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## The Great Repeatable Business Model

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create new and more-lasting differentiation.**

*by Chris Zook and James Allen*



# The Great Repeatable Business Model

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**DIFFERENTIATION IS THE** essence of strategy, the prime source of competitive advantage. You earn money not just by performing a valuable task but by being different from your competitors in a manner that lets you serve your core customers better and more profitably.

The sharper your differentiation, the greater your advantage. Consider Tetra Pak, a company that in 2010 sold more than 150 billion packages in 170 markets around the world. Tetra Pak's carton packages extend the shelf life of products and eliminate the need for refrigeration. The shapes they take—squares and pyramids, for example—stack more

efficiently in trucks and on shelves than most cans or bottles. The packaging machines that use the company's unique laminated material lend themselves to high-volume dairy operations. These three features set Tetra Pak well apart from its competitors and allow it to produce a package that more than compensates for its cost.

In studying companies that sustained a high level of performance over many years, we found that more than 80% of them had this kind of well-defined and easily understood differentiation at the center of their strategy. Nike's differentiation resides in the power of its brand, the company's relationships with top athletes, and its signature performance-focused product design. Singapore Air's differentiation comes from its unique ways of providing premium service at a reasonable cost on long-haul business

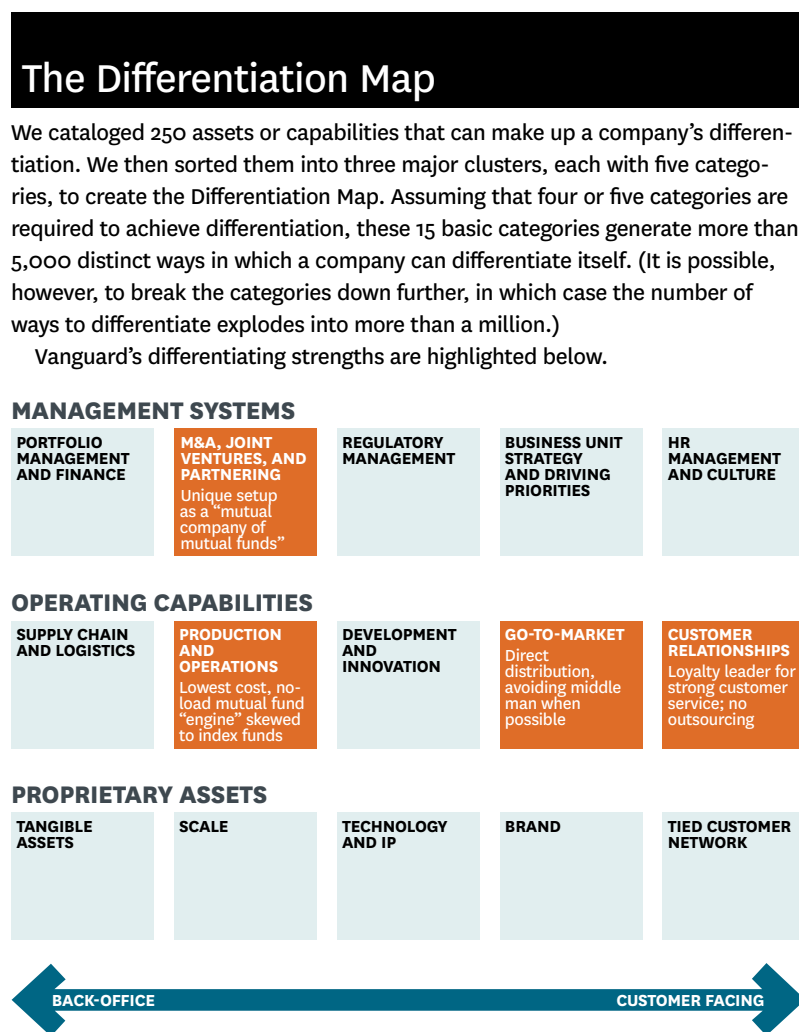
flights. Apple's differentiation consists of deep capabilities in writing easy-to-use software, the integrated iTunes system, and a simplicity of design and product line (Apple has only about 60 main SKUs).

