

## BUILDING MARKET-FOCUSED ORGANIZATIONS

By Michael J. Lanning & Dr. Lynn W. Phillips

In a world of increasingly frequent and severe change, business organizations must follow one of three fundamentally different paths. We believe that the most successful organizations will take the path toward "Market-Focus." They will orient all business actions around one integrating objective: superior Value-Delivery to target customers at a cost allowing acceptable profit.

Value-Delivery means Choosing, Providing and Communicating an explicit "Value Proposition," which is the combination of: end-result Benefits offered; and Price charged by the business. If the business' targeted customers perceive that this combination of Benefits and Price results in a Value superior to alternatives, then this is a superior Value Proposition, producing preference by these customers and thus revenue. It also produces acceptable profit, of course, if the cost of Delivering this Value Proposition is enough below the revenue produced. Organizations on the path to Market-Focus define competitive advantage as the ability to profitably Deliver superior Value to target customers.

Value is used here to express the net effect a customer gets due to obtaining the end-result Benefits offered and paying the Price charged by a business. Value thus equals Benefits minus Price and Value is of course only positive if the Benefits exceed the Price, as understood and believed by the customer. Customers select among competing options by accepting the Proposition that they believe will give them the most positive Value, whether or not that is the Proposition offering the lowest Price and whether or not it is the one offering the most Benefit.

This deceptively simple principle elicits due lip-service from many but contrasts sharply with the other two paths which are far more often traveled. See Exhibit One.

On the "Internally-Driven" path, managers see competitive advantage in owning assets, or having functional excellence, that competition lacks. Decisions thus are based on functionally-rooted, inside-looking-out criteria that give inadequate attention and focus to understanding or delivering the end-result benefits customers most value. When the activities of the various functions in the business (e.g., R&D, Operations, Manufacturing, Marketing, Sales, Regulatory, etc.) are not integrated around a specific chosen Value Proposition, the functions usually pursue their own objectives and agendas which often unintentionally undermine superior Value Delivery .

Some organizations, wanting to avoid the myopic path to Internally-Driven, try to do anything and everything customers suggest, following the seductive path of the "Customer Compelled" organization. Just "be close to the customer, listen and do what they say," beckons this panacea. Yet, while customers often make many good suggestions, they also suggest many courses of action that are unactionable or unprofitable. And the diversity of requests is limited only by the diversity of customers a business serves.

Randomly following some or all these suggestions is fundamentally different from Market-Focus - making a disciplined choice of which customers to serve and which specific combination of Benefits/Price to deliver to them (and which to deny them). Only when this specific Value Proposition is chosen and all functional activities integrated around it can functional chaos and disillusionment be avoided.

All businesses in effect deliver some Value Proposition, whether or not it is superior or profitable and whether or not the people running that business ever think much about that Proposition or even know what it is. The great majority of organizations (even though they may drag themselves through vast arrays of strategic planning processes) simply do not consciously Choose and commit to consistently Deliver any specific Value Proposition. Many an organization knows a lot about its customers and their desires but actually deciding, articulating and committing all functional activities to Delivering a specific set of end-result Benefits and Price, at a profitable cost, is much rarer.

Most organizations' energies are diffused, with no particular customer or Benefit focus, often embroiled in endless cross-functional conflicts. If they do end up profitably Delivering a superior Proposition it is thus the result of luck. The Market-Focused organization believes in improving the odds by deliberately Choosing a specific Proposition, then rigorously integrating all activities around profitably Delivering it . Exhibit Two shows several examples of superior Value Propositions from clients of ours in recent years.

#### UNDERSTANDING A CENTRAL CONCEPT: END-RESULT BENEFIT

End-results for the customer, NOT product/service attributes - The most important concept that a Market-Focused organization pursues is that of end-result Benefit. A common and well established confusion in managers' minds is between the attributes and features of a product or service and the real end-result Benefits desired by customers who may use that product/service. The reality that counts in a business success, the issue on which to focus, is about how the customer's life can be improved, not in what goes on within the walls of the business.

For example, one client (in the medical diagnostic instrument market) not long ago issued a description to field sales reps of "the benefits to your customers" of the company's pre-natal cardiac monitoring system, as follows: "higher capacity Winchester disk (now 84Mb); ... can store more patient records; ... faster throughput of patient data; ... faster printing; ... LaserJet III printing via PCL5 ... for full disclosure printing; ... 8MB

RAM on-board in the QS20 ..."

Of course, all these features and attributes may (or may not) lead to valuable end-result Benefits. The great tendency in many organizations, however, is to assume that these end-result Benefits and their connection back to features and attributes are well understood, both within the organization and among customers, a convenient but dangerous and usually dubious assumption. "Our customers aren't stupid, you see," we are sometimes assured. No doubt true, but that doesn't mean that a lot of obstetricians make the right connection (if any) between "8MB RAM on-board" and what goes on when trying to diagnose a pre-natal heartbeat. And it doesn't mean that any three people within the manufacturer assume exactly the same connection. Thus, the Benefits and their connection to what the business is offering go unstated, unverified and unchallenged.

"Video tapes" of a day-in-the-life of a customer - A tool we have found very useful for thinking about end-result Benefits is to imagine making two contrasting video tapes of a day in the life of the customer. The first tape would capture a typical scenario today for obstetricians trying to monitor a baby's cardiac condition in the womb. It might show them trying to analyze data, struggling to accurately and quickly enough diagnose a possible problem, then trying to monitor the effects of therapy. What are they trying to accomplish, what obstacles do they encounter and how do they cope with those obstacles?

