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A Wellspring of Enduring Innovation

The Soft Edge

Innovate or die. The choice is not optional. The clock is ticking. If this sounds a bit melodramatic, it is also the truth. Disruptive waves seem to hit our companies more frequently than before. If we are to survive and prosper, innovation needs to be more than a one-time event. It must be perpetual, built-in, an automatic response to challenges and changes.

The "innovation response" in companies is very much like a healthy immune response in living organisms. People who enjoy long-term health don't have episodic bursts of health. They are healthy nearly all the time. Their immune systems routinely fight off most threats. Can the same be true of companies? The analogy fits. In great companies, innovation is a natural response to threats.

Why, then, do some companies have a more robust innovation response than others? From where does such vitality come? From the chief executive? This might be true in a small percentage of companies. But even for those relatively few, it is worth noting that CEOs don't stay on the job forever.

From clever strategy? If you think so, then you must believe your strategy will always be the correct one. But in all of industrial history, you will not find a single company that has always had a great strategy. History is littered with apparently solid companies suddenly undone by wrong strategic assumptions and bad bets. Eastman Kodak, Digital Equipment, MySpace anyone?

From flawless execution? Dell, with the fastest-growing stock in the 1990s, is legendary for its tight control of costs, mastery of supply chain, speed of delivery, and other flawlessly executed skills. Dell's smooth operations worked brilliantly in an era of PCs and laptops and corporate information technology departments that purchased both types of product for company employees. Then Dell's perfect execution model was suddenly not enough to sustain greatness. It was trumped by a shift toward smart phones and tablets and by employees' bringing their own technology to work.

Maybe it comes from large bets on research and development? That's certainly implied when you read an annual report and the company brags about the size of its R&D budget. (What company *doesn't* brag about this?) But R&D, while critically important to an innovative response and future health, is not sufficient by itself.

Finally, how about having an army of technology wizards to apply the latest cutting-edge advantages in big data, cloud, mobile, social, and so forth? Ah, that must be it! Think again. A technology advantage doesn't last as long as it once did. Consider weeks and months, not years and decades.

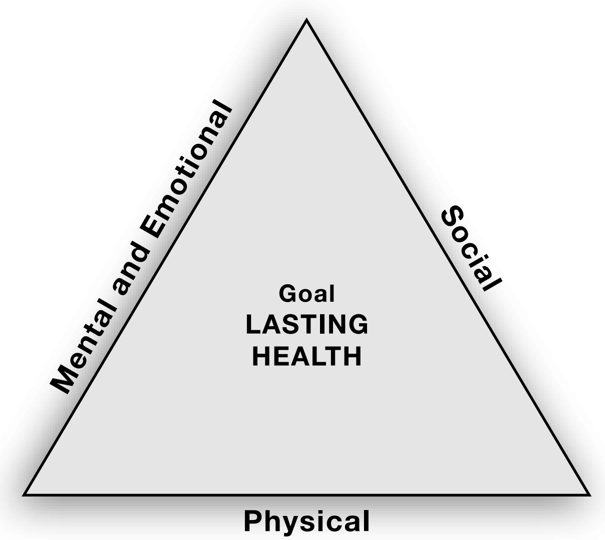
A healthy innovative response comes from a deeper place within your company. But it begins somewhere, and that somewhere is what I call the *soft edge*.

HOW A SIMPLE TRIANGLE CAN PREDICT LONG-TERM HEALTH

In the biological world, we know that a healthy organism has a better chance of surviving and adapting to change than an unhealthy one. No news here. Now let's suppose we want to predict any person's chances for long-term health. Can we do it? One framework for doing so is a simple equal-sided triangle like the one in Figure 1.1.

