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Winning Moves for 12 Industries

Every industry faces its own challenges in 2012's turbulent, uncertain economic environment. These capabilities systems could pave the way for business growth and development in a dozen key sectors.

BY THE PARTNERS AND PRACTICES OF BOOZ & COMPANY;

INTRODUCTION BY THOMAS A. STEWART

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Illustration by Harry Campbell

In a prolonged period of economic weakness, it's easy for business leaders to focus their attention on the external macro-level challenges facing them: political and regulatory uncertainty, skittish consumers, rising commodity prices, and slowing GDP growth in emerging economies. Each industry also has its own challenges and uncertainties. For example, pharmaceutical companies are contending with a dramatic wave of patent expirations on blockbuster drugs — at a time when overall growth is slowing and R&D productivity is slumping. The chemicals industry is changing dramatically because of the sudden boom in natural gas from shale rock, producing a surfeit of raw material for ethylene-based plastics. The retail banking industry is transitioning from a high-margin business to a lower-margin one. And in commercial aerospace, the Boeing–Airbus duopoly is eroding as new companies from China, Russia, and Canada enter the industry.

Yet it's not enough to look externally; internal factors make all the difference. In good times and bad, some companies succeed while others fail. Success is determined in large part by the particular mix of capabilities — the combination of processes, tools, knowledge, skills, human capital, and organizational forms — that companies deploy. That's why, particularly in difficult years like those we've experienced recently, every corporate leader should be asking, "Do we have the capabilities we need to win in our industry going forward?"

All companies need at least two types of capabilities. The first group of capabilities are prerequisites for entry into a sector. Kellogg School of Management professor Thomas Hubbard calls these "competitive necessities"; we at Booz & Company call them "table stakes." For example, every consumer products company must manage a supply chain; every oil company must meet environmental and safety requirements; every telecom operator needs to develop and reliably maintain its network technology.

Distinctive capabilities make up the second group: They are unique to each company's identity, linked to its strategy, and hard for competitors to copy. A company's investment decisions, operating model, and product and services mix align to support and enhance these differentiating capabilities. In successful companies, these combine into a mutually reinforcing "capabilities system," defining what the company does well, and are applied explicitly to everything it does: every product and service it offers, every market it enters, and every deal it makes (including M&A). (See "The Capabilities Premium in M&A," by Gerald Adolph, Cesare Mainardi, and J. Neely, *s+b*, Spring 2012.) Whether in aerospace, consumer products, or telecom, companies that succeed in building such a system are invariably better positioned to outperform competitors. Disney's excellence at marketing to youth and Amazon's proficiency with online retailing are two prominent examples.

Every year, Booz & Company industry teams take a step back to think broadly about the challenges and opportunities their client companies are likely to encounter in the months and years ahead. This year, these efforts included a concerted emphasis on identifying the capabilities and capabilities systems that are most likely to result in success in home markets and around the globe.

What follows is a sample of the thinking from these teams. For each of 12 industries, we've highlighted just one or two distinctive capabilities as intriguing sources of strength. (Links to longer, more comprehensive write-ups for each industry by the same authors are also provided.) Not surprisingly, some recurring themes emerge. Capabilities that enhance a company's digital platform loom large in consumer packaged goods, retail, retail banking, and wealth management. In automotive, healthcare, and pharmaceuticals, capabilities that allow a company to operate more efficiently and effectively, rendering it "fit for growth" (in Booz & Company parlance), are of central importance.

We hope this collection of vignettes provides you with ideas and perspectives about what capabilities you can develop in any industry as your company sets forth to grow stronger.

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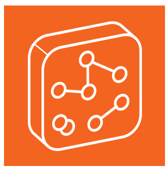
1.
Chemicals
Deploy Natural Supply Chains



There are certain things that chemical companies can't change: where their customers are, and where they buy raw materials. External forces, such as new supplies of oil and natural gas, are making the cost and availability of feedstocks uncertain, and demand depends on the global economy. In this context, the most forward-looking chemical companies are distinguishing themselves in the way they design and develop their capabilities.

