O Brave New World

Driving Profitable Growth in the New Demand Economy

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The business world will never again be the same.

For more than twenty years, the growth formula for American business has been simple: increase revenues by expanding product offerings while reducing supply chain costs.

In other words, fill up the store shelves and keep the consumer's attention by constantly offering new variations on existing products, packaging and prices. Meanwhile, use the powerful new palette of Supply Chain Management tools to manage and drive down the cost of production to maintain constant productivity improvement.

As a strategy, this growth formula worked brilliantly for a generation … long enough for both business executives and academics to forget that this strategy was merely the appropriate response to a distinct economic era, not a fundamental law of business.

Now, we are being punished for that forgetfulness. This has, in fact, been the case in many industries for much of this decade—but it was largely hidden by the rush to open new international markets.

However, the current world-wide "Great Recession" has exposed the awful truth: in the developed world we now live in an economy characterized by contracting markets. Worse, even when this economic downturn ends, the best we can hope for is a period of healthy, but flat, markets even as the emerging middle class in the developing world generates new demand opportunities.

What this means is that the world economy has changed, probably forever. For the first time in the memory of most working people, we now live in a world of contracting markets, diminished consumer demand and anemic pricing power. And that in turn means that our current and widely adopted formula for growth is now obsolete.

Smart companies, big (Allstate, Anheuser-Busch, Best Buy, McDonald's, Hershey) and small (the corner coffee joint that now Tweets its best customers), have already recognized this new reality and are racing to gain first-mover advantage within this new landscape. Thus, while their competitors are still stuffing store shelves with endless new product variations, packaging permutations and marketing campaigns—none of which will improve profits—these smart companies have made their new strategy that of identifying and capturing those elusive pools of high-profit demand that remain … and then binding to them as tightly as possible.

In other words, today's smartest and most forward-looking companies have come to the realization that orienting their operations completely around supply is no longer enough. Indeed, it may even be self-defeating. Instead, they are turning themselves into demand-driven companies. They haven't abandoned their powerful supply tools, most notably Supply Chain Management; rather, they are constructing and adding a new apparatus—a "Demand Chain"—that can discipline and optimize the supply chain.

The numbers of these demand-driven companies grows by the day—driven by necessity, if nothing else. But the best companies undertaking this transformation also understand that change of this magnitude, for those brave enough to embrace it, also brings unprecedented opportunity. That opportunity takes multiple forms.

For one thing, this transition from a supply-driven to a demand-driven economy upends the Old Order: long dominant companies in every market may soon find that their historic advantages are gone as new contenders, playing by new rules, rush to capture their best (but not best understood or best treated) customers. History teaches us that market revolutions inevitably reshuffle the cards on winning and losing companies.

That's the big view. But up close, the new opportunities are just as vivid.

For example, consider McDonald's. From the mid-1990s until 2002, the company lost its way by choosing to focus almost exclusively on supply—in its case, building ever more restaurants and acquiring other food chains—rather than on what its millions of customers really wanted. It was only when McDonald's went back to paying attention to those customers—what they liked, what they wanted, and what they might like (i.e., current, latent and emerging demand)—that the company found its way back to success.

The company scrambled to uncover what had gone wrong after so many years of success, and was stunned at what it discovered: in McDonald's headlong rush to become bigger, to dominate the global market, it had lost track of its parallel need to also become better at understanding consumers' latent and emerging demand. As company executives saw it, McDonald's had three major business challenges to address, and it had to deal with them concurrently: overexpansion, declining customer satisfaction, and cultural transformation.

Beginning in 2003, McDonald's began to execute all five components of its Plan to Win. New store openings dropped from 1,000 per year to fewer than 500. It shed its noncore businesses, and set about renovating its existing stores and implementing a massive company-wide revised training program for all 1.5 million of its employees. The menu was rewritten as planned to incorporate value meals, healthy choices, and premium items.

The result? After hitting bottom in 2002, McDonald's revenues and income both returned to their historic, upward market, even during a growing recession. From 2004 to 2009, McDonald's total sales jumped from $50.8 billion to $72.3 billion, or 42 percent. Net income jumped 96 percent, from $2.3 billion to $4.5 billion in the same period. And perhaps most important, McDonald's was revitalized by all of these changes and this new strategy. Customers could feel the change the moment they walked in. Employees felt it too, and ultimately the stock market felt it as well. McDonald's was one of only two Dow Jones Industrial Average stocks that ended the recession year of 2008 with a gain and also outperformed all of its fast food competitors.

By comparison, the Hershey Company, in its transformation into a demand-driven corporation, enjoyed an equally positive—but different—result. The legendary confectioner had enjoyed consistently strong growth for many years, holding or increasing market share in all of its businesses, and buoyed by people's love of chocolate that has held steady in good times and bad. The company had become so efficient at supply chain management, production and distribution that for more than a decade it had consistently added new variations in products, pricing and packaging that captured ever greater real estate on store shelves.