A person with the best chances of enjoying long-term health is one who is healthy on *all* sides of the triangle. Such a person will possess *physical* health—robust energy, few illnesses, and easy

Figure 1.1 Health Triangle



mobility, whether for work or leisure. Good *mental and emotional* health is a second component of well-being. This does not equate to a life of bliss, of course. It means a person will have a balanced perspective, understand cause and effect, have the ability to plan ahead, and be able to function even in difficult circumstances. The triangle's third side, *social* health, implies that people have a better shot at living a healthy life when surrounded by family, friends, and colleagues, in environments with low crime and stable rule of law, social cohesion, and economic opportunity. Remove any of these social pillars—live in a war-torn country, say—and your health prospects will be jeopardized, even if you're currently physically and mentally strong.

Seen this way, a trip around the health triangle can quickly reveal *where* a person would be at risk of not enjoying long-term health.

THE TRIANGLE OF LONG-TERM COMPANY SUCCESS

Now let's get down to business. Suppose we drew a triangle similar to the one that predicts long-term personal health. Only this triangle would predict a company's chances for lasting success. In its most basic form, it would look like Figure 1.2.

Here's a quick trip around the triangle, starting with the bottom, the *strategic base*. How important is getting your company's strategy right? When I visited Fred Smith, the founder, CEO, and chairman of FedEx, at his Memphis headquarters, he said it was his company's top priority.

The Strategic Base—Fundamental

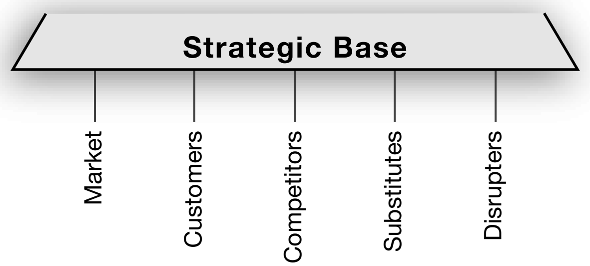
As Fred Smith told me: "The number one thing that every organization has to get right is strategy. You can have the best

Figure 1.2 Triangle of Long-Term Company Success

operations. You can be the most adept at whatever it is that you're doing. But if you have a bad strategy, it's all for naught. Think Digital Equipment. Think Wang. Think Lockheed in the commercial airplane business. There were forks in the road where these companies chose the wrong strategy. Absent a viable strategy, you're in the process of going out of business."

This isn't a book on strategy. But you won't be able to understand the difference between the soft edge and strategy unless you have a clear understanding of what strategy really is. So let's take a quick look. When you talk to the best CEOs—who, like Smith, have proven themselves over several business cycles and market shifts—and when you further read classic business strategy books such as (to name only three of the best) *Competitive Strategy* by Michael Porter, *The Innovator's Dilemma* by Clayton Christensen, and *Playing to Win: How Strategy Really*

Figure 1.3 Strategic Base



Works by A. G. Laffley and Roger Martin, you keep coming back to the five pillars of strategy illustrated in Figure 1.3. To take them each in turn:

Market: What markets are you in now? Are they the right markets for your business? Should you enter some or exit others? What are the adjacent markets? What are the forces shaping these markets? Which of your markets are growing, and which are stagnating?

Customers: Who are your customers? Why do they buy your product? Who are your potential customers? Why have they *not yet* bought your product? Are your products priced right for your customers? How would your customers respond to higher prices? Lower prices?

Competitors: Who are your direct competitors? How do your competencies and products match up to theirs? Where are you better and where are you worse? What is your market position relative to theirs?

Substitutes: Who are your indirect competitors? Where would your customers go if you didn't exist? Do these substitutes threaten to become direct competitors? Or do they suggest an opportunity for you to expand and acquire?

Disrupters: What are the technological game changers in your industry? Do you see new emerging players offering vastly cheaper or more convenient products than you can offer, even if these disrupters are not yet your direct competitors? Are these disruptive products finding new customers who were previously ignored? Are you losing valuable employees to these disrupters? When will you start to lose them?