One important capability in this industry is using the "natural supply chain": using all functions — customer service and marketing, logistics and storage effectiveness — to serve customers in a more differentiated way, and thus to grow the top line while keeping costs competitive. This includes designing rigorous production and distribution strategies tailored to customer needs. Natural supply chains first segment a chemical company's product portfolio into three main categories — basic chemicals, specialties, and petrochemicals — and then further segment them by the way the producer adds value. The goal is to apply common elements across the enterprise as market requirements allow; for example, using one set of logistics when there are long lead times and standard supply volumes, and another for products with shorter lead times or greater need for order flexibility.

This capability makes chemical companies far more operationally effective; after implementing natural supply chains, one large producer improved fulfillment times by 20 percent, reduced inventory by 40 percent, and cut operating costs by about 20 percent.

Another important cross-functional capability has to do with the way some companies take their expertise to market. These companies adopt the role of "solutions providers": They offer partnership, guidance, and services to help customers make the most of materials and products. This capability combines deep knowledge of customers with innovation in chemical applications and technology, and performance-based pricing (in which the materials provider assumes some of the risk and gains some of the reward in customers' innovations). Thus, for example, the Swiss chemical company Lonza Group Ltd. markets itself as a "partner of choice" in biotech, providing expertise in mammalian and microbial fermentation, as well as in life-science manufacturing, to allow its pharmaceutical customers to bring their products to market more rapidly.

Companies that build this kind of capability can enjoy the sustainable and stable revenue returns inherent in any "razor blade" business model — in which the original sale opens the door to an ongoing customer relationship. By selling the chemicals themselves at relatively low prices, they can keep customers coming back for ancillary products: in this case, more value-added services and collaboration.

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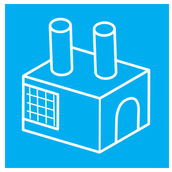
2. Industrials Embrace Strong-Form Product Management



This is a perfect moment for industrials companies — the companies that make and maintain heavy machinery, construction and building components and equipment, energy products such as turbines and windmills, and similar products — to invest in developing distinctive capabilities.

One of the most promising is improved product management. At too many companies, decision making is fragmented across a variety of functions. Sales decides which products to maintain and which to kill; R&D determines when an enhanced version of a product is ready for release; and operations may have the final say in choosing suppliers. Product managers are little more than administrators without much decision-making power; they police the results, focused on one or two broad mandates. At a low-cost manufacturer, they nix costly features that are nice but unnecessary; at a premium company, they block cost-saving initiatives that would erode the customer experience. Although narrowly valid, this siloed approach often results in customer insights that are gathered but never used, slow innovation, and disappointing product profitability.

By contrast, strong-form product management elevates product managers to a cross-functional role, giving them the authority to make decisions about the timing of innovations, pricing, channel strategy, and everything else that affects the success of product portfolios. This ensures that the company's core strategy makes its way into the design and launch of products and services. At a company practicing strong-form management, product managers become the focal point for a higher level of strategic judgment.

At its best, strong-form product management is an accountability model — a way of assigning responsibility for results to a single individual who can take a lifecycle view of a portfolio of related products, rather than to a series of people who lack a holistic perspective. At a time when competition and customer demands have intensified, this can be a differentiating capability, fortifying the connections to customers and increasing the odds that a company will make the right trade-offs and win in the marketplace.

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3. Aerospace
Shorten the Product Launch Cycle

The commercial aviation industry is poised for intense growth, particularly in emerging economies. But it is also rapidly becoming more competitive. From outside the U.S. and Europe, manufacturers such as Bombardier (headquartered in Montreal), Comac (Commercial Aircraft Corporation of China), and the United Aircraft Corporation (from Russia) are preparing to challenge the long-standing Airbus and Boeing duopoly. At the same time, the supply base has become more concentrated.

A clear understanding of the industry structure, as it reaches a new equilibrium in each supplier market, is thus essential for making strategic decisions. One major capability that is becoming critical is faster, more intensive innovation. The industry is already beginning to see a shortening of the product launch cycle and an increase in R&D spending.