You can find high performers like these in most industries. The cold truth about hot markets is this: Over the long run, a company's strategic differentiation and execution matter far more to its performance—our research suggests at least four times as much—than the business it happens to be in. Every industry has leaders and laggards, and the leaders are typically the most highly differentiated.

But differentiation tends to wear with age, and not just because competitors try hard to undermine or replicate it. Often the real problem is internal: The growth generated by successful differentiation begets complexity, and a complex company tends to forget what it's good at. Products proliferate. Acquisitions take it far from its core. Frontline employees, more and more distant from the CEO's office, lose their sense of the company's strategic priorities. A lack of consistency kills economies of scale and retards the company's ability to learn. Small wonder that "reinvention" and "disruption" have become leading buzzwords; companies struggling with complexity and fading differentiation come to believe they must reimagine their entire business models quickly and dramatically or else be overwhelmed by upstarts with disruptive innovations.

Most of the time, however, reinvention is the wrong way to go. Our experience, supported by more than 15 years of research into high performance, has led us to the inescapable conclusion that most really successful companies do not reinvent themselves through periodic "binge and purge" strategies. Instead they relentlessly build on their fundamental differentiation, going from strength to strength. They learn to deliver their differentiation to the front line, creating an organization that lives and breathes its strategic advantages day in and day out. They learn how to sustain it over time through constant adaptation to changes in the market. And they learn to resist the siren song of the *idée du jour* better than their less-focused competitors. The result is a simple, repeatable business model that a company can apply to new products and markets over and over again to generate sustained growth. The simplicity means that everyone in the company is on the same page—and no one forgets the sources of success.

Let's look in more detail at what this involves.



**Idea in Brief**

**Really successful companies build their strategies on a few vivid and hardy forms of differentiation that act as a system and reinforce one another.**

They grow in ways that exploit their core differentiators by replicating them in new contexts. And they turn the sources of their differentiation into routines, behaviors, and activity systems that everyone in the organization can understand and follow.

Powerful differentiations deliver enduring profits only when they are supported by simple, non-negotiable principles and robust learning systems that drive constant improvement across the business.

**Sources of Differentiation**

Opportunities for differentiation are rich and varied in virtually every industry. To examine them more closely, we built a database of 8,000 global companies and tracked their performance over 25 years. We created another database of 200 global companies, which we studied in detail. We supplemented that research with two other data sets: a survey conducted with the Economist Intelligence Unit of nearly 400 global executives, and 50 interviews with chief executives around the world. Building on the data, we cataloged 250 assets or capabilities that can contribute to differentiation and sorted them into three major clusters of five categories each. (See the exhibit “The Differentiation Map.”)

The most enduring performers, we found, built their strategy on a few vivid, robust forms of differentiation that acted as a system, reinforcing one another. To illustrate, let’s examine the factors that make the mutual fund company Vanguard one of the most consistently high-performing businesses in our study.

Ever since its founding, in 1974, Vanguard has been a different kind of company. Its founder, John Bogle, believed passionately in the value of index funds. He saw that a company based on them would need few fund managers and researchers and could therefore charge considerably less than companies with actively managed funds. Bogle also felt he should deal directly with customers and offer them highly responsive service, thus building loyalty. These characteristics are at the core of Vanguard’s differentiation today, as can be seen in “The Differentiation Map.” The company has the lowest-cost mutual fund “engine,” a distribution system that avoids middlemen and allows direct contact with customers, and the highest level of customer loyalty in the industry.

The strongest sources of differentiation in a company’s strongest businesses are its crown jewels. Yet

our research shows that most management teams spend little time discussing or measuring them and therefore don’t agree on what they are. This lack of clarity permeates entire organizations. For instance, more than half of frontline employees say in surveys that they are not clear on their companies’ strategic tenets and differentiators. Customers are even more mystified: Although 80% of managers told us they thought their companies were strongly differentiated, fewer than 10% of customers agreed. Yet understanding and agreeing about differentiation, where it can be applied, and how it must evolve is what makes a strategy work.

A systematic approach to understanding your sources of differentiation is key to rectifying this situation. It enables you to have a meaningful discussion of what distinguishes your company from competitors and what you can build on. When we

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ask each of a company’s top 15 managers privately what he or she feels are the most differentiated and important assets and capabilities, we often find a surprising lack of agreement.