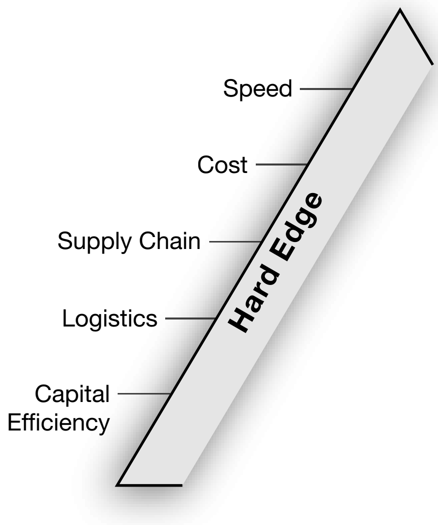
These are vital considerations for your company, but they're not the questions that get asked at the soft edge. As important as they are, I must leave them now, because—as I said—this isn't a book on strategy. (For my top picks of great strategy books, please go to my website, richkarlgaard.com.)

The Hard Edge—Precise Execution

When Apple became the world's most valuable company in September 2012—a title it lost a year later, but may yet claim again—its CEO was Tim Cook, who had been in the job for only thirteen months. Prior to that, Cook had been Apple's chief operating officer since 2007.

Cook was widely considered the best large company COO in the world. What made Cook so effective? One, he was (and is) a workhorse. He typically begins e-mailing colleagues at 4:30 AM. He often skips meals, munching on energy bars throughout the day. On Sunday night, he convenes an Apple managers' meeting (by phone, thankfully) to talk about the week. Cook pushes himself to excellence and expects the same of his colleagues. For example, when an Apple manager described a problem with a factory in China, Cook's response was to stare incredulously. *Why, then, are you here?* Cook asked. *Go to the airport now, get on a plane, and solve the problem.* The manager didn't even bother to pack.[1]

Figure 1.4 The Hard Edge



The second reason Cook was such a great COO is that he was a master of what I call the *hard edge* of business, as shown in Figure 1.4.

Cook himself calls it the execution side. Hard-edge execution is all about managing exactly to the numbers. The people who live on the hard edge of business are good at making the trains run on time. They focus on profit. Their language is time, money, and numbers. Every company in the world needs these employees, these Tim Cook types. Companies that fail to execute precisely on the hard edge of business will ultimately fail.

These are the five pillars that undergird the hard edge:

Speed: When FedEx promises overnight delivery, it has to make it happen or the brand will suffer. The same thing goes with Amazon, which now is offering daily delivery in certain markets. The execution needed to make this happen is the sum of a lot of numbers. Are the airplanes on time? How fast is each plane unloaded? How fast are the conveyor belts moving? Speed is also crucial to new product development. In Chapter Five, I describe how giant software firm SAP blew up and then reconfigured its team approach to cut product development time by 60 percent.

Cost: Not all companies compete on having the lowest price, but no company will succeed for long if it continually leaves money on the table because its costs are poorly managed. That's money not available for R&D, for more salespeople, for higher bonuses for deserving employees, and for shareholders.

Supply Chain: Harvard Business School professor Michael Porter, the dean of strategy thinkers, would put suppliers into the strategy category. In his most famous book, *Competitive Strategy*, he asks two related questions: What leverage do your suppliers have over you? What leverage do you have over them? What has changed since Porter's seminal 1980 book, of course, is technology that can monitor and report supply chain changes in real time. That's why I put supply chain on the hard-edge side.

Logistics: Norman Schwarzkopf, who was commander-in-chief of the U.S. Central Forces Command in the Persian Gulf War, told a TV interviewer, "Armchair generals talk strategy. Real generals talk logistics."[2] Logistics overlaps with supply chain, but logistics is really the *how* of the supply chain. Where are the trucks? What is fuel availability? How much is this costing? Are we operating fast enough? All great companies have a firm grip on their logistics.

Capital Efficiency: This hard-edge advantage is crucial to success. Are you using your capital to the best advantage? Say you are Southwest Airlines. How should you hedge your fuel purchases? This one decision can make or break airline profitability for the next five years. Or say you are a fast-growing start-up but not yet profitable. Should you raise money by issuing stock?

By expanding your credit line with your bank (assuming you can)? Should you go the high-yield-bond route? Great companies think about their capital structure. Tax strategies would also fall under capital efficiency.

