"Essential reading for leaders focused on making a positive difference in the world and delivering growth for both the near and long term."
—Robert A. McDonald, Chairman, President, and CEO, The Procter & Gamble Company

STRATEGY FROM THE OUTSIDE IN

PROFITING FROM CUSTOMER VALUE

GEORGE S. DAY
THE WHARTON SCHOOL

CHRISTINE MOORMAN
THE FUQUA SCHOOL OF BUSINESS, DUKE UNIVERSITY

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To my family—my proudest legacy

—*George*

To Ed, my touchstone, my rock, my greatest love

—*Chris*

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Praise for Strategy from the Outside In

"Throughout P&G's long history, we have focused on the four customer value imperatives outlined in this excellent book—and are as committed to them today as ever. This is essential reading for leaders focused on making a positive difference in the world and, as a direct result, delivering growth for both the near and long term."

—**Robert A. McDonald,**
Chairman, President, and CEO,
The Procter & Gamble Company

"Strategy from the Outside In *is thought-provoking, practical, and full of ideas on how to strengthen your company's customer value proposition."*

—**Tom Lynch,** CEO,
Tyco Electronics Corporation

"American Express's success has rested largely on our ability to focus on our customers and adapt to their changing needs over the past 160 years. Strategy from the Outside In *is an insightful book with practical advice about how to do just that."*

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"An in-depth look into the basic premise of what, in my view, makes successful business. Certainly worth reading once and then once every year to remind all of us what keeps us in business. For marketers, a great benchmark to help focus on how to add value most effectively."

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and Chief Marketing Officer,
Royal Philips Electronics

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Walmart

"Getting your company to organize around what customers value most sounds easy in theory, but it's very hard to do consistently well. Day and Moorman provide a thoughtful, realistic, and actionable blueprint for delivering the most value to your most valuable customers."

—**Beth Comstock**, Chief Marketing Officer, GE

"Only a few books can really help marketing professionals make a difference in their organization. Strategy from the Outside In *falls into this category. Creating superior customer value is or should be a priority of all marketers. Day and Moorman provide a clear path for delivering on such value. Most important, their work is based on the real-world successes (and failures) of organizations which they have studied."*

—**Dennis Dunlap**, CEO, American Marketing Association

"Strategy from the Outside In *offers a refreshing reminder that answers to managers' most pressing questions always start by looking outside the organization and meeting consumer needs better than the other guys! It provides a combination of solid evidence and user-friendly frameworks that can be put to use immediately. A must-read not only for today's challenged CMO but for the rest of the C-suite as a guiding framework for the entire enterprise."*

—**Rob Malcolm**, President, Global Marketing,
Sales and Innovation, Diageo PLC

"Strategy from the Outside In *provides a handbook to re-imagine a business through the eyes of customers. It is full of current case studies, research, and practical frameworks that senior marketers can use to refine their own thinking and influence their colleagues."*

—**Greg Gordon**, SVP Consumer Marketing,
Liberty Mutual

"Day and Moorman advise companies to leave their comfortable positions of controlling their businesses to the uncomfortable position of allowing their customers control. This is a book only for companies courageous enough to listen to their customers instead of themselves."

—**Ron Nicol**, Senior Partner and Managing Director,
Boston Consulting Group

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Part One

Seeing Outside In: Shifting Your Perspective

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Strategy from the Outside In

With the wreckage of the Great Recession still smoldering and slow economic growth expected for the foreseeable future, it's not surprising to see that many companies are turning inward and hunkering down. Profits, growth, and value creation seem to have become stretch goals rather than baseline expectations. Companies that were praised over the last decade for delivering shareholder value have largely fallen on hard times; buried under debt, they have no clear plan for capitalizing once customers are willing to spend again. The Fortune 500's top 25 at the beginning of the century included companies such as General Motors, Ford, Citigroup, Bank of America, AIG, Enron, and Compaq. Measured by market value, only 8 of the 25 largest companies in the world in 2000 can claim that distinction today.

