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False Assumptions

The year is 1886. Gottlieb Daimler has just unhooked the horses from the front of a stagecoach and installed an engine in the back. He has created the first four-wheel automobile. But it's noisy, smelly, and smoky—mostly an oddity.[1] Daimler's company soon joined with Karl Benz and, early in the 1900s, the story goes, financial planners at the new Daimler Benz company attempted to forecast the eventual size of the world market for cars, looking ahead seven to ten decades. After careful analysis, they predicted that in another century there would be perhaps 1 million cars in use worldwide.

But this forecast, as audacious as it must have sounded at the time, was woefully inadequate, because by the year 2000, more than 600 million cars were already in use around the world. Nearly 60 million new cars were manufactured in that year alone.

Granted, this was a very long-term forecast, but still: How could Daimler's finance people have missed the number by a factor of nearly 1,000? It wasn't the time lapse that created the error. Nor was it sloppy calculation, nor the fact that in those days they had no electronic calculators or spreadsheet programs. Their error was due to a *completely false assumption*.

The planners predicted that in a hundred years, the world population of chauffeurs would be about a million, and this would be a de facto limitation on the growth of the horseless carriage industry. Their prediction about the world population of chauffeurs was surprisingly close to the mark, but their assumption that all cars would have to be operated by *chauffeurs* was dead wrong. The error was not in the accuracy of the measurement but in a false assumption about what they measured.

Assumptions just like this one—just as carefully and accurately measured and every bit as fallacious—are every day corroding decisions about what truly limits the growth of businesses—maybe yours.

Like Bell forecasting that the market for telephones would be limited by the availability of human operators to make the connections, or IBM's Tom Watson famously predicting that the world would never need more than about five large computers, it's not hard to be blinded by the current business model. Even when the model is for a brand-new product category.

For most of a century now, three unspoken assumptions have underpinned businesses' efforts to grow, meet financial goals, and make shareholders happy. But these three assumptions about how a business creates value are false, and we call them "Rules to Break."

RULES TO BREAK

1. The best measure of success for your business is current sales and profit.
2. With the right sales and marketing effort, you can always get more customers.
3. Company value is created by offering differentiated products and services.

What, are these Peppers and Rogers people nuts? Who could quarrel with the idea that the surest, most reliable indicator of any business's success is when sales and profit tick upward in the current period? When sales aren't that great, more effective marketing is what you need, right? Bring in more customers until you push the numbers up. And we all know that the most reliable way to do this is to offer products and services that have a clear point of difference, compared to competitors.

No, no, no. No to all of the above. These Rules to Break are really just assumptions about how business works, at the most basic level. They probably aren't written down anywhere in your strategy document, but they have almost certainly backed up your thinking and your company's actions for as long as you remember.

The problem is, each of these assumptions is *dead wrong*.

More than that. If you operate according to these false assumptions, not only will your business fail to create much value, but you'll also soon find yourself trapped in a *Crisis of Short-Termism*. Everything you do will be so furiously centered on making today's numbers that you will become increasingly blinded to everything else. Businesses swept up by this crisis find that even as they try to do the right thing for their shareholders, they end up destroying value rather than creating it. So while these Rules to Break may look no more dangerous than ordinary common sense, in truth they're deadly.

A "PERFECT STORM" OF NEW TECHNOLOGIES

Once upon a time, perhaps during the age of mass marketing but before the World Wide Web, these rules served as reasonable guides for running a successful business. But a number of new technologies have introduced capabilities and influences on business that have together created what you might call a "perfect storm" of radical change. Customers share their experiences electronically with millions of other customers. Business is transacted at the speed of wireless email. And the lowliest employee can leap tall corporate hierarchies with a single click. The technology of business has changed so radically that the old accepted wisdoms just don't work anymore.

In their place we're going to propose a whole new way of thinking about how to create real shareholder value in today's competitive environment, operating with today's technologies. As we explain the nuances of our proposed new way of thinking, we'll introduce 12 Laws to Follow—guidelines to ensure that your business can surmount the Crisis of Short-Termism smothering so many businesses today. No one knows how long these Laws to Follow will adequately guide your decisions, but one thing is certain: If you want to succeed, starting tomorrow morning and stretching out at least into the future we are capable of imagining today, then you'll have to start by standing the old assumptions on their collective head, because they've already become more destructive than helpful.

Which begs the question: If the Rules to Break are so wrong, why are they so widely accepted? Why is it that so many businesses pursue their goals this way, in just the way their executives learned in the MBA program, the same way they've always done it?

IMITATION, CIRCULAR MILLS, AND MYTHBUSTING

In a word: imitation. Imitation is one of life's most important defense mechanisms. Young deer learn to survive predators by imitating older deer that have survived predators. Birds learn to fly, wolves learn to hunt, beavers learn to build dams, and human beings learn to walk, talk, play, work, and flirt all by imitating others of their species.

Businesses, too, grow stronger and faster by carefully observing what has worked before and then imitating other successful businesses. Case studies, best practices, benchmarking, competitive reviews—call it what you want, there is no question that one company's success often becomes the object of imitation by others. (Listen, we believe imitation can be a good thing, in general. In fact, we're hoping you bought this book precisely because so many other people did.)