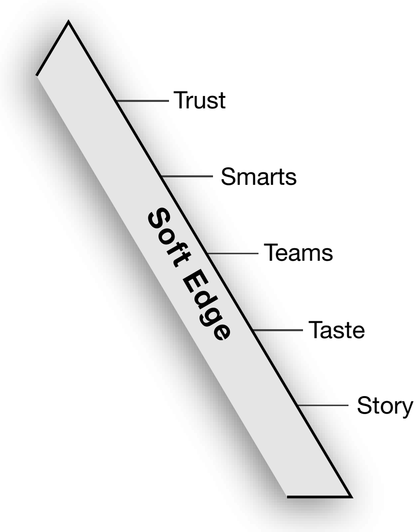
I discuss the hard edge more in the next chapter. But now it's time to introduce the central theme of this book—the *soft edge*.

The Soft Edge—Expression of Your Deepest Values

The soft edge is the most misunderstood side of business. It also tends to be neglected and underfunded in too many companies. Several reasons explain this: One, the soft edge is harder to measure. Two, because it is tough to measure, it's more difficult to attach an ROI (return on investment) figure to any investments made in it. Three, most CEOs and board chairmen are not comfortable talking in the language of the soft edge.

Figure 1.5 sets out the soft edge as this book describes it.

Figure 1.5 The Soft Edge



The rest of this book, with the exception of Chapter Two, focuses on the soft edge and the enduring company advantages to be found there. Here are the five pillars of the soft edge, along with some of the lessons presented later in the book:

- Trust
- Smarts
- Teams
- Taste
- Story

Trust

Trust is the foundational soft-edge advantage. It starts with two questions: Does your *external* market, your customers and shareholders, trust you? And two, does your *internal* market, your employees and suppliers, trust you? Let me illustrate the importance of trust by asking you to imagine a career that most people would be loath to try. That would be a commissioned sales job, selling to people who balk at buying your product. Life insurance fits this description. Yet Northwestern Mutual has built a $25 billion revenue juggernaut on that one word, *trust*. Remember Roberto Espinosa from the Preface? He saw his productivity jump *fivefold* when he began to trust his career.

Within an organization, trust begins with culture and values. There are reasons why companies that make the best-places-to-work lists published by magazines actually do perform better than their peers. Companies that develop trust have a recruiting advantage. They have a retention advantage and a productivity advantage. Externally, trust means that your product or service is authentic and robust enough to withstand the immediacy of today's media. When things go wrong, customers and stakeholders believe you'll do the right thing. Trust buys grace.

Trust may seem like a blurry concept in terms of ROI. But research and market results have proven that deep trust creates measurable real-world returns. Trust underlies effective working relationships. It improves group effectiveness and organizational performance. Maybe most important, trust underpins innovation by facilitating learning and experimentation. Chapter Three discusses ways to create an environment that engenders this kind of trust, including keys for developing a higher purpose and building a safe organizational culture.

Smarts

In most technical fields, from medicine to software, formal education quickly becomes out of date. How do you keep up? How do teams and entire companies learn and become smarter over time? What is *organizational smarts*, anyway—processing speed, memory, pattern recognition? Chapter Four discusses how Mayo Clinic, Stanford University women's basketball, and others stay on top by relentlessly pursuing an advantage through smarts.

But what, exactly, does it mean to be smart in the world of business? Unlocking knowledge and supporting learning are pivotal to success. But there's another dimension to being smart: one that relates to a few old-fashioned-sounding concepts like grit, perseverance, and hard work. These traits are fundamental to accelerating learning and helping you adapt more quickly to disruptive trends.

Chapter Four ventures to deepen understanding of what it means to be smart in today's complex world. It also explores a group of habits—like establishing beneficial relationships, learning from mistakes, and thinking laterally—that are sure to help you gain an edge over your competitors.

Teams

How does FedEx's Fred Smith manage 300,000 worldwide team members who move more than 2.5 billion packages in a year? What balance of central authority and peripheral autonomy works in such a logistically complex organization? Or why, in an entirely different industry, did German software giant SAP blow up the management framework for its 20,000-person development department and replace it with small teams?