The service life of aircraft could be reduced as airlines opt to buy newer, less expensive narrow-body aircraft, rather than further extend the lifespan of their existing fleet. This means that suppliers will also see a shorter services stream on their installed base. Suppliers that can aggressively manage these shorter life cycles, and handle changes in demand, will be in a much stronger position. For example, Boeing and Airbus are under pressure to respond to the new aircraft challengers with their own designs for narrow-body airframes. To do this, they need efficiency improvements and other innovations. Many of those will come from the supply base. There are significant opportunities for suppliers with strong capabilities in research and innovation.

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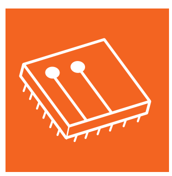
4. Technology
Digitize the Verticals



The combined trends of cloud computing, connectivity, and big data analytics are forcing information and communications technology (ICT) companies, and their customers, to rethink their established ways of doing business. Technology is finally living up to its promise: Industry after industry — healthcare, utilities, transportation, and others — can now change their product offerings, go-to-market strategies, and internal business operations, thanks to emerging IT building blocks. This presents an opportunity for technology companies to become active partners of industry verticals (the value chains of interrelated companies in particular sectors) as they embark on digital transformations.

To take on this role, however, the leading IT companies will need to build new capabilities systems. They must get even better at understanding how each industry vertical conducts its business, where to find opportunities to drive value, and how emerging technologies can help solve the specific challenges each industry vertical faces. They must learn to work collaboratively with customers to build industry-specific solutions that can scale across corporate boundaries. They must provide the security and reliability that no one else can, especially across the span of a supply chain. In short, IT companies must become better at designing new high-touch, customized operating models for new types of customers — the companies embedded in vertical industries, traveling down the digital road.

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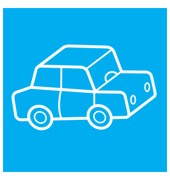
5.
Automotive
Prepare for Black Swans



In 2011, U.S. car and light truck sales exceeded 12.5 million units — a nice bump up from 11.6 million in 2010, but still far short of the 17.3 million sold at the turn of the millennium. In the mid-2010s, earnings for automakers will depend on a number of unpredictable factors — the rapid introduction of inexpensive new models from around the globe, the growth in demand in emerging markets, and the competition over market share in the U.S. between Japanese and Detroit-based automakers. The most important capability for automakers continues to be optimizing operations for greater profitability. They have to get the fundamentals right: creating new vehicles that the market wants, aligning supply with demand, and investing smartly in new technology.

Last year's headlines highlighted another capability: managing the risk of supply chain disruption in a cost-effective way. In 2011, two major "black swan"–style catastrophes — the Japanese tsunami and the flooding in Thailand — forced several automakers, including Toyota, Honda, and (to some extent) Nissan, to curtail production around the world. There is a natural tendency following such horrific events to evaluate a full range of risks and prepare large-scale contingency plans. But most black swans are devastating because of the cumulative impact of a cascading series of events. It is not justifiable to build costly, fully redundant supply chains when more focused and flexible preventive measures would be more effective.

Companies are better off learning to prioritize their preparations according to such factors as magnitude, chance of exposure, expense, and ease of implementation. For example, manufacturing key electronic components in one location may yield attractive economies of scale but also create significant risk. To mitigate that risk, automakers could split global volume across at least two facilities in different regions. Developing agile response systems deep in a supply chain is very difficult but unavoidable; it is the heart of this capability.

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6.
Pharmaceuticals
Go to Market More Effectively

During the past two decades, large pharmaceutical companies have relied on a sales and marketing approach based on prescription drug blockbusters. But now, this model is no longer generating growth. (See "Big Pharma's Uncertain Future," by Alex Kandybin and Vessela Genova, *s+b*, Spring 2012.)

