

## Chapter 1

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# Innovating and Outperforming the Competition

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*Our vast progress in transportation, past and future, is only a symbol of the progress that is possible by constantly striving toward new horizons in every human activity. Who can say what new horizons lie before us if we can but maintain the initiative and develop the imagination to penetrate them—to the end that greater degrees of well being may be enjoyed by everyone, everywhere.*

—Alfred P. Sloan Jr.

## CREATING A NEW INDUSTRY . . .

On FedEx's first night of operation, April 17, 1973, a small group of people stood around a makeshift system and sorted 186 packages. They then loaded them onto 14 small planes that promptly took off for 25 cities across the United States. On that night, FedEx became the first transportation company dedicated to overnight express package delivery. Thirty-two years later, FedEx handles over five million packages every day serving 215 countries around the globe.

FedEx's revenue grew from just \$6 million in 1973 to over \$24 billion in 2004. In 1983, it was the first company to grow to \$1 billion within the first 10 years of its existence, without acquisitions. During the first three years of its operation (1973–1975), FedEx

lost over \$29 million as it built its infrastructure and established the network that would allow it to start making a profit. For the past three years (2002–2004), its net income has been over \$2.3 billion.

Today's FedEx, which has constantly evolved to meet customer needs, consists of four operating companies connecting the global economy with a full range of transportation, information, and supply chain services. This change and growth did not happen overnight. The factors that contributed to FedEx's phenomenal success included developing customized business solutions. One example is FedEx's relationship with Hewlett-Packard. In the fast-changing computer industry with new models coming out every month, HP realized that any computer stored in a warehouse runs the risk of becoming obsolete. FedEx and Hewlett-Packard worked together to develop a supply chain solution that eliminated the warehousing of HP's industry-leading notebook PCs. The notebooks were shipped directly from the manufacturing facilities in China to homes and businesses throughout North America in just two to three working days.

Over the past five years, FedEx's stock price has doubled. During the same period, the stock price of its main competitor, United Parcel Service (UPS) increased by only 15 percent, and the Standard & Poor's 500 fell by 20 percent. FedEx has been recognized as one of the 100 Best Companies to Work for in America (*Fortune*, 1998–2004) and also as one of America's Most Admired Companies (2001–2004).

### **... BY TAPPING EMPLOYEES' CREATIVITY AND COMMITMENT**

Before starting FedEx, Fred Smith hired consultants to do a feasibility study and help develop his business idea into a detailed business plan. The consultants estimated the total market potential for

air freight to be around \$1 billion. Today, FedEx's share of the express transportation industry is over \$17 billion. What allowed FedEx not only to create the express industry and grow the overall market, but to continue to enjoy a dominant market share?

FedEx became an international powerhouse and one of the most trusted global brands by implementing leadership practices that tapped into the discretionary effort, creativity, and commitment of its employees at all levels of the organization—the foundation of a thriving innovation and performance culture. True, Fred Smith had the original business idea, but it was the creativity and commitment of employees that turned it into a successful business. The employees of FedEx have designed and delivered unique customer value propositions (what customers value) that have kept FedEx one step ahead of the competition.

Even though the managers at FedEx did not consciously set out to build and sustain an innovation culture, that is precisely what they accomplished. The open and supportive environment allowed employees at all levels in the organization to be part of the innovation process. The day-to-day leadership practices and behaviors and the company's organizational support systems have been keys to FedEx's phenomenal growth.

This book provides a model, or a framework, that explains how these leadership practices and organizational support systems, working together, built and sustained the FedEx's innovation and performance culture.

There is no company manual entitled *The FedEx Way: How to Build and Sustain an Innovation Culture*. The book you are reading is based on FedEx managers' *firsthand experiences and interpretation* of those experiences in the context of the innovation culture model and the three-step process (generation, acceptance, implementation).

Business leaders also should keep in mind that it is neither feasible nor practical to adopt principles and practices “lock, stock,

and barrel” from another organization and try to fit them into their own existing culture because *each organization is unique*.

Some organizations may already apply some of the leadership practices that promote innovation but do not get the collective benefit—a thriving innovation culture—because some of the pieces may be missing. The goal is to help managers *identify and implement* the missing piece(s) to actively engage every employee in the innovation process.

The leadership practices and support systems discussed in this book are not unique to FedEx; they have proven to be equally effective in other organizations.

