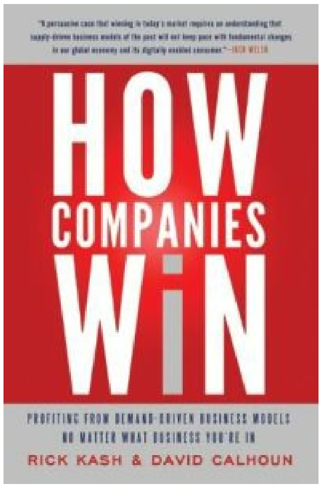

Book How Companies Win

Profiting from Demand-Driven Business Models No Matter What Business You're In

Rick Kash and David Calhoun
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Recommendation

The concept of supply and demand has a venerable history. Scottish social philosopher Adam Smith used the phrase in *An Inquiry into the Nature and Causes of the Wealth of Nations*. Other great economists and thinkers, from John Maynard Keynes to John Kenneth Galbraith, covered it extensively. Today's wisdom: Forget about it. Consultant Rick Kash and executive David Calhoun turn this bedrock concept inside out, transforming it into the "Law of Demand and Supply." They explain why businesses that focus on supply and attempt to force demand to align with it will lose big. The sooner sellers accept the reality of the demand economy and adjust, the better chance they will have to survive rocky economic times and flourish in the years to come. *BooksInShort* finds that this book conveys an important message to business leaders. While these authors may not be Smith, Keynes or Galbraith, they certainly have a keen grasp of big concepts.

Take-Aways

- The traditional concept of supply and demand needs updating to reflect today's economic reality. Now the idea of demand and supply dominates.
- To use this new paradigm, managers must accurately assess today's demand and anticipate its ramifications and changes.
- View demand strategically; it can be "current, latent" or "emerging."
- Group your consumers into "demand profit pools" according to why they want your products and services.
- Gaming firm Harrah's works to meet the wishes of its 90-plus customer demand pools.
- Your "demand landscape": "profitability, competitors, brands, channels, innovation opportunities, packaging, media habits, price sensitivity and other critical metrics."
- Ball Park Franks upped its market share by promoting hot dogs as an after-school snack for tween and teen boys.
- When properly used, innovation can drive demand or respond to it.
- To charge premium prices, pay attention to differentiation.
- The demand-and-supply world requires innovation, adaptation and flexibility.

Summary

Economic Paradigm Shift

A major transition is now underway. No longer is business just about what you can supply. Today, it must focus on whatever consumers demand. Formerly, great companies – for instance, IBM and Ford – promoted their innovative products or services and then optimized their distribution channels. This business model is passé. Today's great companies, such as Google and Apple, do not focus on distribution or supply channels. They spend their energy on "consumption models" or demand, involving their customers in every aspect of their businesses, including planning, product design and testing. Now consumers, not manufacturers and certainly not supply-chain insiders, are in the driver's seat. Successful businesses heed their clientele and offer the products or services they want, instead of remaining imprisoned by habitual or static inventories. Supply concerns the product's packaging, advertising, distribution, pricing, servicing and branding. Demand involves the product's practical, emotional and psychological ramifications, and how it meets people's immediate and long-term needs. Demand takes three forms:

1. **"Current"** – This is immediate market demand, exemplified by Microsoft's hurry-up effort to develop Internet Explorer in response to Netscape's Navigator.
2. **"Latent"** – Google fulfilled a pending "need that millions of Internet users had but had yet to fully articulate." They "never knew they wanted Google...until they saw it."
3. **"Emerging"** – Twitter's inventors first saw the microblogging site as a "minor application" – until countless smartphone users found that it met their burgeoning need to send concise messages.

> "If Adam Smith were writing *The Wealth of Nations* today, he would invert this famous phrase to reflect this new reality: the Law of Demand and Supply."

A "four-phase transformation" inverted supply and demand into demand and supply:

1. **"Market equilibrium**" – Until 1990, supply and supply-chain management ruled.
2. **"Oversupply"** – From 1991 to 2007, universal abundance bred a surplus of companies and commercial offerings, all chasing a limited number of customers.
3. **"Demand contraction"** – Trade fell in the severe economic climate of 2008 and 2009.
4. **"Demand-driven economy"** – From 2010 on, slower growth, higher prices and stronger developing-world manufacturing will cause "hypercompetition." To make money in this environment, seek profitable demand.