The second video tape would show what this scenario would be like if the obstetricians could wave a magic wand and improve the monitoring process dramatically. Through much faster access to and better-resolution printing of more accurate and detailed data, perhaps we would see the physicians able to more quickly and more accurately diagnose a cardiac condition and thus provide more effective therapy. Carefully and explicitly articulating these desirable end-results is critical to achieving clarity of direction, within the business and with customers.

Become the customer - Yet, uncovering and fully understanding these end-result Benefits desirable to potential or current users is not nearly as simple as many people would like it to be. Directly asking customers what they want often does not reveal the end-result Benefits they would most value but rather only elicits their description of the attributes, features and Price they think should be offered by our product or service. We find it far more powerful to "become the customer," that is, to take an anthropological approach of studying intensively how the customer lives, asking: "What would it be like to 'be' this customer and what would I want, as an end-result scenario, if I were that customer? What does this imply our business ideally should do to improve the lot of this customer? Could we do that profitably and better than competition?"

For example, when Weyerhaeuser Sales Reps from their Adele, Georgia particle board plant in the late '80s asked a large furniture maker what they wanted from particle board, the maker's materials-buyer made it clear: low price with adequate quality. Weyerhaeuser's arguments that it had higher quality fell on deaf ears ("we compete on price") and Weyerhaeuser couldn't make an adequate return with lower Price.

However, when a Weyerhaeuser multi-functional team established a close enough relationship with this maker to visit their furniture plant, they gained a picture of how the maker used particle board to make table legs. Like many manufacturers this maker was laminating together narrow pieces of board to make a thicker piece, since the particle board industry could not efficiently produce thick board. But by learning to make thick board, although more expensively, Weyerhaeuser was able to save the maker the cost of their laminating process. In net, thus, doing business with Weyerhaeuser allowed the maker to produce table legs at a lower total cost even though paying enough for the thick particle board to cover Weyerhaeuser's higher costs.

After experimenting at length with this thicker board, the maker also learned that the smoother surface translated to real additional savings in tool wear and even produced a slightly better final appearance. Despite the efforts of competitor Georgia Pacific to later imitate the thicker board, Weyerhaeuser was able to hold onto this business at significant and profitable premium and later to expand into a leading and profitable position in the Southeast for thick dimension particle board that saves customers laminating and tool-wear costs and enhances their final product's appearance.

Weyerhaeuser would not have likely ever discovered this major opportunity simply by asking the customer. The materials buyer and the manufacturing manager were not staying up nights worrying about their laminating line and would have likely never asked Weyerhaeuser to help them eliminate it. By becoming the customer and asking how the customer could better succeed, however, Weyerhaeuser did discover an opportunity to profitably deliver a combination of highly valuable end-result Benefits and Price.

For actionable Benefits, Peel the Onion - For an end-result Benefit to be strategically actionable for a business, it must be understood at a specific and precisely measurable enough level of detail to allow integration around it by all elements of the organization. People disagree as to priorities in a business; an effective Value Proposition must allow resolution of these disagreements and to do so the end-result Benefits in it must be highly specific, measurable and as unambiguous as possible. If a Benefit is understood at too vague and amorphous a level, widely varying interpretations of the Benefit are inevitable, within the organization and among customers.

Common attempts at Benefit description that we see at many clients and other businesses are frequently well meaning but so vague as to give no real direction and lead to no meaningful integration, such as: "great quality;" "superior service;" "performance;" "reliable supplier;" "a partnership;" or even emptier fluff such as "excellence" or "total satisfaction." A Benefit is like an onion, with an outside layer of vague meaning which must be "peeled back" until a deep and specific enough understanding to integrate all business activities has been achieved. What exactly does this Benefit mean for the customer, what is the second video tape and have we expressed the Benefit clearly and specifically enough that it allows us to measure whether or not we are delivering it to the customer?

Thus, when a soft-goods retail client of ours, Mervyn's, defined one of its end-

result Benefits as "Quality," this was a start but too vague. Existing technical testing based on industry "Quality" standards really measured, in great depth, how tough a garment was. Listening to, studying, researching its core customers deeply, however, Mervyn's peeled the onion back and found several rich Benefit dimensions to the Quality desired from its Merchandise, including Comfort, Durability, Ease of Care and Functionality of that merchandise.

Within these dimensions, further peeling of the onion revealed additional specific detail. Comfort could be peeled back into Tactile Feel and Fit, for example. The recent great success of Mervyn's "Cheetah" (private label brand) line of fleece (sweat shirts and sweat pants) was largely due to its more Comfortable tactile feel (softer and plusher) and more consistently Comfortable fit, compared to competitors' fleece.

The most Comfortable Tactile Feel and Fit can be defined and measured by type of garment. Thus Mervyn's is learning now to Provide a truly more Comfortable Tactile Feel and a more Comfortable Fit across all its merchandise, a dramatically different approach and understanding of a key Benefit, due to peeling the onion.

#### A BUSINESS IS A VALUE DELIVERY SYSTEM

If Delivering a superior Value at a total cost below revenues, allowing an acceptable return, is the obvious objective of a business, then a business can be described in terms of the activities needed to accomplish this objective. We break these activities into Choosing, Providing and Communicating a superior Value Proposition. Thus, a business, from this perspective, is a System integrated around the profitable Delivery of some superior Value Proposition: a "Value Delivery System."