One way to bring data to bear on this range of views is to rate the success of your company’s past 20 growth investments and determine what they have in common. This is a starting point for mapping the company’s differentiation. Discussions of what really differentiates a business from its competitors are, however, often based on past beliefs more than on current data. As you deliberate about your own key differentiators, you might consult these criteria: Are they (1) truly distinctive? (2) measurable against

## Making Your Differentiation Easier to Repeat

1

Replicating your greatest successes means deeply understanding their root causes, maintaining a 360-degree view of where they could be adapted, and ensuring that the entire organization internalizes the strategy and the differentiation on which they are built. **Here are six actions to consider:**

2

**Make sure that you and your management team agree** on your differentiation now and in the future. You may want to ask each person to write it down; then you can collate the results in advance for discussion. At a minimum, consider three questions: (a) What do our core customers see as our key sources of competitive differentiation? (b) How do we know? (c) Are these sources becoming more or less robust?

**See whether the front line of your organization agrees** with what you come up with. Can employees and supervisors describe the strategy and the areas of differentiation as you do? Do they feel that they understand the strategy? Is it simple and clear? Online surveys, anonymously tabulated, can be a big help with this task.

competitors? (3) relevant to what you deliver to your core customers? (4) mutually reinforcing? (5) clear at all levels of the company? Though each of the five seems obvious, reaching agreement on your differentiation and testing it against these criteria is not as easy as it sounds. The harder it proves, the more valuable the exercise. In our experience, many companies fail these tests—but the most successful ones pass them every time.

The ability to recognize and test the sources of your differentiation in this way is important for focusing innovation. Most innovations, even disruptive ones, affect only one part of a business model, leaving the rest intact. The shift from glasses to contact lenses, for example, had little effect on the basic customer need for vision correction, the industry's distribution system, or the network of eye doctors. The shift from wired to wireless telephony caused chaos for many incumbents, yet some used their infrastructure, customer access, brand, and ability to work with regulatory organizations to prevail. The more precise your understanding of your model and the sources of its success, the more precisely you can focus innovation resources on the areas where the threats and the need for change are greatest.

### Growth Based in Differentiation

The best way to grow is usually by replicating your strongest strategic advantage in new contexts. Companies typically expand in one or more of four ways: They create or purchase new products and services, create or enter new customer segments, enter new geographic locations, or enter related lines of business. A company can pursue each of these strategies in various ways—for example, adding new price points or finding new uses for a product or service that will appeal to new customers.

The power of a repeatable model lies in the way it turns the sources of differentiation into routines,

behaviors, and activity systems that everyone in the organization can understand and follow so that when a company sets out on a particular growth path, it knows how to maintain the differentiation that led to its initial success. The global agribusiness Olam is a case in point. The company began as a cashew trader. It purchased nuts directly from farmers in Nigeria and sold them to a dozen customers in Europe, managing a supply chain from the farm gate to the shop door. This approach was unusual for the industry. It cut out middlemen, safeguarded Olam's access to products, and increased the company's market intelligence and speed of reaction. To do this well, of course, Olam had to learn to work closely with small farmers. It also had to develop a risk management system that drew on information garnered from farmers, customers, and commodities and foreign exchange markets to minimize the risks of crop problems, price and currency volatility, and supply disruption.

These capabilities translated into other contexts. Olam realized that its knowledge of small farmers in Nigeria could be applied to small farmers in, say, Burkina Faso. Its risk management skills could be applied to peanuts or coffee beans as well as to cashews. The company accordingly added both farmers and customers in new countries and new products. It now sources 20 agricultural products from farmers in 65 countries and delivers them to more than 11,000 customers across the world.

Of course, Olam's differentiation evolved as the company grew. For instance, as it expanded into certain countries, it found opportunities to acquire and fold in small operations based in those countries. Although Olam had no experience with M&A, its capabilities and assets, including good contacts at the ground level in its countries of operation, gave it an advantage in recognizing promising opportunities

3

**Write your strategy on a page,** or even on an index card. Does your description of it center on the key sources of differentiation? Is your page sharp and convincing to others, including customers and investors, and backed by data?