Yet a number of companies operating in the same challenging environment have gained market share, grown revenues and profits, and created more value for customers, in contrast to their competitors' intense focus on budget cutting. Indeed, there are companies that have managed market share, profit, and customer value growth throughout the vertiginous boom-and-bust business cycles of the last 20 years. These companies may not have been favorite stock picks, nor have all of them topped the lists of the decade's most profitable corporations. But what they have done is found a way to build value over the long term. These are not flash-in-the-pan companies, world-beaters one year and stragglers the next. They are companies like

Johnson & Johnson, Procter & Gamble, Fidelity, Cisco, Walmart, Amazon, Apple, IKEA, Texas Instruments, Becton Dickinson, and Tesco, among others.

These companies have been successful because they have remained true to the purpose of a business (as stated by Peter Drucker): to create and keep customers. They've kept that purpose not by focusing on shareholders and meeting quarterly numbers, by playing games with their financial statements, or by focusing just on competitive advantages. Instead, they've done it by consistently creating superior customer value—and profiting handsomely from that customer value.

We've spent years looking at these companies—and many not-so-successful ones—looking for patterns and commonalities that explain their stellar results, and we've concluded that they offer three very important lessons for any executive who wants to consistently create superior customer value and generate economic profits over the long term. There is no step-by-step formula, but there are consistencies in how these companies think, how they make strategic decisions, and, most important, how they operate to ensure they are maximizing the value they create and the profits they capture.

- These companies approach strategy from the outside in rather than from the inside out. They start with the market when they design their strategy, not the other way around.
- They use deep market insights to inform and guide their outside-in view.
- Their outside-in strategy focuses every part of the organization on achieving, sustaining, and profiting from customer value.

Two Paths to Strategy

The first thing that distinguishes these value- and profit-creating companies is that they drive strategy from the perspective of the market—in other words, from the *outside in*. This may sound trivial, but it is shockingly uncommon. For all the talk about "putting the customer first" and "relentlessly delivering value to customers," most management teams fail to do this. Put most simply, outside in means standing in the customer's shoes and viewing everything the company does through the customer's eyes.

Far more common than outside-in thinking is inside-out thinking and inside-out strategy. Inside-out companies narrowly frame their strategic thinking by asking, "What can the market do for us?" rather than, "What can we do for the market?" The consequences of inside-out versus outside-in thinking can be seen in the way many business-to-business firms approach customer solutions. The inside-out view is that "solutions are bundles of products and services that help us sell more." The outside-in view is that "the purpose of a solution is to help our customers find value and make money—to our mutual benefit." Some differences in the two ways of framing strategic issues are shown in Figure 1-1.