Choosing vs. Hoping for the Best - We believe that a business organization should first Choose a Value Proposition (the target customers and the combination of end-result Benefits and Price it intends to offer that target). If the organization sees the need and/or opportunity to profitably Deliver several superior Value Propositions, then the organization is deciding to compete in several businesses. For each business, Choosing the Value Proposition (VP) means explicitly and formally deciding, articulating and adopting it in written form as the strategic basis for every aspect of the business. Of course "Choosing" as we define it here is only advisable if you want to increase the probability of making money. An alternative is to trust to luck and hope for the best. Any business always Delivers some VP, whether it's a winning VP or not and regardless of how randomly, unconsciously and weakly it is Delivered. Very few customers may want the VP Delivered and/or the business may lose lots of money Delivering it. Or, if lucky, the business may profitably enjoy great customer preference, despite never deciding deliberately to pursue any particular customer or to focus on offering any particular reason for the customer to prefer that business.

Though it seems self-evident that a business ought to deliberately and consciously decide what effect it wants to have on customers such that they will prefer that business, it is striking and fascinating how rare it is to find organizations actually making that decision. It is equally noteworthy how strongly managers frequently believe at first that

surely they have made such a decision when there is in fact scant evidence. And finally it is interesting to observe the enthusiasm with which so many managers, consultants and academics can come up with creative and sometimes elaborate explanations for why no Value Proposition can or should be Chosen.

Most organizations, however, do not actually Choose a VP in the sense meant here. If your organization has really Chosen a VP, then

- ¶ you have a clear specific statement of it
- ¶ it represents a disciplined decision to pursue one of numerous options (not a vague global set of promises to be good and nice)
- ¶ every function, department and virtually every person (not merely Marketing, Planning or top Management) knows what it is, understands it and uses it to guide their everyday operational decision making and to resolve operational issues and tradeoffs

Providing the Value Proposition - After Choosing the VP then the business must, obviously, see to it that the target customer actually experiences this Value Proposition, that is, see to it that the business actually Provides the chosen Benefits and Price to the chosen target customer. This cannot usually be expected to occur simply by issuing copies of the VP to all departments ("attention! please make this happen"). Rather, a business must explicitly decide and articulate how it is going to Provide each of the chosen Benefits to the target customer, all at a cost that allows adequate returns.

Work with Valley Care, a large Northern California hospital group, articulated a VP that focuses on obstetrics and includes among end-result Benefits the notion that the consumer should receive "superior emotional well-being" which means in part that she and her family: "understand what's happening, what she and they can and should do to help the pregnancy; and, are included in medical decisions." Providing this specific Benefit and these dimensions of it is not accomplished simply by writing-down this Benefit nor even simply by telling consumers this hospital will give them superior emotional well-being. The Benefit can only be Provided by actions such as, for example:

- ¶ Education proactively integrated into the pregnancy from the outset (versus simply making a few courses available and passing out some literature)
- ¶ Highlighting and discussing the key actions mother can take to help pregnancy so she really understands her options and consequences (e.g., in diet, exercise, work habits, stress, etc.)
- ¶ Education for mother includes understanding the range of likely responses by her family and how she can best manage these (e.g., how to minimize the first child's jealousy)

In our work with Apple Computer, an articulation of Apple's VP that emerged was focused on the end-result Benefit that "knowledge-workers" would experience (due to using an Apple) "greater access to what a computer can help them do, thus better improving their intellectual output, making it more creative, more persuasively communicated and more efficiently produced."

How might Apple actually Provide this Benefit better than competition? The original success in the late '70s, Apple II, did it by giving knowledge workers their first practical opportunity to improve their access to computing since the introduction of large computers. Apple II let the customer put some kind of computer right at their finger tips for the first time. Then, Microsoft, Intel and IBM and its clones offered an alternative to Apple that let the user: process larger amounts of data faster; seemed a safer bet because of the association with the dominant IBM computing environment; and had a lower Price. Apple survived because it then offered Macintosh which again Provided superior access to computing, this time by utilizing an architecture and operating system inherently more user-friendly that enabled the introduction of a "graphical user interface." This use of symbols on the computer screen (icons) and a mouse to point and click at the icons, in conjunction with other design elements of the system, made it much easier for people to learn and use applications on the Mac.

In turn, this ease of use led to people using the Mac much more (typical research indicates that the average IBM/DOS user actually uses about 1.2 or so applications, versus about 3.5 for Mac users). Mac made it easier, not to do the same limited tasks that the IBM user accomplished, but to do far more, getting much greater access to what a computer can really help them do.

Unfortunately, Apple made two fundamental mistakes after introducing Macintosh. First, the Company in the '80s seems to have not defined their competitive advantage in terms of end-result Benefit. Rather it operated under the assumption that its graphical user interface was itself the advantage, rather than seeing the ability to Deliver superior access to computing as the actual advantage. The Company did not accomplish much in the way of improving how well Apple Provides this Benefit in the decade since introducing the Macintosh.

With a focus on improving this Benefit, the Company might have put higher priority earlier on the portable/lap-top computer rather than making marginal improvements in the interface. Being first, rather than last, into the market with a portable and then lap top would have enhanced the Providing of greater access to computing. Meanwhile, as inevitably had to happen, competition dramatically narrowed Apple's advantage in the ease-of-use of the interface.

Should we actually TELL anybody about this? - In addition to Providing a Benefit, a business must ensure that target customers realize and fully appreciate the fact that doing business with them will allow them to experience these chosen Benefits. And the business must ensure that the customer appreciates the full economic value for them of those Benefits. No matter how well a business can Provide a superior Value Proposition, it must also succeed in Communicating that Proposition to actually win

customer preference.

This does not necessarily mean that a business must try hard to tell its story, that it even needs either a Sales Force or Advertising efforts of any kind. After all, if you discover a cure to cancer and obtain regulatory approval to sell it as such, one press conference will suffice for Communicating your Value Proposition. One way or another, however, a business clearly does not Deliver a Value Proposition unless it both Provides and Communicates that Proposition.