## **DEFINING CREATIVITY IN THE BUSINESS WORLD**

Two key terms are often used interchangeably—creativity and innovation. People normally associate creativity with artistic endeavors—Monet, Picasso, Michelangelo, and Mozart, the artist’s studio, the visual arts, or the performing arts. In the context of the business world, I define *creativity* as the process of *generating ideas* that will help the organization become more competitive in the marketplace. Business creativity is generating ideas that will improve the customer experience, increase revenue and market share, or improve efficiency. The thought process uses imagination just as artists do: “What if . . . ?” What if we make this change in our business strategy, product design, manufacturing process, distribution process, billing system, accounting system, and so on?

Walt Disney, after seeing run-down rides and bored adults during a visit to an amusement park with his daughter, thought, “What if there was a place where kids and adults could play together?”

Similarly Sam Walton, CEO of Wal-Mart, asked, “What if we connect the cash register to the inventory planning systems and substantially reduce the cost of doing business?”

After realizing that there was a growing demand for a time-definite express mode of transportation for shipping high-priority, time-sensitive cargo such as computer parts, critical documents, medicines, and electronics, Fred Smith thought, “What if we develop an airline dedicated to providing overnight express service to meet this growing need?” He went one step further and thought, “What if this airline used the hub-and-spoke system?”

Initially, Fred developed and proposed the hub-and-spoke system to the Federal Reserve System for overnight delivery of checks between their 36 locations around the country. At that time, clearing checks used to take anywhere from one to four days. This created a huge *float*, that is, checks written and presented for deposit but not yet cleared and credited in the recipients’ accounts. The overnight express system would have eliminated the float. The word “Federal” in the company’s original name came from the proposal to carry the Federal Reserve’s checks and “Express” represented the speed with which the new company would carry them.

Creativity in the business world means exploring what ifs—taking time to seek the connection between seemingly unrelated variables, to see other possibilities, and to look at the bigger picture when making decisions. Fred Smith thought out his ideas while he wrote his now-famous Yale term paper. When he was raising venture capital in the early 1970s to start FedEx, a shipper could send a critical package using passenger airlines.

Passenger airlines, for many reasons, did not always guarantee a time-definite and cost-effective service. First, because the primary goal of the passenger airlines was flying passengers, the departure and arrival schedules were built around the needs of the passengers. A flight might not be scheduled to leave at the time a customer wanted to ship a package. Or a flight may not have been scheduled to the destination the package needed to reach, or there might not have been a flight scheduled to arrive at the time the shipment needed to be there. Second, customers had to take packages to the

airport because the airlines did not provide pickup service. The only way to avoid that problem was to have a third party pick up the package and transport it to the airport, which added substantially to the shipping cost.

A similar situation existed at the destination end. On arrival, the recipient or a designee had to pick up the package and deliver to the final destination. In general, the handling systems of the passenger airlines were designed to serve the passengers. Processing packages in an expeditious manner was not part of the design.

Fred's creative idea substantially improved on the then standard express transportation service by making custodial control and "door-to-door" service part of the design of his proposed venture.

## **THE THREE-STEP INNOVATION PROCESS**

Whereas creativity deals solely with the generation of ideas by exploring what if scenarios, innovation starts with creative ideas but takes the process two steps further. As Rosabeth Moss Kanter says in her landmark book, *The Change Masters*, "innovation is the generation, acceptance, and implementation of new ideas, processes, products or services. It can thus occur in any part of a corporation, and it can involve creative use as well as original invention. Application and implementation are central to this definition; it involves the capacity to change or adapt." Innovation is the act of introducing something new. Innovation is applied creativity.

The process involves an increasing number of people as it moves through the three steps:

*Step One:* Individuals freely generate and express creative ideas.

*Step Two:* A small group composed of people in departments and disciplines affected by the idea(s), accept and work collaboratively to develop the raw idea(s) into sound business plans.

*Step Three:* A much larger group—in some cases the whole organization, depending on the scope—adopts the idea(s) and works to develop and implement it.

Walt Disney, Fred Smith, and Sam Walton had original ideas. But it required people from various disciplines to shape those raw ideas into viable business plans. And it required an even greater number (entire organizations) to successfully implement the business plans. Disney, Smith, and Walton understood that humans are inherently creative beings and have a psychological need to make a difference and to be part of a winning team. As leaders, they developed an environment in which the employees could unleash their potential and be part of the innovation process. The leaders and their employees together created truly world-class organizations.

Typically, employees think innovation means coming up with a unique idea. That's why it's so important to let employees know that they are also making valuable contributions when they are being open to new ideas and putting them into practice. Employees who help implement new ideas are playing a vital role because great results require great ideas and great implementation (execution).