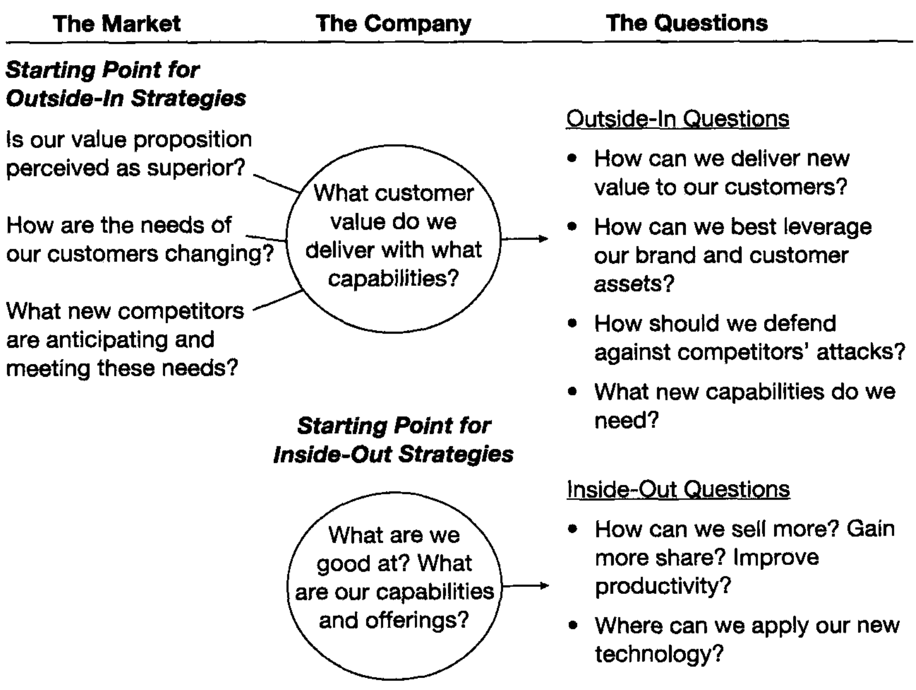

FIGURE 1-1 Which Path to Strategy?

Inside-out thinking helps explain why a large database company that was looking to grow by leveraging its deep information about the companies' finances spent several million dollars to develop a product for small and medium-sized enterprises without first having in-depth conversations with potential buyers. Management, seduced by the seemingly vast potential of this market, relied on the assurances of the sales force that customers would buy. During the process, no one asked what value the company would be offering customers, or how the company's new product would offer customers more value than the status quo. Instead, managers focused on what customers could do for the company. As a result, the new product flopped and was abandoned in less than a year.

An even more costly example is Ford's unfortunate decision not to add a sliding door on the driver's side of its Windstar minivan.[1] The extra cost of the fifth door was the major factor in this decision, but just to be sure, the designers asked a sample of buyers their opinion. Only one-third of the sample thought it was a good idea, while the rest said no or weren't sure because they couldn't envision the benefits. Meanwhile, Ford's competitors were "living with" prospective buyers at shopping malls, do-it-yourself stores, and soccer fields. That fieldwork showed that the fifth door could solve a lot of problems for families and handymen. Based on these benefits to customers, Ford's competitors, including Honda, Chrysler, and GM, added the door, which was an immediate hit. Ford's sales suffered so badly because of the lack of this feature that the company was forced to add it later. Doing so meant that Ford had to redesign its van to match competitors'—at an out-of-pocket cost of $560 million (not including the opportunity cost of lost sales).

Winning from the Outside In

With an outside-in mindset, top management's strategy dialogue starts with the market. The management team steps outside the boundaries and constraints of the company as it is, and looks first at its market: How and why are customers changing? What new needs do they have? What can we do to solve their problems and help them make more money? What new competitors are lurking around the corner, and how can we derail their efforts? This perspective expands the strategy dialogue and opens up a richer set of opportunities for competitive advantage and growth.

Jeff Bezos, the founder and chairman of Amazon.com, is a champion of the outside-in approach. He explained how Amazon was able to meet the needs of its customers for Web services by offering access to its cloud computing network and for a more convenient reading experience with the Kindle. He describes it as a "working backward" mentality:[2]

> *Rather than ask what we are good at and what else can we do with that skill, you ask, who are our customers? What do they need? And then you say we're going to give that to them regardless of whether we have the skills to do so, and we will learn these skills no matter how long it takes.... There is a tendency I think for executives to think that the right course of action is to stick to the knitting—stick with what you are good at. That may be a generally good rule, but the problem is the world changes out from under you if you are not constantly adding to your skill set.*

The difficulties faced by Dell Computer over the last four years illustrate the need for outside-in thinking. For several decades, Dell's celebrated mastery of logistics allowed it to deliver leading-edge computer hardware at prices and speeds that no rival could match. The whole organization could concentrate on assembling and shipping PCs, laptops, and servers as cheaply and quickly as possible. This single-minded emphasis on efficiency made Dell the worldwide market share leader in 2005. Growth came by expanding globally and broadening the range of hardware sold through its direct-to-customer model. Everything was viewed through the prism of this business model and how to leverage it further.

But this inside-out emphasis also kept Dell from seeing and responding to a sea change in its market. More and more customers wanted to buy at retail and own products that conveyed a sense of personal style. Both Apple and Hewlett-Packard (HP) had seen the trend building and were ready to oblige. HP redesigned its machines with a focus on customer experience and distinctive value, beyond price or the latest technology. It advertised, "The Computer Is Personal Again."[3] The market responded, and HP assumed market share leadership in 2006. Dell, on the other hand, faltered and lost sales. Nevertheless, the efficiency focus was so embedded in Dell that manufacturing executives resisted offering distinct designs, even at a premium price.