Thus, the second major failing of Apple was inadequate Communication of its end-result Benefit. A Macintosh does speak for itself; people who learned to use a Mac usually came to understand the Benefit quite well and so word-of-mouth helped to spread Mac's popularity enough to make it a modest success. However, most people remained unaware of the real Benefit advantage to Apple and market share is only 8-12%, despite the fact that Mac Provides what would have been a superior Value for a much larger portion of the market in the '80s.

Apple's Communication efforts after the introduction of Mac spent most of their energy on relatively minor, irrelevant or even unproductive issues. For example, Apple advertising presented messages such as: 1) IBM is like Big Brother in Orwell's 1984, so be like this woman who throws a hammer at Big Brother and switch to Apple; 2) you who use IBM are lemmings, marching blindly off a cliff, so switch to Apple; 3) Apple can let you produce formal elaborate graphics presentations instead of having a printer do it; and 4) even you, who are so afraid of computers that you would wander for days in semi-panic at the very thought of being asked to learn to use one, even you can use an Apple. During the '80s, the majority of desk-top computer users resisted Apple partly because of the beliefs that it was: some sort of California counter-culture product inconsistent with a professional business operation; a specialized computer for elaborate desk-top publishing; and/or a computer so simple that even the computer-phobic could learn on it, but therefore a computer without the power and capability needed for everyday intellectual output such as from spread-sheets, data-bases, word-processors or presentation packages. The messages Apple Communicated most likely reinforced rather than challenged these common misperceptions. Finally today, Apple's advertising has started to tell the story that Apple users actually do more with their computer, but it may be too little too late.

Apple since the early '80s could have focused on making new breakthroughs in giving users the Benefit of greater access to computing which results in more creative, persuasive and efficient intellectual output. And Apple meanwhile could have aggressively Communicated this Benefit, showing how it was Provided by Mac's being so much easier to use. Perhaps Apple today would not, sadly, have been reduced to unprofitable Price slashing and an unholy (if "strategic") alliance with lifelong enemy IBM.

Value Propositions are often TRADEOFFS - Often clients at first assume that by "Market-Focused" we are simply talking of the same ideas popularized in the '80s by Tom Peters, the Total Quality movement and others who urged management to simply

"listen to the customer and do what they say." This simplistic advice sounds glib and appealing but is fundamentally flawed by two problems: customers may tell a business what to do without giving any insight into the end-result Benefits they would most value; and even if a business learns the Benefits desired it still must make tradeoffs that it must identify and which the customer is not likely to suggest or request.

For example, one of the most popular video-tape business cases taught in the US comes from "In Search of Excellence," based on the Peters and Waterman book. This case is Stew Leonard's, a fabulously successful grocery store that with only 750 items does vastly more volume than its competitors who typically carry 16-20,000 items. Customers rave about shopping at Stew Leonard's where, they conclude, the food is really fresher, the shopping experience is actually fun instead of a drudgery, where the relationship with the store seems much more personalized and where the Price is about 6-8% lower. The store does over US\$120 Million annual volume and the profit margin is very healthy, even with the lower Price.

In this case, one sees managers and employees constantly talking with and intently listening to customers. A giant customer suggestion box is filled to capacity every day and copies are distributed throughout the store. Regularly, random groups of customers are convened to talk informally with managers and employees. The success of the business is explained in the video as simply that at Leonard's they "listen to the customer and do what they say."

However, closer examination reveals that in fact Stew Leonard's has made a disciplined choice of which Benefits to Deliver and which not to Deliver. The decision not to Choose some Benefits for their Value Proposition results from a deep understanding that the requirements to truly Deliver the Benefits they did Choose preclude Delivering the other Benefits, even though desirable to the customer.

In order to Provide truly fresher food, they buy everything direct from the producers, reducing transit time and ensuring that they, not a distributor, select the merchandise. They never carry anything frozen. They pursue with obsessive zeal an understanding of what their customers want and expect fresh to mean. They will at least experiment with even the most minor input from customers by which the food could be made fresher. Rather than have corn in stock when the store opens but corn that is a day old, they decide to not to have any in stock every morning until 10:30 AM. They let customers pick their own strawberries rather than sell them in the little green baskets because that way the customer takes home the freshest strawberries. To Provide a more personal relationship, the store constantly tries to respond positively to the smallest input from the customer. By buying all items in bulk direct from suppliers and selling very high volumes, the store keeps product costs low, allowing good margins even with low Price in a very low margin, supposedly "commodity" industry.

Virtually every item in the store has been selected, bought, shipped, unloaded, shelved, presented, packaged, checked-out at the register and bagged in such a way as to maximize the customer's net long-term conclusion that shopping at Stew Leonard's results in having fresher food when one gets home and in a more personal relationship,

where the store really listens to the customer.

However, to Provide and Communicate these Benefits prevents Stew Leonard's from Delivering the key Benefit that competitors offer: one-stop-shopping convenience. To use Leonard's is to shop at least twice given their limited selection. But to Deliver one-stop-shopping would require carrying thousands of items that the store could neither make more fresh nor in any other way respond to customer input. The net effect on customers would be greatly diluted by carrying 20,000 items (and thus Delivering one-stop-shopping), only 5-10% of which can help Deliver the "Fresher Food" and "More Personal Relationship" Benefits. And most of those items could not be bought at a lower cost by trying to buy direct and so their Price would not be 6-8% lower. Only by being willing to deny the one-stop-shopping Benefit can Leonard's truly Deliver their Value Proposition.