The successful implementation step is sometimes more important than the generation and acceptance of ideas. On more than one occasion, I have witnessed a well-implemented mediocre idea that has produced great results. I have witnessed poorly implemented great ideas that produced poor results. But the worst results I have seen are great ideas that were not accepted and implemented at all. This is where companies feel the negative effects of missed opportunities for increasing the market share, reducing the cost of doing business, or improving the customer experience as their competition moves ahead of the pack.

## IMPLEMENTATION IS KEY

Top executives have plenty of ideas and understand the importance of implementing them, but few have figured out how to do so, according to two new surveys. A recent survey of 350 executives in the United States and a similar polling of business leaders in the United Kingdom both sponsored by management and technology services firm Accenture suggest that:

- More than half of the executives polled say innovation is one of the five most important factors in building competitive advantage, and 10 percent say it is the most important factor.
- More than 75 percent of top managers say their people generate enough good ideas.
- Only 10 percent of executives say their organization excels at innovation, and 46 percent say they implement fewer than 20 percent of their promising ideas.

“The best companies have an innovation culture,” says Peter Cheese, a managing partner at Accenture in London.

—From “Great Ideas Abound, But Implementation Lags,” *HR Magazine*, March 2003

In early 1980, a few months after I started working at FedEx, the company was guaranteeing overnight delivery by noon. As part of my new employee orientation, I put on a FedEx courier uniform and rode all day with Susan, a courier in Dallas, while she picked up and delivered packages. That day, Susan completed her deliveries by 11:15 A.M. As soon as she finished, Susan called the other couriers in her part of town to see if they needed help. Bill, another courier, radioed back that he could use some help. Susan asked where he was headed for his next delivery stop, and we met him at a Walgreens drugstore close to his stop. We transferred some packages from Bill’s van to Susan’s van and delivered the packages. With



this last-minute collaboration, all packages were delivered on time that morning.

I was completely amazed.

At RCA Records (my place of employment for 10 years before joining FedEx), an employee on a shift who completed his production quota earlier than his shift schedule would just sit in the break room until it was time to clock out; I was surprised at the unfamiliar practices of the FedEx employees. While riding along with Susan, I asked if the other employees did the same thing she had done for Bill when they completed their deliveries. She looked at me with an expression that conveyed, “Why would you even ask such a question?” and replied, “Of course, Bill and other couriers have helped me out many times when I was struggling to make all my deliveries on time. We all know from experience that on a given day some routes will be heavier than the others. Also, there may be traffic problems in some part of town. Everybody’s goal in the Dallas pickup and delivery operations is the same—on-time delivery to our customers every day.”

This experience and others like it in the first few months of my arrival convinced me that the unique culture at FedEx influenced employees to go above and beyond the call of duty to make sure the company kept its promise to its customers.

## **PSP PHILOSOPHY**

In the first week at FedEx, I attended an all-day orientation session conducted by the human resources department. The human resources manager talked a lot about FedEx’s PSP (People, Service, Profit) culture and its “People First” philosophy. Put simply, the PSP culture means that FedEx puts its people (employees) first in everything it does, and as a result, FedEx employees put the customer first in everything they do.

FedEx has to rely on employees for crisp execution of its operating plans for the pickup and delivery of five million packages worldwide daily. Even though operations and schedules are planned extensively, the reality is that on a given day there will be delays in the system (flight delays because of bad weather, traffic delays in the city because of construction and other uncontrollable factors, etc.). Overcoming these problems comes down to the front-line employees, who must adapt to the disruptions and ensure FedEx meets its service commitments. Another metaphor used to explain the PSP culture was a three-legged stool. Each of the three legs is equally important. And each leg must be equally strong for the stool to be stable. For FedEx to be healthy and successful, all three elements of the PSP culture had to be strong. If you treat people well, they will be more inclined to provide excellent service, which will generate profits that benefit everyone.

Within four months of joining FedEx, I received a letter from Fred Smith, announcing a special 3 percent raise for all employees. The letter made it clear to us that it was because of our efforts in providing superior service that the company's financial picture was much brighter. Although we did not get special raises after that, FedEx's profit sharing plan has ensured that employees continue to benefit from the company's success. Based on the company's profitability, all employees receive a check before Christmas as part of the current profit-sharing plan. At the end of the fiscal year, another distribution is made as part of the deferred profit-sharing plan. This amount is deposited into employees' deferred profit-sharing accounts. You will have to design your program based on the reality of your business environment. The goal is to tie personal well-being with the company's overall performance.

