

The Most Powerful Paths to Profits by Mia de Kuijper

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The Most Powerful Paths to Profits

Twelve strategies to shape a company's destiny.

by Mia de Kuijper

Here's a new way to look at the death of the old AT&T Corporation. In the 1990s, AT&T still controlled a huge share of the lines, hardware, and software required to deliver long-distance networking and telephone services to businesses and consumers in the United States. With minimal competition, the telecom giant could charge deliciously high rates for its services. The company's vast network infrastructure amounted to what I call a power node: a source of strength or leverage that the company could reliably use to effortlessly dominate its market and fend off rivals.

In AT&T's case, the power node was its preeminent stake in a network. But a power node can also be a coveted brand, a skill, a set of industry relationships, a process, or access to resources. In short, it can be anything that a company depends on to influence financial outcomes and help or hinder cash flows, risks, and investments for itself or other players over an extended period of time.

Unfortunately for AT&T, toward the end of the century, that extended period of time was rapidly coming to an end — particularly because the company could not sustain the leverage that its power node provided. A wave of startups had mounted an ongoing attack on

AT&T's infrastructure, building enough high-speed, high-capacity fiber-optic networks to expand U.S. digital capacity by 100 million times. Because customers were relatively scarce, the new providers began to offer network capacity for next to nothing. The price of long-haul services and ancillary products fell precipitously.

Although these startups had destroyed AT&T's power node, the company refused to believe it. Even as its prices and revenues went into a tailspin, AT&T continued to invest billions in its long-distance telecom assets. This new equipment was worth pennies on the dollar the moment it was installed.

Ironically, AT&T actually had another power node that it could have exploited in this new competitive environment: business customers. AT&T had built up a significant base of corporate clients over the years, and rather than pumping money into its antiquated systems, it could have leased raw infrastructure capacity from its new rivals and offered business customers a state-of-the-art network, using the protocols of the Internet to ensure a seamless product. To be sure, these corporate customers would have bargained with AT&T for price reductions. But it would have been in their interest to stay with AT&T, even at a premium, because it is extremely cumbersome for a company to retool its entire

communications and computing setup. By using this customer base as the core of a distributed business with the new wave of network providers as its weaker partners, AT&T could have become the business telecom provider of choice in the United States. Failing this, in 2005, what was left of this great American icon was sold to SBC Communications, one of the original Baby Bells. In making the purchase, SBC was primarily interested in those same business customers.

The story of AT&T shows the danger of failing to pursue a power node strategy. Companies that make the most of their power nodes have wide latitude in choosing which activities to perform, how much capital they wish to invest, and how much risk they want to assume. Companies with strong power nodes have the ability to insist that other companies take on expenditures and risks that they themselves do not want.

Established Leverage

Twelve power nodes will be the most important sources of profit in the decades to come. Ten of the older nodes are already well-established sources of leverage.

- **Brands.** Think of the leverage wielded by McDonald's, Coke, and Intel over their suppliers and partners simply because customers are attached to their names.

- **Secret, special, or proprietary ingredients.** In 1986, when a private equity firm acquired the antifreeze maker Prestone from Union Carbide, a deal was struck allowing Prestone to purchase ethylene glycol from its previous owner at a confidential low price. Shortly thereafter, the price of this chemical skyrocketed, owing to refinery accidents and

increases in feedstock prices. Preston's reliable inexpensive supply of ethylene glycol ensured that it retained its profitable position while competitors suffered.

- **Regulatory protection.** In certain industries, regulators can grant privileges to businesses like hospitals, banks, and nuclear plants; rights to use scarce natural resources like broadcast frequencies or offshore drilling sites; certifications of professions, including those of doctor or electrician; and permits for importing agricultural products and building developments, among many other things. Essentially, the regulations represent a barrier to entry and limit the number of competitors a company can have; as a result, the strongest companies in heavily regulated sectors generally enjoy sustained profitability.

- **Focused financial resources.** Some companies have innovative means of access to capital that other enterprises cannot duplicate, and that access can be deployed to exert control over the business environment. In rural Indian villages, local banks called *creditwallahs* provide loans to storekeepers so they can buy items from distant manufacturers. The retailers are dependent because they know this financial lifeline can be severed at the *creditwallahs'* discretion.

- **A customer base with switching costs.** Customers don't like to pay to switch loyalties. This is what attracted SBC to AT&T. Another example is the personal computer interface; for years, many people have refused to switch from Microsoft-based PCs to Apple computers (or vice versa) because the "look and feel" of the other system seems unnatural to them.

- **A proprietary process or**

modus operandi. Some companies have unique methods and procedures that guide their people, equipment, or systems. FedEx's delivery network is an example.