The problem is that imitation is so powerful, as both a learning tool and a survival mechanism, that when things get a bit out of kilter, the drive to imitate can sometimes lead to irrational and even self-destructive behavior. Army ants, for instance, are genetically programmed to follow each other in packs in order to find food, each army ant traipsing along in the footsteps of the ants in front of it. But occasionally naturalists have observed "circular mills" of army ants. These are battalions of several thousand ants that have somehow become separated from the main army, doubled back on each other, and are now marching around in a closed circle, because the leading foragers have chanced on the tail end of their own battalion and have begun following it.

When ants get themselves into circular mills, they will march around and around and around until they all die of weakness and starvation, literally *imitating each other to death*.

It seems to us that businesses have gotten into a kind of circular mill themselves—with each following the other in applying these three false assumptions despite the fact that these principles are no longer producing real growth. Most executives sense that business growth has become more difficult, yet their response to this challenge is to redouble their efforts and to apply these same false assumptions all the more diligently.

Businesses are doing the wrong things, for the wrong reasons, but doing them better, faster, more efficiently—even though what they are doing is based on assumptions as wrong as the belief 100 years ago that only a professional chauffeur would ever have the skills necessary to operate a motorcar.

The result is that businesses are following each other around and around, army-ant style, in a futile search for growth.

CRISIS OF SHORT-TERMISM: THE MOTHER OF ALL PROBLEMS

In our travels, we often ask chief executives and other decision makers what their biggest challenges are. We know this isn't a scientific poll, and we get a whole boatload of answers, but there is absolutely no question that the single most frequently cited problem is some form of this dilemma:

How can we do what's right for the company when the pressure to make our current-period numbers is so great?

The Crisis of Short-Termism is so all-consuming for businesses that it embodies many other problems, as well. Deep in our guts we all feel the need to "do what's right for the company," and we can usually grasp what the "right" thing is by paying close enough attention to our instincts, but the requirement to make the current numbers—to show concrete financial results *right now*—is so overwhelming that these instincts get submerged beneath a whole tidal wave of other concerns. The fallback position becomes "Make this quarter's numbers and the future will take care of itself," which sounds to us a lot like the tramp of army ants in a circular mill.

The most straightforward advice we can give business executives is to suggest that they change their mental models of what it means to succeed during the quarter or during any currently measured time period. And in this book we're going to do our best to give you a new mental model for business success, based on two very straightforward principles:

1. Customers will do business with you tomorrow only if they (and their friends) trust you today. Therefore, customer trust is a prerequisite for long-term business success.
2. Your employees will work to earn customer trust only if they trust you, their employer. So your job is to (a) motivate your employees to treat customers fairly and (b) enable them to do so by providing the right tools, training, and authority for taking action.

Obviously, this approach is going to be a lot easier for us to say than it will be for you to execute. But fortunately for all of us, the same breathtaking rush of technology that is driving businesses into ever shorter cycle times also makes it feasible to execute against this new mental model, today. To paint an accurate picture, we need to take account of how significantly technology has already transformed the business environment—and how the technology pouring toward us in the near future will drive more transformation:

- Technology makes possible sophisticated analytics to help companies calculate the current economic value of increased customer trust, which will be an important asset for beating the Crisis of Short-Termism.
- Technology subverts the power of hierarchies, which means corporate culture is now your most important management tool. The corporate culture that will give you the best chance to succeed will be centered on earning and keeping customer trust.

- Technology connects customers electronically with other customers, so bad news (and good news) travels at light speed. But because of the randomness inherent in how customer networks form, you can't "manage" them. All you can do is prepare for and encourage them.
- Technology undermines the advantages of new products, so business success requires constant innovation. To create a climate of innovation, you need to foster a culture of trust while harnessing the electronically networked intelligence of your employees.

QUESTIONS EVERY BUSINESS NEEDS TO ANSWER

To reexamine the false assumptions that seem to have governed business for so long, we will have to look carefully at some very basic issues. You can't come up with a new mental model for how to run your business today unless you can answer several questions:

- **How do companies create value?** Start with the simple and undeniable fact that every minute of every day, your company is going up or down in value. We're not talking about your stock value here but about your company's actual economic value as a business (i.e., how a perfectly efficient stock market *would* value your business if it really did know everything there was to know about it). Your business creates or destroys value with every decision it makes, every action it takes, every customer contact or interaction it has.

  The kind of value logged in your financial statements has to do with sales made, or revenue received, or costs incurred. But more often, value is created or destroyed when, as a result of some decision or action you take, the overall value of your company as a financial asset goes up or down. For instance, when a customer's complaint is not handled well, your actual value as a company declines just a bit, because the expected future cash flow from that customer declines. Until recently, it just hasn't been technologically feasible to track or project these small changes in the value of a company, and from our experience, the financial metrics are still pretty difficult. But it's no longer impossible, and the point is that even as a purely mental construct, this idea has some extremely important implications for how you manage your business.