My department was responsible for developing long-range operations and facilities plans for FedEx locations worldwide. I rode with couriers in Tokyo, Hong Kong, Bombay, and other cities. My experience riding with Susan—observing the mutually respectful

interactions between the customers and the couriers—confirmed for me the key role of the PSP culture and the People First philosophy in helping FedEx set the industry standard for customer service and reliability. In my 22 years at FedEx, whenever I went on a business trip, I tried to schedule at least half a day riding with a courier in that city. I found this to be the best way to get a feel for the unique characteristics of that market and the current operating scenario. I observed the same above-and-beyond dedication in employees in every city and country. Leading the people the FedEx Way was producing similar results worldwide.

Many times, friends and business acquaintances have commented, “FedEx employees are the most friendly and customer service oriented employees.” A friend of mine in Chicago continually praised employees at the FedEx’s Business Service Center close to her office on Michigan Avenue. Once she told me, “Sometimes I’m running late and there is a long line just before the closing time in the evening. But the staff goes out of their way to make sure every person in the line has his or her shipping needs met.”

In the following months, I learned much more about the PSP culture and People First philosophy as well as about the critical role managers and employees at all levels play in making it a day-to-day reality. The PSP culture and the People First philosophy are key innovations that have made FedEx the industry leader it is today. Many companies espouse a similar people philosophy on paper in their manuals and annual reports. What sets FedEx apart is the remarkable way it has breathed life into that philosophy.

In the following chapters, I describe not just how FedEx institutionalized the PSP philosophy but how it encourages the leadership practices that support innovation. The genius of PSP was not just the telegraphic and shorthand way the principles were enunciated and communicated, but the metrics that were put in place to measure whether they were working. Accountability was built into the system. Every company has a metric for profit, but FedEx

created a measure for people/leadership and another for service from the customer's perspective. Other companies have enlightened practices, but FedEx figured out how to measure the extent to which those practices are being followed. Later chapters show how FedEx created systems to ensure that people (employees and customers) were treated well and that impeccable service would be delivered virtually all the time.

Leading under the PSP philosophy, managers recognized that some people were naturally good at generating ideas. Some people were skilled at working with other departments in further developing the raw ideas. And others were adept at implementing the developed ideas. At different stages of the innovation process, the roles can change. A programmer might not have the knowledge base to generate ideas about the corporate business strategy but certainly would have creative ideas while designing and programming a specific part of the management information system to execute this strategy. With this recognition, the managers encouraged and allowed the employees to play the roles in which they were most successful. Procter & Gamble's CEO, A. G. Lafley said it well:

People get as much credit for giving good ideas as for receiving them.

—A. G. Lafley, CEO, "Innovation Special,"  
*Fortune*, May 31, 2004

And the result:

Since he took over in the summer of 2000, operating income, adjusted for extraordinary gains and charges, is up an average of 17 percent. The stock price has nearly doubled. Lafley brought a whole lot of creativity and rigor to P&G's innovation process, a tough thing to do in the notoriously rule-bound culture. During the past two years, P&G has raised its new-product hit rate

(the percentage of new entries that deliver a return above the cost of capital) from 70 percent to 90 percent. That's terrific in an industry where half of new products fail within 12 months, according to market-research firm Information Resources.

—Story by Patricia Sellers, "Innovation Special,"  
*Fortune*, May 31, 2004

I also share how Susan and other individuals helped build FedEx into one of the world's most trusted global brands. It is the brand that people associate with on-time performance, reliability, *innovation*, and customer-driven technology.

## **POSITIVE PACKAGE TRACKING AND ON-TIME GUARANTEE**

FedEx was founded on the idea of meeting time-definite express transportation needs, but it really took off when Fred Smith realized and verbalized that the company was not in the transportation business but in the peace-of-mind business. The new business purpose resulted in the development and implementation of innovative package tracking systems designed to let customers know exactly where their packages were and when they arrived at their final destinations. On the surface, it may appear to be a creative application of the existing technologies. But a deeper look reveals the involvement of hundreds of people in developing the idea and the entire organization in implementing it. The successful implementation of the expanding business models required innovative thinking at all levels of the organization.

I called Harry Dalton, who was Director, Systems Engineering & Design when the project began and later was Vice President, Strategic Integrated Systems. I asked him, as project leader for this industry-changing innovation, to discuss the details surrounding

FedEx's implementation of the tracking system. I told him I wanted to learn about it from the person who made it all happen. To that, Harry responded, "You are being too kind. I had lots of good people working with me."

