

## *New Risks for a New World*

By David A.J. Axson

*This paper is adapted from David Axson's forthcoming book, *The Management Mythbuster* which will be published by John Wiley later in 2009. For further information visit [www.davidaxson.com](http://www.davidaxson.com)*

Credit risk, interest rate risk, foreign exchange risk—these are all risks that are familiar to managers. Most organizations have sophisticated mechanisms for measuring and managing such risks. Of course, sometimes these procedures breakdown as was spectacularly demonstrated by the absence of effective credit risk assessment in the U.S. mortgage market between 2003 and 2007. However, as the world becomes increasingly interconnected and communications are near instantaneous a whole new class of risk has emerged that requires close attention by managers—that is the risk of irrelevance.

Managers agonize over the threat from competitors, analyzing every piece of new intelligence for insight into a competitor's intentions. The big competitive rivalries are like heavyweight-boxing matches used to be when Ali fought a continuous war of words, and the occasional actual fight, with Frazier and Foreman: over-hyped, vitriolic but great spectacles. Think of Coke and Pepsi, Bud and Miller, Apple and Microsoft, BBC and ITV, and the Beatles and Stones. In each case the players are partly defined by their rivals.

Rivalry is a powerful motivating force, driving each player to push harder for an edge, but it can also be distracting. Did Coke and Pepsi spend so much time watching each other that they were slow to recognize the redefinition of the soft drink market as bottled waters, iced teas and other non-carbonated beverages took hold? For decades, U.S. car companies fought each other for market share and largely ignored the growing threat of import models and major airlines disparaged upstart Southwest for years before recognizing that it was their own model that was broken.

However, being vanquished by a rival is often not the primary risk an organization faces. Far more dangerous is becoming irrelevant in the eyes of your customers. Direct competitors largely play in the same space making similar products that they market and sell in much the same manner as each other. True disruption occurs when a new product or approach hits the market that offers your customers a very different proposition. For

example, the soda drinker may gravitate to the more social pursuit of sitting in Starbucks with a no-fat, triple-shot, latte; the beer drinker may switch to a glass or two of Pinot Noir as part of a (misguided?) weight-loss/healthy heart program; and the Barnes and Noble customer may not defect to Borders but buy an Amazon Kindle and download books on the road.

Keeping an eye on competitors is common sense but it is much more important to understand why customers value your company and its products or services. Becoming irrelevant to your customers is far more damaging in the long run than ceding a few points of market share to a competitor. There are many different reasons for a product, service or organization to be relevant to its customers; understanding that connection is vital.

## **Why Are You Relevant To Your Customers?**

*Convenience:* people don't drive-through McDonalds for the ambience or gourmet cuisine; it is about convenience. Similarly, the corner shop in a London suburb is not competing with a Tesco superstore on price or selection, it is all about being able to buy a pint of milk at 1am in the morning.

*Speed:* originally I was going to write about the drive-through as a time-saver but that obviously is a fallacy as demonstrated by the number of people who park their car, go into the fast-food restaurant and order their food "to go" demonstrates. However, one hour photo processing, overnight delivery and twenty-minute oil changes all sell on speed. At the time of writing, June 2009, I can ship a four ounce (113 gram) envelope from my home in Ohio to San Diego by first class U.S. mail for 96 cents and expect it to arrive at its destination in a couple of days; alternatively I can send it by FedEx and have it arrive at 8 am tomorrow morning for \$56.79. So assuming the post office takes a full three days I am paying \$1.16 for every hour that FedEx saves me.

*Price:* is perhaps the most well understood competitive tool—low prices do work as WalMart's everyday low price strategy and Ryanair's no frills airline service prove; but having the lowest price on a product people do not want or need will do little for your bottom line. Try selling yesterday's newspaper, or a video cassette player; they have ceased to be relevant so no price is low enough—not even free.

*Trust:* building a relationship with your customers that is based upon trust is one of the most powerful connections any organization can develop. Many customers will happily pay a higher price for the peace of mind that trust engenders. It is also very fragile. One of Warren Buffet's many insightful quotes was, "It takes 20 years to build a reputation

and five minutes to ruin it.” The truth of his assertion was proven in September 2008 when the rapid loss of confidence among Lehman Brother’s trading partners consigned the company to oblivion. Similarly, Bob Nardelli’s dismissive treatment of shareholders at Home Depot’s 2007 annual meeting tarnished the company and hastened Nardelli’s departure. The credit crisis has severely weakened customer’s traditional trust in financial institutions. Customers of Northern Rock, Washington Mutual, and many other financial institutions saw supposedly trusted providers disappear and had to rely on government guarantees to safeguard their money. A survey by the U.K. consumer magazine Which in February 2009 reported that 37 percent of consumers thought that banks could not be trusted to act in the best interests of the UK economy, while 21 per cent did not trust banks with their money. Once lost, trust can be almost impossible to regain.

*Choice:* Providing customers with choices has long been a driving force for business. The first department stores emerged in the 1830’s and before long became the dominant retail model. In more recent times, the Internet has greatly expanded customer choices. A few clicks and any consumer can find all manner of different choices for a particular product from life insurance to a plane ticket or a car. The abundance of choice that the Internet provides has actually served to reduce the perceived customer value of choice in the physical retail environment. Today, many customers use the web to research a product and even if they do not buy on the web, they locate the nearest retail outlet with the best price and make their purchase there. Choice in the retail outlet is of much less importance.