Since collaboration and innovation are a must in the global economy, effective teamwork is vital. Yes, we humans are imperfect. We have different needs, roles, and perspectives that we bring to every interaction or team effort. But when we work together, we make each other better. We increase accountability, passion, and effort: we facilitate learning and catalyze innovation.

In Chapter Five, the focus is on small, high-performing teams of eight, ten, or twelve people. By exploring the best ways to identify optimal team members, as well as how to push those chosen few to the next level of performance, the chapter offers a powerful framework for managing flexible, fast, and creative teams.

Taste

Taste is the word Steve Jobs used when he described Apple's unique but universal aesthetic appeal. Jobs felt taste came from his own understanding of the yin-yang of science and humanity. The chief designer of Specialized Bicycles, Robert Egger, called it "the elusive sweet spot between data truth and human truth."

Nest Labs co-founder Tony Fadell said, “If you don’t have an emotionally engaging design, no one will care.”

During the last few decades, good design has become an increasingly valuable competitive asset. But taste is much more than just good design. It’s a universal sensibility, an emotional engagement, that appeals to the deepest part of ourselves. It’s wonderment and desire, power and control. We see it in those magical products that not only show us at our best but also make us feel and perform even better.

What kind of company can consistently make products or services that trigger these emotional touchpoints? And can you do it, too? Those are the subjects of Chapter Six. My goal is to illustrate how a flicker of imagination is transformed into a physical, tangible object that surprises and delights. In the process, I discuss how geometry, familiarity, selfishness (yes, selfishness), consistency, and simplicity all contribute to the mechanics of attraction.

Story

Companies that achieve lasting success, I’ve found, have an enduringly appealing story. But now in the age of social media, the challenge has become: How do you tell your company’s story *your way* when customers, fans, and critics insist on telling your story *their way*? What if you dislike—or really hate—how outsiders tell your story?

Used both internally and externally, stories create purpose and build brand. Purpose may be a soft attribute, but it’s what gives you steel in your spine, especially when cutting corners might temporarily boost the bottom line and delight shareholders. Externally, stories are used to launch new brands and enhance the image of existing brands—a task made more difficult by today’s many new forms of communication.

Humans have evolved as storytellers—that's old news. But how you tell your company's story—that's a still-evolving discipline. Chapter Seven introduces an oddly contentious yet strangely fruitful story-shaping relationship between a company and its customers. Additionally, it sets out some practical do's and don'ts of effective storytelling, including ways to better understand your audience, dial up the verisimilitude, and refine your storytelling technique.

THE PRIZE IS CONTINUAL INNOVATION AND LASTING SUCCESS

Now that you have a snapshot of the three separate sides of the triangle, I can put all the pieces together. If your goal is to build a company that can continually innovate, be healthy in volatile times, and enjoy lasting success, you want a triangle that looks like the one in Figure 1.6.

Keep in mind, however, that this book is focused on the most misunderstood and maligned side of the triangle—the soft edge. And in detailing the benefits, challenges, and practices of soft-edge mastery, the book's chapters are intended to be read in order. As mentioned earlier, trust is foundational. It's the basis upon which learning occurs and great teams are built. Trust, learning, and great teams all contribute to a more defined sense of taste. Taste, along with smarts, leads to more engaging stories, which, in turn, help to better develop trust, and so on.

But if you want to dig into only a few of the soft-edge advantages, don't worry. Each of the chapters is also designed to be self-contained, with its own narratives, techniques, and well-defined terms. If you're fascinated by teams and teamwork, jump to it. If you need to sharpen a few storytelling techniques before next

Figure 1.6 Complete Triangle of Long-Term Company Success

week's big presentation, have at it. In fact, if you go to my website, richkarlgaard.com, you'll find a comprehensive (and free) assessment for determining your soft-edge strengths and weaknesses. Your results can help guide your reading or identify chapters that may be worth revisiting.