Perhaps there is a trivializing explanation: maybe Stew's customers don't really care much about one-stop-shopping. But this is not the situation. Research would reveal that most customers would rank one-stop very high as a Benefit desired. However, it turns out that there is a large segment of customers who would rather get Fresher Food, a More Fun and More Personalized Relationship in shopping and 6-8% lower Price, but have to shop twice. There is still another segment of customers would rather have one-stop-shopping with not as fresh food, a not as fun or personal shopping experience and higher Price. The success of Leonard's results from the understanding that these two scenarios require two mutually exclusive Value Delivery Systems and that the first scenario would in fact be preferred by a large enough segment of customers to make a great business.

In similar fashion, Southwest Airlines has been a great success story as a no-frills lower priced airline in the US despite a long list of failures by other airlines using supposedly similar strategies. The difference is that Southwest did not simply slash the Delivery of all Benefits indiscriminately to contain costs. Rather, as co-founder Rollin King tells the story when occasionally helping us teach the principles of Market-Focus, Southwest first understood a set of end-result Benefits that a large enough segment of travelers wanted, including: loving, friendly personal treatment by all employees; less total time spent traveling; and comfortable, convenient conditions while flying. Rollin and company then realized that a subset of those Benefits, the first two, could be Delivered better than competition, at a lower Price, Delivering in net a superior Value despite not Delivering all the important, desired Benefits, but that this could only be done if they truly denied significant aspects of the third Benefit.

In order to profitably Deliver less total time traveling, yet be lower Priced, Southwest in part turns its planes around much faster, allowing a frequent reliable schedule with fewer planes. To get this fast turnaround, Southwest offers minimal food service and no assigned seating. This saves an average of 20 minutes turnaround time which translates to needing some 25 fewer jet aircraft to maintain their schedule, an amazing savings of several hundred million dollars. Southwest understood that an attractive group of customers exists that is willing to sacrifice the comfort and convenience of better meals and assigned seating in return for the Value Proposition

Southwest Delivers.

But were there customers knocking on Stew Leonard's door asking for a store that doesn't have one-stop-shopping? Did travelers write to Rollin King and suggest, "give us more frequent reliable schedules at lower Prices but hold the good meals and assigned seating?" The Market-Focused strategic thinker must identify these tradeoffs and use the understanding of the customer's desires to determine which tradeoff the customer would most value.

### VALUE-DELIVERY-BASED SEGMENTATION

We believe that market segments should be defined in terms of the Value Delivery System required to profitably win the customers in that segment. A group of customers represents a segment if a business would need to Deliver one particular VP to all these customers. Thus, customers who would prefer the Southwest Airline VP represent a segment. Customers preferring Stew Leonard's VP are his target segment. In addition, customers are in a distinct sub-segment if a business must do something unique to Provide and/or Communicate the VP to them. Stew Leonard's found a sub-segment of customers who, like other Leonard's customers, desire fresher fish but who would not believe the fish was really fresh unless presented on ice instead of wrapped in plastic.

This approach treats segmentation as the basis for defining the organization's fundamental business options (see Exhibit Three). Other, more traditional approaches to segmentation treat it as a "Marketing" exercise, useful mainly to find ways to better sell what has already been decided to make.. Instead, segmentation in the Market-Focused approach divides the market into the strategic possibilities for the organization, each possibility representing a business - the Value Delivery System (VDS) the organization would need to win in that segment. After segmenting a market, an organization must decide in which segments (if any) it can profitably execute the required VDS better than competition. It must determine, for each segment, what key capabilities would be required by the VDS, what capability gaps the organization therefore has and how they would close those gaps if competing in that business. Based on this evaluation, the organization selects the businesses (in effect, the VDSs) in which it will compete, thus determining the organization's strategy.

This approach to market segmentation differs from the "Incomplete Segmentation" we often see in client organizations. Many segmentation schemes may divide the market into hundreds or even thousands of "segments" using demographics, product usage, distribution channels, etc., without ever answering the fundamental strategic questions. For customers in this segment, what VDS would we need and what are the various VDSs we would need to cover all segments and, therefore, what are our strategic options?

Of course some markets are simpler to segment than others. A retailer Delivers Value directly to the end-user, but many industrial businesses are Delivering Value to users who are themselves businesses. Often there are intermediaries between the business and the users and these intermediaries are also businesses. Thus, as in Exhibit

Four, there exists a chain of interlocked Value Delivery Systems, from a business' suppliers through the intermediaries and users and lastly to the final customer, the end-user's customer. Up to this final customer, all these links in the Value Delivery Chain can be understood as VDSs. Many businesses fail to focus far enough down this chain, understanding their immediate customer's demands, but not deeply studying this customer's customer, let alone the further links.

In our work with Canadian National Rail, we helped the client work closely with one food manufacturer in Eastern Canada. The Transportation Department of the manufacturer was complaining that CN was not getting shipments to the Western Provinces fast enough, on schedule enough. This would require consistent 7-day service to Vancouver. CN was ever increasing management pressure through Total Quality and other efforts to increase the consistency of such rapid service, yet for this customer the service varied from 7 to well over 12 days. CN and the customer's Transportation Department assumed that eventually, if consistent 7-day service wasn't achieved, then CN would have to change the mode of transportation use, from all rail ("car-load") to intermodal, a mix of rail and truck. Intermodal is much more expensive in this case but more consistently fast. It also opens CN more fully to competition from truckers for the whole shipment since it would require the manufacturer to make changes that would facilitate later complete changeover to truck.