Going forward, pharma companies will need to focus on building distinctive new capabilities systems for taking products to market. This is especially true in emerging markets, which are forecast to make up 30 percent of the global pharmaceutical market by 2015 (compared with 19 percent in 2010), and which have indigenous healthcare models for authorization, pricing, reimbursement, and distribution.

The needed capabilities will include payor engagement — working with insurance companies to address market access, pricing, and reimbursement (including innovative pricing agreements). Pharma companies will help develop value-enhancing patient services, such as compliance management programs supported by nurses, or telephone hotline services. They will need to know where value can really be attained rather than over-investing in marginal benefit.

They will also be drawn into multi-stakeholder marketing — targeting all relevant players in the healthcare system, including nurses and pharmacists — instead of just marketing to prescribers of medicine. This will require close coordination among various teams (medical, sales and marketing, market access, and pricing) to secure pricing and utilization that reflect the value of each product.

Related to this will be better commercial trade channel (CTC) management: engaging more closely with key stakeholders in the distribution chain, including wholesalers, pharmacists, and patients themselves. CTC capabilities include new distribution models, such as direct-to-pharmacy (DTP), in which manufacturers sell straight to pharmacies, enabling a direct trade relationship and paving the way for targeted loyalty programs. Other CTC examples include patient loyalty card schemes, which are common in Mexico, Brazil, and many other large emerging markets. The success of these new CTC models depends on the management of new partnerships with specialist third-party service providers (for example, to provide logistics services for DTP or to operate loyalty card programs) as well as close collaboration among product supply, marketing, and commercial trade functions.

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7.
Consumer Packaged Goods
Invest in Shopper Marketing

No single group of capabilities can serve all consumer products companies; the industry is too broad and diverse. Nonetheless, one capability — shopper marketing — represents a rich opportunity for growth in all consumer packaged goods (CPG) categories.

Shopper marketing is a term given to efforts to engage with and influence consumers at the time of purchase. These include in-store shelf displays, digital kiosks, shopping list apps, and e-coupons — all of which generate digital data that marketers can use to further refine their pitches. For example, ConAgra Foods Inc. developed a menu-based shopper solution program, "Give Every Night New Flavor," that offered recipes for popular meals, such as stir-fry and pasta, and all the products needed to prepare them, displayed together. The company reinforced shopper awareness away from the stores by creating a microsite, providing digital

Last year's headlines highlighted a capability that auto manufacturers need: managing the risk of supply chain disruption.

coupons, and advertising on search engines as well as in print. Within stores, signs and coupon books led shoppers to pallets that featured the recipes and their ingredients.

This program delivered double-digit growth over the prior year in numbers of items sold, revenues, and profit. It also generated significant market share gains for a leading grocery retailer that partnered with ConAgra. By creating wins for retailers this way, manufacturers can gain more valuable opportunities, such as better display space, visibility on retailer websites, and access to retailers' loyalty program members.

No consumer company has yet figured out all the ramifications of shopper marketing or created the capabilities required to fully exploit it, especially when combined with digital media. But many companies — in the U.S., Europe, and parts of China — are trying hard, and are outpacing their competitors in the process.

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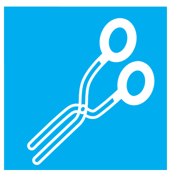
8. Healthcare

Cut Costs, Strengthen Segmenting



The U.S. Supreme Court's decision to hear challenges to the Patient Protection and Affordable Care Act in March 2012, combined with the national elections, would ordinarily have a paralyzing effect on the healthcare payor industry (which includes health insurance and managed care companies). But whatever happens to the healthcare reform laws, there is sufficient certainty about the future for payors to pursue long-term strategies and develop the capabilities they will need to succeed.

For example, baby boomers will continue to age and get sick. Medicare will account for ever-increasing percentages of patients and revenues. Employer-sponsored plans will continue to be the major source of health benefits. Sophisticated IT systems will be deployed. Cost reduction will remain a priority, and patient segments will further expand and shift.

