition and structure of a product
  - Ideation, creativity and originality
  - Aesthetic appeal – both physically and conceptually
Involving customers in your business

- 3M relies on customers called “lead users” because their needs lead those of other users
  - Often lead users are already experimenting with home-made improvements and upgrades

- National Semiconductor provides an online design platform for its customers
  - Creating their own proprietary product designs
  - Over 20,000 new product designs per month!
Crossing boundaries, seeing relationships

- Creativity involves crossing boundaries in the organization, and this requires empathy

- Taking the customer’s perspective requires you to operate in multiple domains

- Research shows that highly creative people are often more androgynous
  - Creative boys are more sensitive and less aggressive than other boys
  - Creative girls tend to be more dominant and tough than other girls

“Perspective is more important than IQ”
- Nicholas Negroponte
Creativity is about new perspectives

See things differently and you may see different things
Everyone know what this is?
How about this?
Truly creative leaders are multi-faceted

Question:
What is Sony’s Norio Ohga doing in this picture?

Conducting the Pittsburgh Symphony Orchestra
The role of humor

- Humor requires boundary crossing, empathy, synthesis, and context

- It is a sign of the creative process at work

- Research shows that the most effective managers use humor twice as often as others
  - Humor is highly correlated with emotional intelligence

There is no question that a playfully light attitude is characteristic of creative individuals

- Mihalyi Csikszentmihalyi
Test your sense of humor…

Complete this note, handed to a Qantas flight attendant.

dear Captain
My name is Nicola I'm 8 years old, this is my first flight but I'm not scared. I like to watch the clouds go by. My mum says the crew is nice. I think your plane is good. Thanks for a nice flight
Data point: MBA is no longer the only “ticket”

- At McKinsey, a dramatic shift in hiring
  - In 1993, more than 60% of new recruits had MBA’s
  - By 2003, just over 40%, because McKinsey doesn’t consider an MBA sufficient, by itself
- Corporate recruiters now visit top arts schools
  - A Masters in Fine Arts is in demand in business, as never before
- Ex-Marine Bob Lutz, cigar-smoking CEO of GM, says GM is in the business of “mobile art”

Source: Pink, A Whole New Mind
Staff your organization with creative people

• Intellectually curious
• Flexible and open to new information
• Able to recognize problems and define them clearly and accurately
• Able to put information together in many different ways to reach solutions
• Antiauthoritarian and unorthodox
• Mentally restless, intense, highly motivated
• Highly intelligent
• Goal-oriented

Creativity requires passion

Innovation is about attitude, passion, and having fun!

- Critical Eye, May 2006

- In reality, innovation requires motivating others for action

- Effective innovators work toward something more important than their business goals
  - Truly successful innovations spring from having a sense of *purpose*
Employees are the key drivers of innovation

- In the US:
  - Given the opportunity, nearly 50% of US employees will engage in identifying and implementing ideas.
  - But on average, just one idea per year from every eight employees, and less than one-third are implemented.

- In Japan, by contrast:
  - Approximately 30 ideas per year per employee, and more than two-thirds are implemented.

- Japanese firms tend to place more emphasis on maintaining the right employee culture.
Toyota

- Globally, Toyota operates 580 companies and manufactures in 58 factories outside Japan
- It sells cars, trucks, parts and other products in 170 countries
- “Just-in-time” provisioning requires that units and employees have autonomy
  - Decisions must be made by people on the scene
  - In this kind of environment, innovative ideas are highly perishable

Source: *Economist*, 19 January 2006
At Toyota, culture is a deliberate act

- What holds Toyota together, according to senior executives, is a **strong corporate culture**

- Every worker, no matter how far down the production line, is a “knowledge worker”
  - *Everyone* is asked to think creatively about improving his particular corner of the organization

Source: *Economist*, 19 January 2006
Five elements in “The Toyota Way”

- **Kaizen**, the Japanese process for continuous improvement

- **Challenge**. Don’t view problems negatively, but positively, as a way to help improve performance

- **Teamwork**. Putting the company's interests before those of the individual, and sharing knowledge with others

- **Respect for others**. If two people always agree, then one is superfluous. Express differences, but respectfully.

- **Genchi genbutsu** (GG). Roughly translated GG means “go to the source”

Source: *Economist*, 19 January 2006
Go to the source of a problem first

Why an Air Force colonel ate my donuts...
3. **Do-ability**: Making innovation happen

- How do we ensure that diverse creative contributors all work toward a common goal?
- Is it possible to focus on long-term exploration as well as exploitation?
- Can the creative and ideation process be managed efficiently and goal-oriented?
- How do we plan and organize in a way that encourages *adapting to continuous change*?
People are smarter than you think...

- Groups make collective decisions much better than even expert individuals do
  - As long as a group includes a diverse set of people making independent decisions
  - It isn’t the number of experts in the group, but the diversity of perspectives that counts

- For example, “decision markets” predict sporting events and election results with great accuracy
  - Bookmakers take their “vigorish” off the top, after adjusting the odds to balance winners and losers
  - Stock market has uncanny accuracy
Where were you on January 28, 1986?

- “No clues” the day, and investigation took six months
- Key space shuttle contractors:
  - Rockwell built the Challenger and its engines
  - Lockheed managed ground support
  - Martin Marietta manufactured the external fuel tank
  - Morton Thiokol built its solid fuel boosters
- That day Thiokol’s stock closed down the most, lower by 12%, with other contractors down just 3%

How did the market know?
Interactivity can create “decision markets”

- Rite-Solutions (software for military applications) began internal stock market for product ideas in January 2005
  - 55 stocks listed on “Mutual Fun,” each with detailed description, and each trading at $10 per share initially
  - Employees bet up to $10,000 in “opinion money,” and also lend support by volunteering to work on project
  - Winners share in proceeds of new products if successful
- Biggest win so far is a type of 3-D visualization software initially rejected by “experts” in R&D department
- One year later, this product accounts for 30% of sales!