Examination of the manufacturer's business from the general management perspective of the food-company to its retailer and on to the consumer revealed a surprising and better solution. What mattered most was that product arrive on grocer's shelves before the shelves run empty. this in-stock performance was the real end-result issue, not the speed or consistency of transit. Of course, if the grocer orders and product does not show up on time, the product is out-of-stock in the store.

However, with the focus on this end-result issue in the customer's customer, CN learned that they could more efficiently help the customer keep product in stock by staying with car-load, even if transit time did not improve in speed or consistency, but change the shipping and inventory patterns at the retailer. By shipping ahead of orders and often holding some product in inventory (even in CN freight cars if needed) in Vancouver, CN and the manufacturer could incur much less cost than by going intermodal yet achieve the in-stock performance they really needed. By understanding the whole Value Delivery Chain, CN identified the profitable solution for an important market segment.

#### THE FIVE STEPS TO A MARKET-FOCUSED ORGANIZATION

As shown in Exhibit Five, we think of the key steps an organization must climb to become Market-Focused as follows:

At foundation, the organization must first come to grips with the principles and concepts of Market-Focus. Only by first accepting this philosophy intellectually and emotionally can an organization prepare to climb these steps, which are: first, to segment the market by Value Delivery System, then select the VDSs to execute, then formalize

that decision in Business Plans each structured by the VDS, then to execute and monitor these VDSs and finally to build the capabilities needed for future improvements in the VDSs.

### CONTRAST WITH OTHER PATHS

Many executives find the basic notion of Market-Focused, as summarized above, self-evident. Organizations like Southwest Airlines and Stew Leonard's operate by this basic philosophy even though the terms presented here are alien to them. However, we find that the two very different paths, to Internally-Driven or Customer-Compelled Land, are in fact much more commonly followed. Some archetypal organizational forms that populate both these landscapes and their underlying management philosophy are described in Exhibits Six and Seven.

Of course, most businesses are characterized by no single dominant management orientation. Our work with over 3,000 employees in more than 30 divisions of a large U.S. computer and instruments manufacturer revealed that most managers described their organizations as Technology Driven and Sales-Obsessed. A recent reorganization of this company's sales force and computer systems business is aimed at enabling operating divisions to achieve greater market focus and manage each business as a truly integrated Value Delivery System.

Some businesses possess the fundamental characteristics of both Internally Driven and Customer Compelled organizations and are best described as being located on Confusion Bridge between the two destinations. Recent work we completed with executives of a worldwide manufacturer of copier equipment revealed that they believed the underlying management operating philosophy was predominantly Budget Bound & Financially Frustrated and Suggestion Boxed.

### Why businesses are not Market-Focused

Organizations stray from the path of market focus not by default, luck, or historic accident. Indeed, many if not most, historically successful organizations begin life with a Market-Focused entrepreneurial idea as the foundation of business success. General Motors' recognition that people wanted different colors of cars other than Ford's basic black, and ultimately, cars with other variations appealing to other customers is a classic example. As successive generations of leadership focus on better executing the formula that stimulated wealth generation in the first place, evolutionary pressures are brought to bear on the business. Customers end-result benefit desires and their priorities change, new segments emerge, technology for serving new and existing segments evolves and other discontinuities in the form of regulatory change, environmental trends and new competition exert pressure for change in either the business' original Value Proposition itself or how it is to be profitably Provided or Communicated. These shocks, if not detected and responded to by appropriate changes in the Value Delivery System, are capable of transforming a once Market-Focused operating philosophy into one more reminiscent of the Internally-Driven organization.

Leadership often recognizes this problem, only to respond by adopting one or more of the operating philosophies characteristic of the Customer Compelled organization. This second path seems appealing but is ultimately simplistic, undisciplined, and unfocused. Few who follow this chaotic yellow brick road emerge successful. Only those organizations who have the courage and leadership to leave the city of Internally-Driven and take the path to Market-Focus will achieve business regeneration and reap the largest longest-lasting competitive advantages. Whether or not this transformation occurs ultimately depends on the business' leadership and their underlying assumptions and philosophical beliefs about the determinants of competitive advantage.

#### Realistic vs. unrealistic views of competitive advantage

Of course, executives do not wake up every morning and reject Market Focus as a business operating philosophy. Rather they act upon a set of beliefs they hold about business success that leads their organization to become Internally-Driven or Customer-Compelled. It is these underlying assumptions of leadership, not the ebb and flow of historical forces that ultimately drive an organization down one path or another.

### Making and selling a product, not delivering value

The Internally-Driven and Customer-Compelled executive thinks of a business as a set of activities, functions and assets all oriented around Making and Selling a Product or Service. The product is thus the starting point around which every issue revolves, the business generates wealth and thus achieves competitive advantage by Making and/or Selling the Product better than competition.

Thus, the Internally-Driven organization sees the pursuit of competitive advantage as residing in achieving lower cost manufacturing, superior technology, a more persuasive Sales Force, an award winning advertising campaign, and so on. A prime fallacy in this logic is as clear as the fact that the Emperor's new clothes, in the famous fairy tale, left him stark naked. Yet, like the Emperor and his followers, many managers avoid seeing the plain truth. While a business may achieve the lowest cost position or state of the art technology or a more consultative sales force, none of these leads necessarily to giving customers a reason to prefer that business. For the Internally-Driven manager, the reality of business success appears to lie in being functionally excellent at making and selling the product. Ironically, reality lies in what they cannot see, how all these functional activities impact a day-in-the-life of the customer for the better. Failing to recognize this reality, the Internally Driven organization becomes ever more functionally excellent, but ever more functionally disintegrating at the point of attack---the customer. The functional empires pursue their own different objectives and agendas often unintentionally undermining the profitable Delivery of superior Value to customers. Depending on which functional empire is most dominant, we see organizations best characterized as driven by some aspect of making or selling, as shown in Exhibits Six and Seven. All these organizational life forms are overly distracted by the content of the work they perform, missing the forest for the trees where the trees are the functional tasks and the forest is the betterment of a day in the life of target customers.