4

**Conduct a postmortem** of your 20 most recent growth investments and initiatives. Are your greatest successes or disappointments explained, in part, by the central differentiators that were transferred?

5

**Translate your strategy** into a few nonnegotiables. Can you describe simple principles that the organization believes in and that define the key behaviors, beliefs, and values needed to drive the strategy? Are they embedded in day-to-day routines, or are they simply words on a page?

6

**Review how you monitor** the most important health indicators of your core business and its differentiators, both for short-term adjustment and for long-term investment in new capabilities. Does your method drive learning and adaptation? Is quickness to adapt a competitive advantage? Are you sure?

and understanding how to negotiate with and integrate acquisitions.

Over time, the company has developed playbooks for M&A and deal integration and now considers them important differentiating features that frontline managers (and everyone else in the organization) understand and value. As Olam's CEO, Sunny Verghese, explains, "Our line managers find and consummate transactions at the local level. It is sort of a hidden asset that we have because our

widely understood principles across the organization, while only 26% of the worst performers had done so. Indeed, a link between well-defined, shared core principles and frontline behavior was more highly correlated with business performance than any other factor we studied.

The logic of this connection seems clear. Nonnegotiables translate the most important beliefs and assumptions underlying the company's differentiation into a few prescriptive statements that all

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people are in the market at a lower level of contact than anyone else. Our ability in transactions is now part of our core, and we manage it centrally with a unique repeatable formula of clear rules and criteria."

### Supporting Your Differentiation

Although differentiation is at the heart of a repeatable model, it needs the support of a rigorously focused yet flexible organization. Our research shows that powerful differentiations create the most enduring profits when a company delivers them to the front line in the form of simple, nonnegotiable principles and when it creates robust learning systems that facilitate constant adaptation. Let's look at these factors in turn.

**Nonnegotiable principles.** This is a fundamental building block of repeatability, a way of keeping everyone on the same page. Analysis of our 200-company database reveals that 83% of the best-performing businesses had established explicit,

employees can understand, relate to, and use as a reference point for making trade-offs and decisions. In effect, they are the headlines of the user's manual for a company's strategy.

To illustrate how companies use nonnegotiables, let's go back to Olam. A key differentiator is that the company manages supply chains right from the farm gate. To support this, Olam requires managers to live in the rural areas of developing countries in order to learn what really goes on at the farms. This nonnegotiable principle is the foundation for hiring criteria, assignments, and the structure and content of training. Another nonnegotiable is that each manager give highest priority to relationships with local farmers. Olam's field operating manual captures many of the routines that support this requirement. The company's principles, and the practices that support them, are central to its culture and provide a bonding experience for managers, who respond to trade-offs and challenges at all levels with remarkable consistency.

Tetra Pak has different but equally powerful non-negotiables. One of them is that the package must save more than it costs, an idea that originated with the company's founder and was the reason for developing its signature tetrahedron-shaped package for milk or juice. Every major new product, package design, or line of equipment must meet that standard. Tetra Pak has developed sophisticated methods for evaluating the systems cost of packaging, including production costs, spoilage, transportation and storage, and disposal costs. It claims that it can reduce operating costs by as much as 12% for a dairy or juice company.

To understand the power of this consistency, consider that from the moment a business is founded, management becomes increasingly distanced from the customer and the front line. Up and down the organization, information slows and grows distorted—the corporate equivalent of the classic game

ing systems, compared with only 9% among the rest. The travails of Kodak, General Motors, Xerox, Nokia, Sony, Kmart, and many others can be seen as cases of arrested adaptation—great formulas that simply did not change fast enough. Most such cases, we should note, didn't involve disruptive innovations that caught the incumbent flat-footed. Stalls and stagnation stem from a failure to learn much more often than from a hard-to-predict disruption.

The most common method of learning in companies with great repeatable models comes from direct, immediate customer feedback. The most powerful demonstration we have seen is through Net Promoter systems, which are used at Vanguard, in Apple's retail division, and at many other companies. In this approach, customers are usually asked one or two questions shortly after contact about their satisfaction with the experience and their willingness to recommend the product, service, or company to

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Telephone, in which a message is relayed around a table in whispers and has become unrecognizable by the time it completes the circuit. When a company internalizes a set of principles, the message no longer gets garbled. A shared point of view, core beliefs, and a common vocabulary improve everyone's ability to communicate and foster self-organization, permitting fewer layers, fewer handoffs, and shorter communication lines. All this increases the speed of a business, which means you can capture more growth opportunities ahead of competitors and accomplish more per unit of time.