Payors have built their established businesses by serving employers and large groups. Now they will increasingly serve other segments of the market, particularly individuals. The new capabilities they will need include managing Medicare and Medicaid populations across multiple sites of care, developing new ways of engaging patients, and reaching individuals through new or revamped retail channels.

Healthcare providers — hospitals, clinics, and medical services groups — make up the sector in the U.S. in which most costs are determined and incurred. Thus, working with payors, providers need to build a new kind of cost reduction capability for the industry's long-term fiscal health. Care distribution will shift from a hospital-centric model to one more focused on ambulatory services (with care given at patients' homes or in other locations). Investment in next-generation IT systems will continue, until most diagnoses, procedures, and results have been codified and an infrastructure for information exchange established. We also expect continued "productization," especially of high-cost inpatient services and chronic disease management. System-level coherence — with shared incentives and seamless interactivity among providers, payors, and patients — will be more valuable than ever before.

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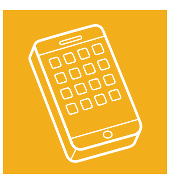
9. Telecom
Provide Experience



Telecom operators are pursuing a variety of strategies as they struggle to win in their converging, complex markets. One of the most intriguing strategies, rightfully pursued by only a few, is becoming an experience provider: offering customers a compelling combination of targeted applications and content, and a high level of online user experience. This is a difficult path for many telecom operators to follow, but it holds promise for those who have enough of the requisite capabilities, and who are willing to invest.

The capabilities needed for this strategy include developing innovative new applications and services, creating world-class user interfaces, and delivering excellent customer service. NTT DoCoMo Inc., a Japanese provider of mobile voice, data, and multimedia services to more than 58 million customers, is an early exemplar. It offers a wide variety of innovative services, including an e-wallet, an advanced personalized information app combining data from a variety of sources, and access to music, video clips, and games. Key to its success has been complete end-to-end control of the value chain, along with a strong pipeline of new product offerings and service delivery options. It boasts the top ranking in its market for customer satisfaction, and a rapidly growing customer base. DoCoMo's personalized app "i-concier," for example, has garnered 6.2 million subscribers since its launch in late 2008.

The model isn't limited to the most advanced telecom markets, such as Japan. Türk Telekomünikasyon AS, Turkey's largest telecom operator, provides a variety of Internet offerings — including telemedicine services, audio with children's music and spoken fairy tales, and two e-learning portals — through a simple user interface, as well as innovative devices such as a video-calling device for the home. The telemedicine subsidiary alone brought in US$18 million in revenue in 2008.

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Turkey's largest telecom operator provides telemedicine services, audio with children's music and spoken fairy tales, and two e-learning portals.

10.
Retail
Become Better Curators

Now that shoppers are bringing online devices into their stores, retailers will aggressively compete. They will expand their capabilities for bottom-line growth by driving operational efficiencies and for top-line growth through richer customer experience. Another capability may not be as obvious, but for some retailers it will be the most critical differentiator: their ability to develop a curatorial approach to merchandising, less bound by product categories and more defined by customer wants and needs.

In an era of frugal consumers, placing the right product in the right store at the right price is essential. Consumers demand a more curated selection; they want the right styles, prices, and experience, all in one store. They also want to shop at stores that reflect local tastes and preferences.

Retailers will be asking themselves a set of very focused questions: How should product assortment in each store differ by region and by the unique demographics and characteristics of the trade area? How much space should be dedicated to one category or product versus others? What should be the base price of particular SKUs in a given category? How should they be promoted, and when?

Localizing each store and getting the merchandising right can be a Herculean task with no apparent shortcuts. Many retailers will need to upgrade their merchandising capability holistically by integrating people (especially analytical talent), IT systems (such as store trait databases, point-of-sale checkout systems, and pricing systems), analytical engines (tracking demand analytics, price elasticity, promotion returns, store clustering, and more), processes (including basic assortment planning, promotions, campaign tracking, and performance measurement), and organization (for example, positioning roles, responsibilities, and decision rights around the "center of gravity" of the enterprise). The returns for undertaking this effort can be dramatic: We've seen retailers improve their top line by 2 to 3 percent.