*Reliability/Quality:* for decades Maytag stood for quality; the Maytag repairman, who first appeared in an advertising campaign in 1967, has become common usage for an individual whose services are rarely needed, a tribute to the reliability and quality of the company’s products. Similarly, Toyota has led the way in establishing quality as an attribute in its vehicles, particularly in the 1960’s and 70’s as American manufacturers struggled to match the quality of imported vehicles. Even today, as many American cars deliver equivalent or even superior quality to imports, the perception of the customer is still colored by thirty years quality shortfalls.

*Technology Leadership:* Companies have long used technical leadership as a means to appeal to customers. Audi’s long running “Vorsprung Durch Technik” (advancement through technology) campaign clearly defined the company’s positioning. Numerous companies tout their products as being “leading edge” or “technologically advanced.” Yet technology leadership is fragile and very susceptible to obsolescence through innovation. Sony led the market for portable music players for over twenty years through both the cassette tape and CD eras but lost its position as the technology moved on to

digital music. Polaroid was an innovation powerhouse but was unable to adapt to the world of digital photography and went bankrupt in October 2001.

*Compliant:* U.S. car insurance company, SafeAuto, markets itself as “keeping you legal for less” by offering policies that meet the minimum legal requirements in each state in which it does business. Numerous lawyers, accountants and consultants offer “audit” services for everything from employment contracts to environmental protection to provide companies with the assurance that they are in compliance with laws and regulations. The pace of regulatory change ensures a steady stream of business for providers in this space.

*Compatibility:* Want to buy accessories for your iPhone? How about games for your Xbox or tires for your BMW? Positioning products as being compatible with products made by another company drives revenue at thousands of businesses. In this case, customer relevance requires that the customer choose another company’s products in order for your business to succeed. Your success depends upon another company remaining relevant to your customers. Get it right and it can be very lucrative; get it wrong, as software developers who backed IBM’s OS/2 PC operating system or toy makers who invested in products tied to the Incredible Hulk movie in 2008 as opposed to Iron Man, and you are rapidly on the road to irrelevance.

*Aura/Hipness:* perhaps the most fickle foundation of relevance is to be fashionable, trendy, cool, hip or wicked. The litany of once hot products that enjoyed brief moments of popularity is long: remember Clackers, the Rubik’s cube, leg warmers, the Osmonds, Cabbage Patch dolls, Beanie Babies, Fresca, the PT Cruiser and Crocs? The key is to capitalize quickly and if possible carve out a position beyond a single product or time period as Nike and Apple have done. Lately there has been a booming business in resuscitating once hot brands that had fallen on hard times. Proctor & Gamble’s Old Spice, grew sales faster than its overall category from 1997 to 2001 on the back of a refreshed product line and new advertising. BMW re-introduced the Mini in 2001 and enjoyed great success with a vehicle that called to mind the iconic original that was one of the symbols of the “Swinging Sixties” in London.

## **Different customers, different connections**

It is easy for managers to describe their company’s positioning in terms of price, quality, or convenience; however the connection between a company and its customers can vary across different markets or segments. For example, Yum brands the parent company of Kentucky Fried Chicken, Pizza Hut and Taco Bell benefited in the U.S. market during

late-2008 as consumers traded down from more expensive dining options to the company's lower-priced offerings. However, in China, consumers were doing exactly the same but Yum was not a beneficiary. In China, Yum's brands were not the lower priced option. Eating western fast food is more expensive than the local fare offered from carts and stands in the street so as the recession bit, Chinese consumers returned to the cheaper alternative. Understanding that your products maybe low cost essentials in one market and high cost luxury items in another market can lead to key differences in the way you plan, market and invest in different products or services. As the world globalizes at an increasing pace these localized differences will become increasingly important sources of profit.

For many organizations the biggest risk they face is irrelevance. Once lost, it is very difficult regain relevance. A rare example is Apple. After burning brightly during the 1980's, the company had stagnated and by 1997 was in danger of fading away. On his return to the company, co-founder Steve Jobs redefined the company and triggered a second epoch for a fading brand. Jobs transformed Apple from a niche computer company to a consumer products company. He recognized that the connection between the company and its customers was through cutting-edge products that were superbly designed and seamlessly integrated. In short, it was cool to be an Apple customer. Once the connection was understood it was a logical step to the iPod, iTunes and iPhone.

Understanding how your customers connect with your organization is a key step in an effective management process. Risk management is more about preparation than it is about reaction. In today's world that means expecting the unexpected. Any sane company should consider the possibility, no matter how uncomfortable, of one or more of the following events occurring and have thought through its response:

- ✓ A 20 percent decline in revenues in 90 days
- ✓ The bankruptcy of your biggest customer
- ✓ The bankruptcy of your biggest supplier
- ✓ A tripling in the price of your most important raw material
- ✓ The merger of your two biggest competitors
- ✓ A four-week disruption to your global supply chain
- ✓ The loss of 20 percent of your sales force over a six month period
- ✓ A major negative news story that challenges some aspect of your organization's credibility.
- ✓ Ranking bottom in a quality or customer satisfaction survey
- ✓ Your biggest competitor calls you and suggests a merger giving you seven days of exclusivity to do a deal.

# DAVID AXSON

PREDICTIVE INTELLIGENCE

- ✓ A major innovation is likely to make your best selling product obsolete in less than five years.
- ✓ All your lenders freeze credit and demand repayment of at least 50 percent of outstanding current debt.

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