**Robust learning systems.** Clear differentiation supported by nonnegotiables confers a competitive advantage—for a while. As markets shift, however, successful organizations must also be able to learn quickly and adapt to new circumstances. Both our research and the recent history of business reflect the importance of supporting your differentiation with rapid learning and adaptation. Some 48% of managers in our top group of performers felt that their companies were characterized by strong learn-

ing systems. The power of the Net Promoter Score lies in its simplicity. Companies that chase more-detailed feedback typically find that customers don't bother to engage, so data are fewer and poorer as a result.

In more-complex environments, companies with direct sales forces have other interesting opportunities to create strong feedback loops with customers. Take the toolmaker Hilti. Founded in 1941 by Martin and Eugen Hilti as a mechanical workshop with five employees in Schaan, Liechtenstein, the company focused on innovative tools for difficult construction jobs. Martin Hilti spent much time at job sites, observing and interacting with customers. This was the start of the Hilti direct sales force. Over the decades, the business grew one tool at a time. The company would develop a basic design and then innovate intensively on the details, using information its salespeople acquired at job sites. Today, in an industry where about 75% of products are sold through indirect channels, this direct customer contact remains a differentiated strength. It accounts in part for Hilti's

ability to command significant price premiums over competitors.

Real-time response is a competitive weapon of growing importance in a world of increasing speed and complexity. The companies that move fastest can often operate within competitors' decision cycles, so competitors are always responding to them rather than the other way around. Marcia Blenko, Paul Rogers, and Michael Mankins recently studied 760 companies worldwide through 40 questions regarding perceptions of decision speed, quality, and ability to execute. When they synthesized the responses into an index of decision effectiveness, they found that companies ranked in the top quintile produced, on average, a total shareholder return about 6 percentage points higher than the returns of other companies. Companies with robust learning systems usually score higher than average on all three counts.

A repeatable differentiation can falter and even collapse without nonnegotiable principles and robust learning systems—and without strong management to preserve and protect it. Think of Nokia. Its leaders created a formula for tablet-shaped handsets that allowed it to achieve enormous economies of scale and dominate the market for more than a decade. Yet despite considerable surplus resources during that time, the company's leaders failed to adapt and invest aggressively in the future. As a result, in just a year Nokia lost its market position to Apple, Google, and Research In Motion. This lesson is all the more sobering given that Nokia's R&D and product development teams had many years earlier created some of the basic concepts later used in the iPhone: a large display, a touchscreen, internet readiness, and an app store.

**THE SEARCH** for profitable growth is becoming increasingly difficult. Today fewer than 10% of companies achieve more than a modest level of profitable growth over a decade, and the odds of success are declining. A series of interviews we conducted with CEOs regarding their challenges on the job spotlight two reasons for this state of affairs. One is that companies are forced to adapt faster than ever. The other—and this one was at the top of the list—is the need to control ever-growing levels of complexity. Sluggish, too-complex organizations are the silent killers of corporate growth and profitability. Interestingly, only 15% of executives in our survey cited a lack of attractive opportunities as a major barrier to

growth. Internal complexity and barriers to speed of adaptation were far more important.

Our findings show that the simplest strategies, built around the sharpest differentiations, have hidden advantages not only with customers but also internally, with the frontline employees who must mobilize faster and adapt better than competitors. When people in an organization deeply understand the sources of its differentiation, they move in the same direction quickly and effectively, learning and improving the business model as they go. And they turn in remarkable performance year after year. ♥

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 **Chris Zook and James Allen** are partners at the global consulting firm Bain & Company and lead its strategy practice. They are the authors of *Repeatability: Build Enduring Advantage in a World of Constant Change* (Harvard Business Review Press, forthcoming in 2012).



"Say what you want about the new regime, but I'm rather fond of my title change from Hangman to Gallows Administrator."

CARTOON: TERESA BURNS PARKHURST