- **Distribution gateways.** The Industrial and Commercial Bank of China (ICBC) relies on its distributed network of 18,000 branches and 150 million customers for cheap deposits and growing revenues — which has helped make it one of the world's largest banks.

- **The dominant position in a layer.** A layer is a horizontal slice within a vertical value chain. In the tea industry, only a few global buyers and packagers, such as Lipton and Tetley, are big enough to dictate

- **Filters and brokers.** Companies and individuals that could be termed filters or brokers, a group that includes wine experts, art curators, and real estate and jewelry appraisers, have influence in situations in which objective information is hard to obtain or people do not have the time or training to choose adequately on their own.

A Digital Environment

The 10 power nodes above have been around for a while. But the remaining two power nodes are strikingly novel. They capitalize on a set of dynamics emerging from new communication technologies and information infrastructures, which

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terms to tea growers and realize significant profits. Meanwhile, the thousands of small to medium-sized plantations that produce tea leaves must make do with relatively slim returns. In 2000, India's Tata Tea Limited, which owned a number of plantations, bought its way out of the lower rungs of the food chain and into a power node by acquiring the Tetley Group. Tata has been selling off its plantations ever since.

- **Increasing mutual utility.** The larger the existing base of users, the more attractive the product is to potential new customers. For example, as the number of iPods on the market increased, so did the incentive for music publishers to license songs to iTunes; in turn, the more songs that were available through iTunes, the greater the incentive to get an iPod.

together have forged a business landscape with remarkable reach and transparency. Anyone with access to media can connect with anyone else instantly and can access information about any product, service, or topic of interest, anywhere, immediately, and essentially at no cost. This unprecedented form of "perfect information" is changing the way that consumers and markets behave, and it makes these new power nodes feasible.

- **Aikido assets.** This power node is named after the Japanese martial art that exploits the energy of an opposing force. In the current information environment, it is no longer useful to "push" advertising and marketing messages to consumers. Most customers reach out for information they need on their own. If they find a source that they

like, they tell other customers. They use search engines, which tend to drive large numbers of people to the most popular sources. The key to aikido assets is being able to perceive and move with the momentum of the network.

Companies whose power node is based on the aikido approach are skilled in new forms of marketing. They “sow seeds,” tossing out many messages at minimal cost; Frito-Lay, for example, continually puts new flavors and packaging in the marketplace. These companies conduct surveillance, continually analyzing their digital media to see which messages are catching on; Procter & Gamble Company has done this with its own websites. (See “The Promise of Private-label Media,” by Matthew Egol, Leslie H. Moeller, and Christopher Vollmer, *s+b*, Summer 2009.) And they react very quickly to what they learn from the networks, introducing or discontinuing products almost instantaneously. This may require the rapid retooling of sourcing, manufacturing, and distribution functions as they shift from one product to another.

• **Hubs.** One of the most effective power nodes imaginable in a transparent economy is the ability to become the beneficiary of self-reinforcing popularity. Hubs are people or products that attract viewers, assignments, clients, buyers, or users in part because others are drawn to them as well. The first of J.K. Rowling’s books, *Harry Potter and the Philosopher’s Stone* (Bloomsbury Press, 1997), took off rapidly because friends recommended it to friends. It became a hub as others wanted to know what was driving people to read it, and the existence of this hub ensured the popularity of the rest of Rowling’s series. The

transparency and immediacy of communications added momentum. Companies that can heighten the allure of their products this way, triggering attachment and emerging as hubs, will have a tremendously valuable power node. When hub dynamics are at work, products or ideas that are ahead stay ahead for a long time. That explains why Microsoft and Yahoo have not been able to catch up with Google in search volume. But because hubs are not a winner-take-all phenomenon, Google’s rivals have sizable numbers of users, leaving some room for market share to eventually turn against Google if a competitor comes up with a product that itself becomes a preferred hub. Microsoft hopes to exploit this opening with Bing, its new search engine.

Power nodes may not all be new, but they have never been as crucial as they are now. For companies to thrive in the current environment of transparent “perfect information,” they must be able to use their power nodes to shape and tap the sources of “profit power” around them. This gives them the upper hand in every partnership or alliance, allowing them to retain the largest share of profits while making sure that other companies get enough to survive and remain committed to the arrangement.

Other executives in your company may not be willing to focus the company’s strategy around a power node. The intensity of their discomfort may be a clue that they are coming up against a reality that they have not yet accepted. But sticking with business models that have lost their power node status — as AT&T did — will not help. Denial is not a strategy. Understanding the importance of power nodes, and

which ones are potentially part of the future of your enterprise, is the first step to success. +

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