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And yet, despite all of these positive indicators, Hershey's senior management had a growing sense that something wasn't right with the company. For example, many of Hershey's recent strategic initiatives, especially the company's shift in focus on pack types rather than on brands and product proliferation, had not produced the desired results. Worse, by creating a significant number of new SKUs based on pack types and flavor extensions, Hershey's approach was beginning to run counter to the stated desire of many retail customers to simplify the shelf by reducing product complexity.

The Hershey's team decided to investigate what was going wrong—and just as important, to identify and assess the key forces and factors impacting the confection category in the new marketplace—and then to determine what the implications were for Hershey's and how Hershey's could drive profitable growth in a changing marketplace.

Hershey's research also uncovered something else: the existence of a new Demand Profit Pool—"Engaged Exploring Munchers"—that would prove to be critical to the entire category, and to Hershey's in particular. Hershey would understand more about the unique demands of the most attractive Demand Profit Pools for candy, especially Engaged Exploring Munchers, and would align the entire business to serve that demand profitably. This new demand landscape was the foundation for the development of the new thesis for winning for Hershey's It showed how and why Hershey's would win and the role each part of the organization would play in achieving that success. At the same time, Hershey's also began sharing its new demand model—what it entitled "Insight Driven Performance" (IDP)—with its strategic partners, its customers. This IDP, or Demand Chain, would serve as a collaborative network, composed of manufacturer, retailers, and media companies that enable each participant to better understand—and more completely and precisely fulfill—customer demand.

The results of Hershey's transition to a demand-driven business model have been beyond expectations. At the February 2010 meeting of the Consumer Analysts Group of New York (CAGNY), Hershey CEO Dave West announced that the company had generated record cash flows in 2009 of $1.066 billion. That was more than double its 2008 cash flow and 35% higher than the company's previous record cash flow of $788 million in 2004.

It isn't only on the balance sheet where a new demand-orientation can change the game for the better. Consider Anheuser-Busch, the 150-year old beverage giant that leads the beer industry. It had historically built its business via the introduction of valuable and innovative new products. However, as Anheuser-Busch discovered several years ago, while the company's existing lines had prospered, it had been a long time since Anheuser-Busch had enjoyed a new blockbuster product. Meanwhile by looking at the adjacent alcoholic beverage category, they had found that the majority of growth was being driven by sweeter products, including flavored vodkas. This went against the industry's long-term view that beer had to be pleasantly bitter.

However, the success of these sweeter vodkas, plus Anheuser-Busch's own success with some slightly sweeter beers, led to the hypothesis that there might now be a much larger unsatisfied demand for beer with a sweeter taste than had been previously imagined.

To address this, Anheuser-Busch first set to develop an understanding of the demand for beer in America. They developed, and were guided by a "Palate Map", which clarified the specific taste attributes and benefits consumers were seeking. As the team uncovered, there were, indeed, high levels of unsatisfied demand for exactly the product the Anheuser-Busch Innovation team and the brew masters had in mind.

Bud Light Lime was formally introduced to the public on May 5, 2008. Anheuser-Busch now had its most successful new product in years, and the company was now beautifully positioned to move into new and evolving markets. Bud Light Lime was ultimately ranked the number-one new product launch in the consumer goods industry during 2008.

Nowhere has the opportunity presented by shifting to a demand-orientation been more important than in the recent story of Best Buy.

The Minnesota-based company, founded in 1966 and with annual revenues of nearly $50 billion, has had a storied history. What began as a single Sound of Music stereo shop now has more than 1,100 stores and 150,000 employees around the world. One of the keys to Best Buy's more recent success was its strategy of "geodemographic market segmentation"—that is, segmenting customers by who they are, where they live, and what they've bought. The company had even identified several key customer/geographic groups and had aligned their stores to serve them. It had worked extremely well— well enough to make Best Buy the clear leader among electronics retailers.

But by 2006, Best Buy management began to sense that the company had "hit a wall" in terms of the company's understanding of its customers' changing behaviors and preferences. Further, it had been come apparent that there was a perceived lack of differentiation between Best Buy and its competitors, and a growing concern about emerging low-cost competitors including Wal-Mart and Costco.

And so Best Buy set to trying to develop an actionable segmentation approach to help them differentiate the brand, focus on the most important customers, and move the business forward. They began to look at the forces and factors at work on consumers of Best Buy's technology and entertainment products and services. And what makes this research especially interesting is that it not only looks at current demand, but also seeks to discover emerging demand (where the consumer is going) and latent demand (what the consumer would buy if he or she knew it existed). Forces and Factors analysis , at its best, yields an unequalled understanding of where pools of demand exist today, where they will emerge tomorrow —and which ones are the most profitable.