McDonald's Recaptures Its Old Magic

From the mid-1990s until 2002, McDonald's 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. McDonald's greatness had come about because of a single-minded focus on "QSCV" – quality, service, cleanliness and value. By 2000, McDonald's had more than 28,000 retail locations and total annual revenues of nearly $15 billion. But in 2002, it experienced its first quarterly loss since 1954. In McDonald's headlong rush to dominate the global market, it lost track of its parallel need to also become better at understanding consumers' latent and emerging demand. Customers were increasingly complaining about dirty stores, unclean bathrooms and unfriendly poorly trained employees, and shifting to competitors such as Subway, which they perceived as being healthier. McDonald's realized to its dismay that it needed to revisit its entire product offering to keep up with the changing tastes of the public. In 2003, the fast-food chain embarked on one of the most remarkable restructurings in modern business history.

> "Whoever satisfies demand the best, profits most."

Once McDonald's leaders understood its problem, they fixed it. The chain rolled out a whole new family of healthy alternatives, including more salads, bottled water, fruits and nuts, and yogurt, all featuring notification of nutritional content for the health conscious. It scaled back on new store openings and concentrated on improving the look and service of existing stores. It renovated interiors and bathrooms, and instituted new training programs. McDonald's new "Plan to Win" program worked. From 2004 to 2009, sales increased by 42%, and net income grew by 96%, from $2.3 billion to $4.5 billion. During the 2008 recession, only two Dow stocks gained ground: McDonald's was one of them.

> "The relatively stable, growing economy that the developed world has enjoyed almost uninterrupted since the end of World War II is transitioning to a new economic order."

Thus, McDonald's is now demand-driven. It completely revamped during a recessionary economy, in the face of flat, or even shrinking, demand. The most important lesson to take away from McDonald's notable turnaround is: "In a world where supply is growing ever more efficient while demand is flattening or even contracting, understanding demand becomes the new imperative for how companies will compete and win." It isn't enough just to ask people about their buying preferences. Anticipate their future preferences, and develop evidence-based hypotheses about where your company's demand is heading.

Understanding Demand

"What do you know about the demand of your most profitable customers that your competitors don't know?" Working out the answer to this challenge – the essence of your business strategy – involves asking four additional questions: Which customers generate most of your earnings? What unfulfilled demands – current, latent and emerging – do they have? How can you differentiate your products to satisfy these demands? What "action plan" will you use so your employees know how to proceed?

> "In the new demand economy, the margin for error for all businesses grows smaller and smaller."

Regardless of the new emphasis on demand, some business standards and qualities will remain as important tomorrow as they were yesterday. You still must know your customers inside and out. You need excellent management, including strong supply-chain management, which is still essential but not as decisive as it once was. Your organization requires superior internal alignment and execution, and you must take full advantage of technology. Yet you need to reorient your thinking about "the primacy of demand."

> "Evolving from a supply-driven company to a demand-driven company is as much a matter of attitude as it is a process."

Understanding demand means being precise about who wants what and how much of it. Your goal is to develop a "demand chain" that is as sophisticated as your supply chain. A demand chain is a "collaborative network composed of manufacturer, retailers and media companies," all focused on consumer demand. In this environment, constant innovation – the ability to find and fulfill new demand opportunities – is essential. Develop a realistic "thesis for winning" about satisfying demand.

Build a workable "mental model" of how your firm will succeed in the future. Use it to help employees understand what roles they will play. Align every element of your firm to this demand-based model, and measure your performance accordingly.

"Demand Profit Pools"

Marketers traditionally segment customers by "demographics or behavior." This makes sense, but it does not go far enough. Besides knowing your customers' demographics and typical behavior patterns, you also need to understand the reasons behind their purchase decisions. Find and get to know people you want to target. These high-opportunity groups of customers – called demand profit pools – are your most promising source of sales. Identify them and focus on them. This demand profit pool analysis can change how your firm plans and operates. It helps you conceptualize the way individual groups of customers make decisions about your products.

> "Human beings are complicated and mercurial, and a demand chain that is accurate today may be misdirected tomorrow."

To conduct a demand profit pool analysis, study the "size, growth potential and profitability" of your specific demand pools, and track quantitative and qualitative changes within these consumer groups. Next, outline "demand landscapes," or descriptions, that paint a comprehensive picture of your sales possibilities, covering "consumer demand, profitability, competitors, brands, channels, innovation opportunities, packaging, media habits, price sensitivity and other critical metrics." Charting your sales this way defines your competitors' strengths and weaknesses, and helps you develop reliable, competitive intelligence, from defining your customers' media choices to deciding where you should allocate resources and where you must innovate.