Each of the individual chapters on trust, smarts, teams, taste, and story ends with a glimpse into the future, a look at what's new or on the cutting edge in that individual field. Often, these focus on how technology or data is being incorporated into soft-edge tasks. To the possible surprise of readers who have preferred the hard edge, the soft edge represents one of the final frontiers for numbers and statistics; for bits and bytes. These days, many great thinkers, futurists, and scientists are finding new, fascinating ways to get the best out of an organization. And these are real, tangible tools that can help you do things that were previously believed to be the realm of intrinsic genius.

Additionally, Chapters Three through Seven present a few recurring themes that are closely tied to soft-edge excellence: grit, courage, passion, and purpose. I admit that ideas like grit and courage may not sound so soft, but no one ever said soft is easy. Rather, as Tom Peters and Bob Waterman wrote in their seminal book *In Search of Excellence*, "Soft is hard."[3] The fact is, dictating strategy or crunching numbers is a lot easier than building trust or driving learning. You need grit and passion to build an enduring culture of innovation. And in today's markets, taking a long-term perspective over a short-term profit requires nothing if not an abundance of courage.

So make no mistake: excelling at the soft edge is not easy. That's why only the excellent companies do it.

WHY THE SOFT EDGE NOW?

Many colleagues have asked me why I'm writing a book called *The Soft Edge* now.

I believe the business world is at a crossroads, where hard-edge people are dominating the narrative and discussion. For example, Wall Street is about the hard edge. It's driven by speed, execution, and short-term capital efficiency. It dominates the way we think about free enterprise and capitalism today. Has this been good? (I'll let you answer.)

Also dominating the discussion are trends like big data and analytics. These are tremendously useful tools. But they are the brain, not the heart and soul, of your company. Some companies—many of them located in Silicon Valley, where

I live—have forgotten that. These companies command cutting-edge technology and brilliant 800-math-SAT employees. These companies can succeed for periods, often spectacularly. But they won't thrive for long if they suffocate their soft edge. Hewlett-Packard lost its way after years of neglecting the cultural values given to it by its founders, Bill Hewlett and Dave Packard. The so-called HP Way was universally understood by HP employees as a set of inspirational and ethical standards. For decades, the HP Way guided the company's enduring excellence. But successive CEOs, straining too hard for top-line growth, chipped away at HP's core values. Eventually the HP Way was lost—and with it, creativity, talent retention, brand value.

Finally, growth and profit were lost, too.

Too many businesses leaders today, pressured by a tough economy, badgered by shareholders, find it tempting to neglect their employees' and customers' deeper values. Alienation and distrust are on the rise. A majority of people around the world hate their jobs. This capitalism-leads-to-alienation argument is often made by critics of capitalism. As publisher and columnist for *Forbes*, let me make the same point as a free-market enthusiast. We can and should do better in the way we run our companies. It will profit us in the long run if we do.

Now, I want to be clear that this book is not an academic study. It's a collection of observations and anecdotes. As a thirty-year veteran business observer, at *Forbes* and as a participant in various Silicon Valley start-ups, I feel qualified to share these observations. You may agree or not, but I hope you will.

I have chosen a wide spectrum of companies—large and small, makers of products and services, located inside Silicon Valley and outside, privately held and publicly traded (and even a company owned by its customers). I chose this variety to see if I can derive some universal principles of lasting success.

While I chose variety in size, products, and ownership structures, there's one constant: they are enduring leaders in their industries. The companies described here are industry leaders in revenue or market share, and most have been around for four decades or more. Two have lasted for more than a century. Most have faced big challenges and setbacks. Many, even now, face big disruptive threats. I purposely left out younger superstars like Google and Facebook because of their youth and because neither company has been severely tested. It's true that Google and Facebook look more like Apple than Eastman Kodak, but time will tell.

With a few definitions freshly in mind and a strong grounding in the hard and soft edges of business, let's next take a look at how our conceptions, or misconceptions, affect things like organizational priorities and resource allocation. The following chapter explores this tension between the hard and soft edges by placing both within a historical context and examining their current utility.

Machine rationality versus hippie humanism?

Is that even a fair fight?

Let's see.