Here's a sampling of our exchange:

**Q:** Looking back on your experience from a big picture perspective, what were the keys to success for this project?

**A:** Off the top of my head, I'd say it came down to five things:

1. A clear definition of the project objective, which was to develop and implement a positive tracking system.
2. Thorough understanding of the company's operations. (Prior to the leadership role for this project, Harry was director of operations in the Mid-Atlantic district.)
3. A keen understanding of what the information needs were from the customer standpoint.
4. High-level project sponsorship. (Throughout the project's duration, Harry reported to the president of the company.)
5. Technical expertise within my staff to leverage what we were asking the vendors to do.

**Q:** Walk me through the detailed steps of developing and implementing this trailblazing Innovation.

**A:** We hired smart people and gave them interesting work. We made sure they all knew that the work they were doing was going to make FedEx the first transportation company to offer positive tracking. Engineers like these types of challenges.

The team had complete freedom to explore options for how best to meet this challenge. You have to remember this began almost 25 years ago when the available technology was not what it is today. There were no off-the-shelf portable scanners. The bar code printing technology was not what it is today. At

that time, we couldn't print a readable sequential bar code on the seven-part airway bills and we needed them by millions. We worked with Mead, 3M, and Standard Register for the bar code printing technology. Our bar code was much different than what they were using in grocery stores.

The first thing the group did was to define the requirements and possible operating scenarios. We regularly scheduled all-team breakfast meetings during which everyone had a chance to voice their opinions and ask questions. One of the products we tested at six stations in 1981, and that provided initial rollout, was the Norand scanning device. We continued to meet with vendors and described our need for smaller, more powerful devices. Most of them left the meetings laughing. Finally, we found a vendor located in Charlotte, North Carolina, who was interested in working with us. We tested several different systems. The goal was to develop and implement station-to-station positive tracking initially and then to drive the technology to expand to door-to-door tracking. The tests were successful, and by February 1982, we had 100 percent, systemwide coverage.

During the development phase, we were asked to give a demonstration at the board of directors meeting. We actually were able to track a random package from the previous night into the board room. We were able to positively track the package leaving the origin station the night before and arriving at the destination station . . . 22 years ago!

Throughout the development and testing process, we made regular presentations at each of the director's and vice president's staff meetings and all employee meetings to update them on what was working and what was not working. At every meeting, we asked for feedback. Fred Smith regularly invited us to present updates at the senior officers' meetings. We received tremendous support from the corporate communications department. This ongoing communication and involvement of

operations people in the development and testing phase were keys to acceptance and successful implementation in the field.

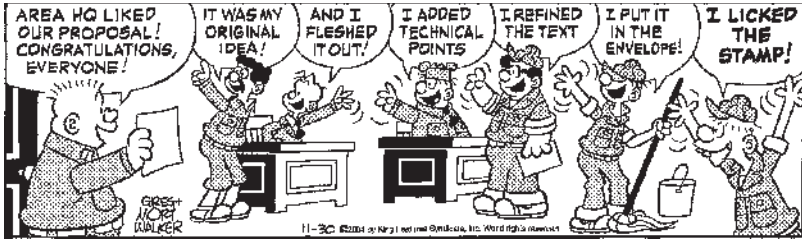
In 1985, we started testing the invention that came to be called the SuperTracker® and we were able to show exactly who signed for each package. This handheld scanning device allowed us to scan packages at every stage in the pickup and delivery process. Now we could tell exactly where the package was at any point in time, whether at the station, in the courier van, or delivered. There were many challenges and modifications along the way before we had a SuperTracker that met our operational needs. We were pushing the envelope of available technology. We trained 26,000 employees to use this technology between November 1985 and May 1986, at which time the roll-out was completed.

Generous recognition of the team members was also a key factor in keeping the group motivated. The project lasted more than four years. At senior officers' meetings, I would ask the team members to make the presentation. I made sure they got the credit. Senior management recognized them by presenting several of them with the Five-Star Award, the highest award for recognizing creativity and leadership excellence at FedEx.

This innovation allowed us to introduce other operation- and service-enhancing improvements, such as the courier printer. Before this printer, which produces labels, the courier had to write a routing code on the package with a marking pen. The courier printer not only automated that function but improved the accuracy. The machine printed the sorting codes that in turn allowed us to introduce automated sorting in the hubs.

The design and implementation of the SuperTracker system shows the importance of each of the three steps of the innovation process—generation, acceptance, and implementation. The





**FIGURE 1.1** Beetle Bailey Cartoon. © Reprinted with permission of King Features Syndicate.

cartoon strip in Figure 1.1 provides another illustration of how this works. Although it pokes fun at the mundane ways some employees contribute to advances within their organization, anyone who has worked within the bowels of organizations large and small knows how indispensable all those contributions really are. Chapter 2 discusses in detail the culture that FedEx developed to ensure that all employees would contribute to the innovation process.