What Best Buy discovered in its research was that there were five major demand segments in its industry, and just two, representing a third of the market—"Enthusiasts" and "Online Aficionados"—were of particular interest. And it was towards these two audiences, and why they buy ("need states") that Best Buy has tuned its business. That's why these days, when you walk into a Best Buy you'll find unique store environment in which knowledgeable and friendly employees work to guide those Enthusiasts through the experience of a new technology or product, help them put together the right package of products to achieve a solution tailored for their needs, and then follow up to make sure that this system was installed properly and delivering the enriching experiences Enthusiasts were seeking.

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The fact that these legendary corporate giants are already shifting from their traditional focus on fine-tuning their supply operations to new demand-based business strategies should underscore the fact that the business world is changing beneath our feet. Some businesses may already be falling behind. Others have seen the opportunities presented by this revolution, and have rededicated themselves to capturing them.

The new reality is this: in a world of increasing oversupply, it is no longer possible for companies to simply create lower cost supply, then search for demand in the market to absorb it … not if they still hope for profitable returns. Instead, the opposite is now the rule: companies need to be led by profitable demand to deliver the products and services that capture that demand and drive profitable growth.

The bad news is that you may already be behind—at least behind the industry innovators. The good news is that your competitors are likely just as far behind as you are—and you still have the chance to lead your industry into this new world.

But the best news of all is that, thanks to these pioneering firms an entire set of proven approaches — enough to help transition your business from a supply-driven focus to a demand-driven strategy, are now available for your use. Here are some examples:

- Demand Profit Pools: to identify pockets of profitable demand,
- Demand Gaps: to determine the changes required in your products and operations to capture this profitable demand,
- Precision Marketing: In the age of Google and GPS there are remarkably efficient and effective tools which ensure that you can match the exact right supply to capture the highest profit Demand everywhere your products are sold, and
- Customer Demand Analysis: to optimize offers to best align with demand while maximizing profits.

But it doesn't end with the implementation of a new set of tools. As we saw a generation ago with Supply Chain Management, the tools eventually transform the toolmaker. Once you shift your focus to demand, applying these new tools in isolation is no longer enough.

Will you embrace this change, and flourish in it? Or will you wait, perhaps too late, until this change is forced upon you?

Instead, you soon learn that there is more power in integrating them along the entire pathway up from the retailer to the distributor to manufacturing and marketing, all of the way back to initial product design. This is the Demand Chain, which realigns the entire company around the current, emerging and latent demand of your most important customers.

But it doesn't end there. Because once the Demand Chain is in place and you understand who your customers are and what they want, you need to build a new working relationship with your retail customers and your media partners in order to win. Ultimately, the Demand Chain builds a collaborative network of manufacturer, retailers and media partners that enables each participant to better understand, and more completely fulfill, consumer demand. You now have an exciting new strategy for success, one that not only gives you a powerful advantage over your competition, but the opportunity to hold that advantage for years.

This new strategy is the basis for your Thesis for Winning.It is around this new Thesis that you rebuild and align your organization, from R&D to sales. Everything is now oriented towards satisfying the desires of the members of your most attractive demand profit pools.

There is one more step. It is not enough to simply align your operations towards demand. You must also inculcate a demand orientation in your employees, and all of the other stakeholders across your business. It is here, where the Thesis for Winning is translated into a shared Mental Model in the minds of everyone in the organization, telling them their role in this new strategy, where victory is finally achieved.

The global economy is changing beneath our feet. Change is here; there is no longer any question about it. And the best companies are already adapting to this new economic reality in which an in-depth focus on demand precedes and informs the development of supply.

So the real question now is: What will you do about it?

You've now seen the roadmap to becoming a demand-driven company. You've read the case studies of successful firms that have already preceded you through this transformation. You can no longer claim you didn't realize this change was coming, or that you didn't have time to prepare for it.

So now there are only two choices: Will you embrace this change, and flourish in it? Or will you wait, perhaps too late, until this change is forced upon you?

In this brave new world, as in the old one, success only comes to those willing to grasp it.

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Rick Kash is the founder and CEO of The Cambridge Group, and coauthor of the new book, *How Companies Win: Profiting from Demand-Driven Business Models No Matter What Business You're In* (HarperBusiness). His previous book was *The New Law of Demand and Supply: The Revolutionary New Demand Strategy for Faster Growth and Higher Profits* (Currency/ Doubleday; September 2002). In addition to The Cambridge Group, he co-founded Spectra Marketing Systems, a micro-marketing supermarket and mass merchandiser information system used by more than 90% of packaged goods and beverage marketers. To learn more about his new book, visit www.howcompanieswin.com.

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