- **Why do customers have more power?** People around the world are talking, blogging, texting, emailing, posting, and networking more than ever before, and in the future everyone will become even more connected to everyone else. One small aspect of this technologically enabled social development is that your customers now find it much easier to connect with other customers and share their opinions about your firm. In our first book, *The One to One Future*, published just before the World Wide Web arrived in the early 1990s, we predicted that when businesses became technologically capable of interacting with their customers in a cost-efficient way, they would use interactivity to try to build individual, one-to-one relationships.

  The subtitle of that book was *Building Relationships One Customer at a Time*. However, now that customers are so effortlessly connected not just with the companies they do business with but also with *other customers*, you can no longer manage your business just in terms of one customer at a time. You have to think about the customer's friends, co-workers, family members, and anyone the customer has on speed-dial—the customer's social network. But guess what? Networks aren't as rational as people are, and are prone to highly unpredictable behavior. We'll explore some of the best recent work on the topic of social networks and delve into what it means for your business that your customers are becoming not only more demanding but less, well, manageable.

- **How can you use the network and your corporate culture to make better decisions?** As the entire world has become more cost-efficiently interconnected, most businesses (probably including yours) have begun relying on interactivity to run their operations more smoothly. Employees emailing other employees rather than phoning; invoices delivered electronically; orders submitted on the Web; business travel booked online; meetings held in self-service, password-protected conference calls; proposals, business plans, and other lengthy documents composed in sections and assembled effortlessly, without so much as a shuffled file folder. Many businesses have thinned out and flattened their organization charts, automating or outsourcing the vast majority of more routine business tasks that used to be handled by full-time employees.

  But while companies for the most part have used interactivity as a mechanism for streamlining and cost-cutting, the cleverer ones have also begun using it as a way to improve management decision making. Sociologists have long known that a group of people organized toward a common goal (such as a company's employees) is capable of making decisions that are better than any single group member could have made—better even than the sum of all the members' individual efforts. Employees electronically networked together can leverage this decision-making advantage and can easily come up with smarter decisions than all the "experts" at the top of the hierarchy. But it's tricky, because while networked employees may be capable of making better decisions, it's still the managers at the top of the hierarchy who have all the authority.

- **How do you stimulate more and better innovation?** It's not your imagination. The pace of change itself is accelerating, which means that creativity and innovation are more critical to your company's survival than ever before. Your organization must not only exploit its current opportunities fully but constantly explore for more, as well. No matter how innovative or interesting your product or service is today, tomorrow it will be a commodity. And tomorrow comes faster now than it used to.

  To tap the combined creative powers of your employees and your customers, you have to create a climate of innovation that thrives on dissent, contrary points of view, and respectful disagreement. Doing this will require a corporate culture in which employees feel free to trust each other. It's the only way you can ensure that the pace of innovation at your firm keeps you ahead of the pack, supplying your company with more useful innovations, faster, than your R&D department would be able to manage by itself. It won't be easy, but the alternative is obsolescence, which will sneak up on you faster than you can text "LOL."

These are the themes you will find throughout this book. Each of these subjects is imperative for a leader of any size business to understand. There are numerous books written on each of these individual subjects, some of them quite good. Our goal, however, is to recognize that these ideas are themselves highly interconnected and then to weave them together, in order to help you think through a coherent and compelling new mental model for your business.

PRIMACY OF CUSTOMER TRUST

If you've followed our past writings, then you know full well how important we have always held customer trust to be. But with the technological developments and social trends just outlined, customer trust has become way more important and useful to a business than it was even a few years ago. We think this recognition of the power of trust will generate a much more fundamental shift in perspective than most people realize. In fact, we believe customer trust is probably the next big thing in business competition.

As we develop our argument, the many benefits of simply enjoying the trust and confidence of your customers should become more and more apparent:

- Customer trust will increase your financial value as a company, because customers who trust you will want to do more business with you and are also more likely to recommend you to friends or colleagues.
- Customer trust can serve as the basis for a corporate culture that will help you manage your organization more effectively, as technology renders hierarchical rules and structures less relevant.
- Having the trust of customers can help you reduce unpredictability when customers act together, as they do more and more often.
- Trust will speed up your company's operations by reducing organizational and bureaucratic friction, improving the decisions and actions of your electronically networked employees.
- Trust will allow your company to become more resilient, adaptable, creative, and innovative.

- Customer trust could be your saving grace if you have a bad moment, because when your credibility with other constituents hits bottom, it's the customers who trust you most who will come to your defense.

And most important of all, perhaps:

- Customer trust will help you beat the Crisis of Short-Termism by providing a guideline for action even if your financial metrics aren't sophisticated enough right now to be up to the task.

We'll develop these ideas throughout the book, but at the same time we will be proposing various tactics and strategies to help you earn and keep the trust of your customers. In other words, our goal here is not just to tell you why customer trust is so important but also to show you some best practices you can use to secure it.

Our first task? To consider the full implications of the three Rules to Break and then to terminate each of them with extreme prejudice.