When the economic outlook is sluggish, effective promotions are critical, especially in the fiercely competitive and spending-constrained lower- to middle-income market. These frugal consumers are highly sensitive to pricing and frequently use coupons. Leading retailers invest in shopper marketing and loyalty programs, they tailor promotions to their customers, they partner with manufacturers to design and refine promotional events for particular consumer groups, and they develop the measurement and analytical capability they need to better evaluate the results.

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11.

Retail Banking

Build Customer-Oriented Capabilities

With limited avenues for growth, the banking sector will be hypercompetitive for the next three to four years. Banks will face competition not just from innovative financial-services companies, but also from nonbanks, such as mobile phone companies with bill-paying apps. They will also need to resolve long-standing customer pain points. Too many customers feel that dealing with their banks is complicated and time-consuming, that they receive impersonal treatment and little recognition, and that they are not empowered to make decisions. They also want the banking system to provide a way for them to engage with friends and family on financial matters.

Traditionally, retail banks have differentiated themselves in several ways: financial management, human capital management, risk management, operations, IT infrastructure, and acquisition and integration. Now, these capabilities are quickly becoming basic competitive necessities. For a sustainable "right to win," banks must invest in and develop additional capabilities that will truly set them apart.

For many, this will mean assembling a more customer-oriented capabilities system, drawing together diverse processes, practices, and skills. The elements will vary from one company to another. They might include designing an integrated multichannel customer experience incorporating the online bank and local retail branches; expanding the use of fact-based decision making for loans and investments; putting more analytically driven decision-making processes in place; delivering highly tailored, customer-focused product and service offerings; fostering greater collaboration across organizational silos within the bank; and partnering across enterprise boundaries.

Investing in these new capabilities will be expensive, and funding will need to come from somewhere: probably less from raising fees and more from wringing costs out of the operation. Banks will have to continuously focus on expense control — on how work gets done as well as what work to do — using lean and technology-enabled process redesign. They will also need to tap new ways to make money. For example, many banks provide skills and information to customers, particularly in commercial and small-business sectors, as bundled add-ons or even as loss leaders. Some of this can be unbundled in a way that more effectively monetizes the bank's existing capabilities. Banks could aggregate information for the marketing and sales efforts of middle-market and small businesses, leverage their financial and risk management expertise for clients, offer white-label analytics, and perform outsourcing and transaction processing services. Companies ranging from Amazon to American Express to General Electric to UPS have converted capabilities built for internal use into new revenue sources. In these times, every bank should be doing the same.

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12.

Wealth & Asset Management

Bolster e-Relationships

These are hard times for investors. Many are adrift, uncertain about where to put their money and who to trust. They need sound advice as never before, but they have been badly burned in the last four years, and their patience and trust have worn thin.

If being an investor in this climate is challenging, so too is operating a wealth management firm. The market is unusually fluid at the moment, making the competitive positions of long-entrenched firms less secure. Investors are more willing to test new relationships, and therefore this is an ideal time to exploit rivals' vulnerabilities and peel away clients.

It's also a good time for wealth management firms to distinguish themselves by using emerging technologies to enhance the client experience. Many firms struggling with top-line revenue growth and increased regulatory costs will under-invest in this critical capability. That could be a grave long-term error.

New information technologies that have been slowly developing (for example, tablet computers with rich interfaces and new displays, online tools that can help firms gain client insights from a trove of unstructured data, powerful 4G networks, and public and private clouds) have reached a tipping point, allowing firms to run their operations and engage with clients in innovative and more efficient ways. It's possible to envision a future in which the client's connection with the firm is fast, always on, and full-service through multiple channels; and where these interactions — with advisors and also with peers via social media — are collaborative and secure. A few wealth management firms will assemble these capabilities into vibrant systems, geared toward solving real customer problems, and transforming the client–advisor relationship. In time, those who are served well by wealth management firms could go on to start other businesses, and thus a highly capable wealth management company could become, in itself, an engine of growth for every sector in the economy. +

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