In Search of Chaos - The Customer Compelled organization rightly seeks to change the objectives and agendas of the functions to be about the customer, but does so in a chaotic fashion by asking customers directly what to do, an approach guaranteed to block functional integration around a winning Value Proposition. Like the Internally-Driven organization, the Customer-Compelled executive seeks an answer to the question of "How Should we Make or Sell our Product or Service Better?" Unlike the Internally-Driven organization, the answer is sought by bringing in outsiders--the customers--and asking them what to do, a step viewed as futile by the Internally-Driven organization. Yet listening to all customers from all possible segments and trying to respond to all or even just some of their requests is fundamentally different from making a disciplined choice about which segments to serve and not serve and which Benefits to offer to customers and which to deny to them. The Internally-Driven organization fails by starting on the inside in its search for advantage (its functional strengths and core competencies) and imposing itself on the outside (the market and customers) regardless of what customers actually want. The Customer-Compelled organization fails by starting on the outside and trying to impose the customer's requests on the inside regardless of what the organization can actually profitably do.

## CONCLUSION

The underlying beliefs of the Internally-Driven and Customer-Compelled manager are different, but both are fundamentally flawed and increasingly unrealistic and ineffective. Yet for now they continue to dominate the business landscape both in management practice and in the reinforcing theory offered by the academic and consulting worlds. Inevitably, they will be discarded as a model of business in favor, we believe, of the dramatically different principles of Market Focus.

## EXHIBIT SIX

### SOME TYPICAL INTERNALLY DRIVEN OPERATING PHILOSOPHIES

#### The Technology Driven Organization

By this orientation, products should be developed based on the strengths our business has in certain technologies and/or based on technologies that are currently being pursued by competition; then these products should be marketed and sold to the customers most needing them. Although product development, in this approach, is supposed to react to some input from customers, it does not start with an understanding of end-result Benefits customers want and then accordingly shape the product development process; it starts instead with technology and then may try to shape the Benefits delivered to customers by the technology developed; starting with the customer in this process is viewed as futile since the customer does not understand the technology and/or technology changes too fast to get useful customer input. Thus, understanding the customer's business or the end-user's current scenario for achieving desired end-results, then looking for new opportunities to better deliver superior value to customers based on new or potential technologies is not how information about evolving technology is evaluated. Such information is intensively monitored and collected and used to guide product development without relating it to specific-Benefit issues.

#### The Sales Obsessed Organization

Sales' job is to get the customer to buy whatever it is we make; if necessary, to bend the will of the customer to want what the "make" side of the business (R&D, manufacturing, operations) is good at producing. Sales is not there to identify what end-result Benefits customers would most value and then help other functions understand these desires, leading to a Value Proposition the business Chooses to deliver. Nor is Sales' job to help other functions understand how different customers, and thus segments, vary in terms of what they want, and how, therefore, the business' Value Proposition might vary by segment. Understanding the customers business is an activity the Sales Force engages in only to make a more compelling sales presentation, not for the purpose of identifying new possible products and Value Propositions for the business to pursue. Sales, if they are good, can sell anything and will. Their job is done if the customer buys; if the customer does not get the value they wanted or perceived, that is not Sales' prime responsibility (see the Marketing, Service or R&D Department).

#### The Cost-Controlled Organization

Cost must be controlled and having the low cost position is critical (or equivalent) to success and therefore our business must cut costs across the board first and worry about delivering Benefits to customers second; we may give some emphasis, in pursuing this cost control, to "not reducing quality or service", or even to "increasing" these while

reducing cost; but beyond these vague generalities, there is no specific commitment to achieve delivery of any particular Benefit while cutting cost; cost is largely seen as a separate issue that must be Controlled first; but "cost of delivering what Specific Benefit?" is not answered, false cost-savings therefore frequently occur, where some measured cost is reduced but either other costs increase by even more as a result or, more subtly, Benefit delivery is so much reduced that profit ultimately falls. This contrasts to the Market Focused business' use of cost data, which relates cost information to Value Delivery issues, looking to understand first what VDS is appropriate, then what it will cost.

### The Budget-Bound and Financially-Frustrated Organization

Our business must deliver certain short-term, largely financial, quantitative results expressed in our Budget process, often at the expense of delivering or even measuring Value to our customers. Sales volumes, costs, profit, asset levels and financial ratios (e.g., ROA, ROE, etc.) are the dominant content of the documents that count, our Budgets. Our business must manipulate whatever variables necessary to produce those results over 1-year and shorter time frames. We may blame share holders or some other force for this orientation, but making these numbers is equated with management and leadership; real understanding of and commitment to the factors that drive these numbers, especially medium-to-longer term, are not of prime importance in this philosophy. Thus, identifying, understanding and committing to delivering some superior Value Proposition at a certain cost is considered nice, maybe, but separate from and far less important than "making money", unlike a Market-Focused philosophy that recognizes that the former determines the latter.