As one commentator put it, "Dell began to treat consumers and even some business customers like they were passengers on a Greyhound bus."[4] Between 2Q 2008 and 2Q 2009, Dell's share of the U.S. personal computer market dropped from 31.4 percent to 26.3 percent. On top of that, many of Dell's advantages were neutralized as HP and other competitors improved their supply-chain management and lowered costs.

Anecdotes aside, there is abundant evidence for the superiority of outside-in thinking. Much of it comes from studying the relative profit performance of market-driven companies.[5] These firms have an inherent advantage over their more self-absorbed rivals because of their superior ability to understand markets, provide superior value over time, and attract and retain customers.

Inside-Out Myopia

Given both the intuitive and the data-driven appeal of outside-in strategy, why is the inside-out approach to strategy so pervasive? There are many subtle forces that converge to encourage inside-out thinking and slowly disconnect the business from its market.

Positive Reinforcement

Inside-out strategic thinking ultimately relies on gaining maximum returns from existing assets—in other words, increasing efficiency. Increasing efficiency usually produces positive results. However, the quest for steady improvement in operations crowds out the question of whether the operations are worth doing in the first place! While the efficiency of the existing assets may be rising, the market is shifting, and customer value is slipping away. By the time companies that are caught in this cozy positive-feedback loop notice they are no longer delivering customer value, it's too late—competitors have seized the initiative.

Competing Priorities

For most executives, there are often many stakeholders who are closer at hand than customers. Employees, boards, partners, suppliers, and regulators all stand closer to executives than customers do. This proximity means that their concerns can easily become more urgent than those of customers. Meanwhile, within the organization, internal concern about resource allocation, budgeting, and turf wars with other functions become the most pressing priorities.

Contemporary Strategy Theories

The capabilities- or resource-based view of the firm is one culprit. These ideas have inadvertently tilted the dialogue within firms toward an inside-out view. Their supporters argue that the source of a firm's defensible competitive position lies in its distinctive, hard-to-duplicate resources and capabilities. Excellent service operations, strong supply chains, and superior human resource practices are advantages that are cultivated slowly over time. They are hard for competitors to copy, but they also limit the ability of the firm to adapt. In this theory, these resources exist to be used, and the task of management is to improve and fully exploit them. This is certainly a worthwhile goal to be eventually achieved. But as a starting point for strategic thinking, it myopically narrows and anchors the dialogue prematurely.

Darwin in the Enterprise

A contributing factor to the lure of inside-out thinking that can't be ignored is employees' inherent drive for self-preservation. Because firms (and business units, departments, and teams) are made up of human beings, they are inevitably tempted to put their own survival first. This instinct naturally accords with an inside-out view, since the outside-in view often requires a firm to reinvent itself—to employ creative destruction internally to meet ever-changing customer value expectations.

Going with the Flow

Another human trait that also drives inside-out strategy is the tendency to go with the flow and behave like the others around us. Social scientists call this social norming or "groupthink" when they study social dynamics, but companies and organizations are susceptible to social norming, too. Over time, the companies in any industry or sector tend to behave in the same way and to focus on the same issues and strategies—usually inside-out ones. When these industries or sectors are truly shaken up, it is usually because a new entrant makes a breakthrough in delivering customer value that the incumbents have overlooked.

These factors and others continually push executives toward inside-out strategy. Without constant effort and vigilance, inside-out thinking comes to dominate in the firm, and outside-in strategy disappears.

Detecting Inside-Out Thinking

The myopia of inside-out thinking is hard to detect when it becomes embedded in our mental models and shapes the way we do business. Mental models are simplifying frameworks that include prevailing assumptions, norms, and even the vocabulary used to talk about customers. They help impose order and provide handy rules of thumb. The problem is that these inherent simplifications and untested ideas don't announce themselves. Table 1-1 illustrates some that we have encountered in our study of inside-out and outside-in thinking.