Why focus on employee *culture*?

- Employee culture will be increasingly important for *helping organizations adapt to change*

- Employment structure is upgrading rapidly
  - Production jobs (~20% of all jobs) and transactional jobs (~40%) and are being rapidly automated
  - *Non-routine decision-making jobs* (~40%) require employees to deal effectively with ambiguity
Changing nature of employment…

- Non-routine decision-making jobs grew 2½ times faster than other jobs in last five years
  - 70% of all US jobs created since 1998
  - These jobs pay 55% to 70% more than other jobs

- Competitive success requires a firm to increase the productivity of these high-value employees

- Interaction, networking and collaboration are the activities that must be facilitated

- You want your employees to be **engaged**

Source: McKinsey Quarterly 4, 2005
Understanding “employee engagement”

- According to the Hay Group, there are four elements in engagement:

1. Clear and promising sense of purpose
2. Confidence in the organization’s leaders
3. Collaboration and collegiality
4. Development opportunities

Source: Hay Group, 2006
But employee engagement by itself not enough

- Hay Group’s research shows two factors contribute nearly equally to employee performance
  - *Engagement*, giving employees a sense of purpose
  - “Support for success” – i.e., empowerment, training, resources and tools

*Employees need to be empowered, not just motivated*

Source: Hay Group, 2006
Engagement and empowerment are related

Support for Success (Empowerment)

High  Low

Employee Engagement (Motivation)

Low  High

Detached  Effective

Ineffective  Frustrated
At one major health insurer

% of employees who exceed expectations

- **Support for Success (Empowerment)**
  - Low: 22% exceed
  - High: 27% exceed

- **Employee Engagement (Motivation)**
  - Low: 24% exceed
  - High: 34% exceed

- Employees are 50% more likely to exceed performance expectations when both motivated *and* empowered.
This is what customers **want** from companies

“Through 2010, empowering employees will be the quickest route to improving the customer experience.”

- Ed Thompson, Gartner

Richard Lee and David Mangen survey: “Customers Say What Companies Don’t Want to Hear”
Empowering employees

“Ladies and gentlemen serving ladies and gentlemen.”

The Ritz-Carlton®

“No one tries harder for customers.”

FedEx® Express

Stena Line

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Great to empower employees, but…

Will they do the right thing for your business?
A tale of two UK airlines…
Dealing with customer “moments of truth”

- All customer interactions are “moments of truth,” but some are crucially important
  - When the issue is highly important to the customer, the outcome is critical to the future of the relationship

- How “moments of truth” are handled is vital to the health of every customer relationship
  - Positive outcomes increase share of customer
  - Negative outcomes reduce share of customer
How employees deal with “moments of truth”

- **High Importance to Consumer**
  - Surprises, trials and tribulations
    - Employees making non-routine decisions
  - Predictable customer lifecycle events
  - Threats to cost efficiency
    - Business as usual

- **Low Importance to Consumer**
  - Effective decisions require employees who are
    - Motivated
    - Empowered
  - Process Standardization
Culture can provide a competitive advantage

- Efficiency advantages from automating production and routine decisions are easily matched
  - Every cost reduction and automation advantage eventually pervades a whole industry sector
- But proficiency at non-routine decisions can’t be imitated by competitors so easily
  - More complex organizational models will slow the dissemination of performance improvements
  - What is a “best practice” in non-routine, judgment-based decision-making, anyway?
- **Culture is harder to copy**
Think global, act local

- ExxonMobil
  - 86,000 employees (down from 100,000 in five years)
  - Ten separate operating companies, using three major brands – Exxon, Mobil, Esso
  - Presence in more than 150 countries
  - ExxonMobil’s annual sales mean if it were a country, it would be almost as large as Taiwan

- **Total headquarters staff: 300**
Improving productivity of high-value employees

- Training, empowerment, and motivation are each required

- But the most powerful motivations are not usually in monetary form:
  - Control of one’s own destiny and autonomy of decision-making
  - Support of a team or a cohesive group
  - A purpose-driven profession or career

A culture of customer trust provides the ideal platform for maximizing these motivations
And when customer trust is part of the culture

Sustainable innovation is not the only benefit
Integrity has no elastic properties

• No one ever has just “some” integrity

• If your employee culture is designed around earning and keeping the trust of customers, then

• Trust is also more likely to characterize other relationships, as well
  • Employees trusting each other
  • Channel partners trusting and respecting the brand
  • Vendors, investors, and other stakeholders
Some suggestions for international success

• Place the customer’s interest first in all decisions
  • First question anyone should ask when making a decision…
  • Cultivate customer feedback

• Study and improve your employee culture
  • Welcome dissent and encourage trust
  • Create a “sense of purpose” for the organization

• Move people around
  • Multi-disciplinary experience leads to more creativity
  • Harness the “network effect” of your intellectual capital
  • Push everyone to make one improvement every day
Your most competitive weapon: Culture

A great culture will not only improve your ability to innovate...

...it will improve your company
Customer strategy consulting

150 people around the world
Minneapolis, London, Brussels, Istanbul, Dubai, Riyadh, Kuwait, Mexico City, Sao Paulo, Singapore, Sydney

Now the strategic consulting arm of Carlson Companies
Magazines, newsletters, research white papers

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