### The Distribution Distracted Organization

The customer is seen as important to our business, but the customer" on whom we really focus rarely includes the actual users most important to the success of our business. Rather, we concentrate on the parties outside our business who most immediately interact with us and our products. Thus, distribution channels, "Value Added Resellers", regulators or third-party paying agents are automatically treated as important customers but the actual users beyond these intermediaries are not considered our real concern. Consequently, choosing a Value Proposition to deliver to actual-users, beyond the intermediary, is rarely given much attention because these actual-users are considered too complex, unwieldy and numerous to understand. Moreover, managers feel helpless about affecting these users since the intermediary distribution channels are seen as controlling them and understanding them far better than we could. We therefore may accept, rather blindly, whatever the intermediary specifies to us about product requirements, price sensitivity, etc.. Accompanying this mentality is a tendency to treat "Distribution Channel Strategy" as almost a separate business rather than an integrated part of our business.

### The Marketing Muscle-Bound Organization

The Marketing function is omniscient and omnipotent; Marketing is the function that can and should truly understand what customers want. Marketing therefore should have the job of instructing the other functions on what to deliver to customers. Marketing function should also measure its effectiveness and competence largely by the extent to which it engages in the technologies and methodologies that a Marketing department is supposed to use. That is, the more "Market Research, Segmentation, Focus Groups, test marketing, psycho-graphics, concept testing" etc., and the more complex (and impenetrably esoteric) it is, the "better" the Marketing department is? This contrasts to Marketing defining and measuring contribution as helping the whole business understand the customer and Choose and deliver a winning Value Proposition. Thus, Marketing's growing muscles make it even more powerful and sophisticated but it verges on being counter productive in helping the business profitably deliver superior Value. One gets the uneasy feeling that management is lulled into confidence because all this information on customers is collected, but that really the data is not translated into the Value Propositions customers would value and the implied VDS to deliver these propositions. Marketing and/or Sales, seems moreover to use this data to justify their control of the business, rather than to help all functions share in the real understanding of the Market.

## EXHIBIT SEVEN

### SOME TYPICAL CUSTOMER COMPELLED OPERATING PHILOSOPHIES

#### The Customer Satisfaction Facade Organization

The business is managed under the philosophy that Sales, Marketing, Service and other front line personnel should promise customers whatever they desire, assuring customers we are highly customer driven; commitments to being customer oriented such as "total (and guaranteed) customer satisfaction," "total quality," "customer partnerships," "total customer service," "customer first," are publicly pronounced externally to customers and internally to employees; yet, in reality, the commitments are largely a facade, masking the fact that the business has not taken steps necessary to fulfill these commitments; limited or no attention has been given to identifying and prioritizing the specific end-result benefits that would have to be delivered to customers to fulfill these vague commitments; and the unavoidable trade-offs involved in giving customers less than all the benefits they desire (to get "satisfaction," "quality," etc.) have not been explored.

As a result, while we make promises to customers about being responsive to their needs, in actuality we are so vague and global in our glib promises that they represent no real decision or commitment. We end up deciding what products and services to provide based on internally oriented criteria such as cost reduction, asset utilization, leveraging our existing skill strengths, or justifying someone's empire-enhancing pet project. Personnel operating in functions responsible for or critical to Providing benefits to customers (manufacturing, operations, R&D) remain largely insulated from customer input and desires and continue to operate comfortably as they have in the past.

#### The Suggestion Boxed Organization

The business is managed under the philosophy that Sales, Marketing, Service and other customer-contact oriented functions should listen to customers, asking what they want and learning all the actions and features desired by them; then these customer-contact people are supposed to inform R&D, Manufacturing and other operational functions that customers desire these actions and features, trying to persuade these functions to fulfill all these desires. R&D, Manufacturing etc., is supposed to then provide all they can, within some constraints of available resources and efficiency requirements.

This approach, like Market-Focus, does start with listening to customers but is unlike the Market-Focused emphasis on segmenting and targeting customers by the Value Propositions appropriate to them and by the actions our business would need in order to deliver each of these Propositions. Rather, this approach may elicit the customer's opinions about what we should do in our internal functions, without helping us understand the end-result Benefits the customer would most value regardless how we would deliver these Benefits. We thus can miss major opportunities and problems involved in delivering superior value. Even when this approach does let us see the end-results customers desire, it inherently leads toward attempting to be "all things to all people" but in fact not superior in value for anyone. It does not lead to clearly distinguishing different segments

of customers nor to a disciplined choice as to which segments to emphasize. Nor does it lead to a priority among the Benefits to be delivered to any segment. Finally it does not produce an explicit identification of which key actions, in what priority, are actually required in order to deliver any given Benefit. Instead it produces an unbounded, unfocused collection of customer suggestions which is dumped in an indiscriminate pile onto internally-oriented functions. These functions then either arbitrarily screen out actions or prioritize these actions based on internal criteria. Or else, attempt is made to deliver the whole lot without any focus and without profitable superior value delivered to most customers.

### The Chaotically Empowered Reactive Organization

The business is managed under the philosophy that all functions, not just Sales or Marketing, must separately ask customers what they want, then react, each giving the customer what the customer wants from that function. Even functions not directly serving the business' customers (accounting, human resources, etc.) are encouraged to find internal customers to serve and explore ways to react sympathetically to these customers. Every function is thus encouraged to help differentiate the product or service being offered by "adding value," leading to customer-driven innovations sprouting up throughout the organization. Since this process is not bounded by a clear definition of target customer(s) segments to be served and trade-offs among the end-result benefit priorities of those customers, the consequence is to swamp customers with an unfocused array of possible features, benefits, and services desired. Moreover, there is no way to bring about a coherent consistence, across functions in terms of the customers to be served and the specific Benefits delivered to them. Each function, though perhaps feeling good by being empowered to react, reacts somewhat uniquely, causing more chaos than profitable delivery of superior value.