Harrah's Hedges Its Bets on Demand Profit Pools

Harrah's, the gaming-resort company, uses the demand approach in its marketing. In 1998, Harvard Business School professor Gary Loveman joined the company; he is now Harrah's chairman and CEO. His game plan: Take "the gamble out of the gambling business." His strategy: Target the right demand pools. This strategy had four components:

1. Harrah's established four separate customer levels ("Gold...Platinum, Diamond and Seven Stars") based on the amount the customer plays in the casino. Greater rewards and prestige motivate customers to move up in the plan and increase their participation.
2. Harrah's then broke its demand pools into some 90 additional categories, segmented by "geodemographics, psychographics and play patterns."
3. The firm developed "real-time data" by carefully assessing and monitoring customers' behavior and preferences. This enables Harrah's to make strategic changes quickly.
4. Harrah's mails almost 250 million pieces of correspondence annually and sends some eight million monthly emails, with a response rate five times the "industry average."

> "For the past few years we have been focused on reengineering our entire supply chain. As a result, we now get the wrong products to the wrong customers at the wrong stores faster and cheaper than anyone else." (CEO of a large consumer goods manufacturer)

Thanks to its "proprietary understanding of demand," Harrah's precisely targets its most profitable customers. Your company should operate just as painstakingly. In fact, it is time to expand the traditional "four *P*s of marketing: product, promotion, place and price" with a fifth *P* – "precision." You must understand demand and target it exactly, including statistical analysis of the people in your demand profit pools.

Ball Park Franks Finds a New Market

When faced with the prospect of flat growth, Ball Park Franks, a leader in the hot dog category for years, focused on bringing new insights to bear to drive profitable growth for the brand. Ball Park had been focused on a strategy of mass marketing to adult males during the summer grilling season. However, summer grilling consumers represented just 30 percent of the total hot dog business. As research revealed, a vast new year-round market was sitting out there, which was all but unaddressed by Ball Park or any of its competitors: teen and tween boys, who came home from school hungry and who had only a short break before sports or other activities. The mothers of these boys were very concerned about the nutritional value and healthfulness of the afterschool snacks their boys ate. These moms perpetually search for snack items that are both healthful and appealing to their sons. The firm examined the market in great detail, including the "palate map" of six hot dog flavors, which defined what consumers wanted in the ideal hot dog. Based on those insights, Ball Park focused on offering a quality all-beef product that reassured moms, with the great taste that kept the tweens and teens asking for more. Ball Park advertised that its hot dogs cook in 30 seconds in the microwave. It placed ads on Internet gaming sites. In three years, sales rose by 40%, and Ball Park's "retail share climbed from 18% to 21%."

Innovation and Pricing

Innovation keeps companies competitive. Research indicates that each "new patent citation" raises a firm's market value by approximately 3%. Do not think of innovation as "a 'Eureka!' moment." Rather, it is completely demand based, hence this definition: "Innovation is finding unsatisfied profitable demand and then fulfilling it." Innovation does not imply only new technology or product development. You can innovate throughout your organization by improving your procedures. Innovation is a process of "identification and realization," wherein you locate underserved demand pools, creatively consider how to reach them, prioritize the effort, develop the best ideas and validate your hypothesis – this is the realization phase – by introducing your new product. You may fail, but try again. Innovation is a continual effort, not a destination.

> "American corporations spend more than $1 trillion per year on innovation, and only get a fraction of that back in return on their investment."

Innovation means little if your prices are so high that prospects won't pay them or so low you can't profit. Set your prices according to demand, use pricing options that clearly tell your customers what benefits they are receiving for the price they pay. Your product or service must be notably different from your competitors' to earn a premium price.

> “The biggest fear of even the...most up-to-date companies is that what two college students are doing in some garage might render their entire industry obsolete.”

In this new paradigm, the true measure of power for one’s supply chain will now lie in its ability to more precisely target and serve the right demand at the right time at the right place in the right package and in the right environment. Of course, this presumes that you are fully in touch with demand: What it is, where it comes from, what drives it and how much of it exists. You also need the expertise to plan, develop, market, and price products or services that meet demand. To keep your firm adaptable as demand changes, run 10 to 20 “small test-and-learn experiments” all the time. This will enable you to build crucial “fast cycle response time.” To win in today’s top-speed commercial world, you must be innovative, responsive and extremely nimble.

About the Authors

Rick Kash, founder and chairman of The Cambridge Group, also wrote *The New Law of Demand and Supply*. **David Calhoun**, chairman and CEO of The Nielsen Company, was vice-chairman of General Electric.