Implementing the Model

Taking a New Business Model into Action

Excerpted from

Seizing the White Space:
Business Model Innovation for Growth and Renewal

By

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The characteristic of scientific progress is our knowing that we did not know.

—Gaston Bachelard

A great business model blueprint is a powerful first step in seizing your white space. But making the leap from the theoretical blueprint to the working business doesn’t happen all at once. It’s a process of controlled experimentation that proceeds in small steps. Hypotheses are put forward and tested, and the lessons learned are used to make the necessary adjustments as you go forward. In this way, long before much is risked, you will discover if the new model won’t work in practice or how it needs to change so that it will.

This is how I use the term implementation: an effort largely focused on testing and validating assumptions while integrating the key resources and processes required to deliver on the customer value proposition and the profit formula. Implementation should be pursued in three stages: incubation, acceleration, and
transition. Incubation should be focused on establishing profitability, but it’s critical not to put pressure on the project to reap revenues at any great pace until the acceleration stages and in many cases real, large-scale revenues won’t accrue until the transition stage.

**INCUBATION**

*Incubation* is the process of identifying the assumptions most critical to the success of the business proposition and then testing them in a targeted and orderly manner to quickly prove or disprove their viability and by extension the viability of the new initiative itself. At this stage, creative problem solving and a discovery-driven approach to project planning are critical skills. The immediate goal here isn’t necessarily business success; it
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is new learning. Testing that delivers clear answers should be encouraged, even if they come from failures.

“For every one of our failures, we had spreadsheets that looked awesome,” jokes Scott Cook, founder of accounting software pioneer Intuit. As the leader of a highly innovative company, Cook learned through experience the value of focused testing. A team once brought Cook a proposal to create a business that paired accountants who had available time on their hands with those who had more work than they could handle, essentially transforming a local service market into an internationally networked one. Accountants, the team assumed, were very good at counting but not as skilled at marketing or acquiring new clients. The team had gone quite deep in its analysis, producing detailed spreadsheets—based on all sorts of noncritical assumptions—about the idea’s potential profitability. It seemed to be a brilliant idea, but the team had no hard data.

“Instead of working nine months to build the whole service,” Cook says, “I asked, ‘Can you find a way to test quickly the supply hypothesis?’ So the team hacked together something in three weeks—had humans doing stuff behind the scenes instead of the computer—and sent a little test mailing to fifty thousand accountants. By the fifth week they had proved—at virtually no cost—that there were good accountants sitting unused.”

And they kept learning. The team continued to develop the project, launching one piece every few weeks, following this test-and-learn approach.

Typically, new business initiatives fail because the people responsible for them take assumptions to be fact. They don’t work hard enough or systematically enough to identify and validate critical assumptions before either committing large resources to the business proposition or walking away. Managers need to test early, test cheaply, and test often. Investing a little to learn a lot helps overcome the uncertainty of new business development by enabling managers to modify plans in response to new knowledge.
“Fast testing is risk reducing,” concludes Cook, “and most people are happy pursuing risk-reducing behavior. Once the value of this approach becomes apparent to all, it becomes part of your innovation culture. New teams, rather than commit large resources to vague planning, begin to ask early on how they can test their key hypotheses.”

To successfully incubate a new business you must identify a foothold market, a small geographic region or customer group that will serve as the low-cost laboratory. Preferably familiar or otherwise friendly, the market nevertheless needs to be representative of the larger target market you intend ultimately to pursue. Hindustan Unilever tested the Shakti Initiative in Andhra Pradesh, a state in southern India, starting with just seventeen women, slowly expanding the number as the company learned what it needed to succeed. Better Place identified a favorable foothold market in Israel, a relatively small transportation island with a vested interest in the project’s success. Hilti worked out the resources and processes of its white-space play with a few large clients in its base market of Switzerland before slowly rolling its model out worldwide. Incubating a new business in your white space is filled with uncertainty, but it needn’t be filled with risk. Foothold markets allow for safe, low-cost, structured testing that yields demonstrable results.

Most critically—and I cannot stress this enough—you must keep the incubation effort free of interference from the core and the way it operates. “Part of the creative challenge is not having too many controls,” says Netflix founder and CEO Reed Hastings. “We manage new innovation through context, through values and influence, rather than control. We talk about supporting innovation, rather than managing, controlling, or proceduralizing it, because it’s so creative.” This is another way of saying that incubation should be oriented toward deploying key resources rather than refining processes.
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A Tale of Two Low-Cost Carriers

While incubating a new business model, constant attention must be paid to the interrelationship of all its key elements and their ability to integrate harmoniously in support of the customer value proposition. Models whose elements don’t mesh well almost inevitably fail.

Consider, for instance, the examples of Southwest Airlines and Delta’s Song Airlines, two low-cost airline players that met with vastly different results. Southwest Airlines is generally credited with starting the low-cost airline revolution. Its story has been told many times. But viewing it through the lens of the four-box business model framework shows how important internal consistency is to Southwest’s success.

At its inception, Southwest targeted regional commuter customers whose needs were being ignored by the big carriers. These were mainly Texas residents who were taking the bus between cities like Austin and Dallas and couldn’t afford air travel. They were nonconsumers, and Southwest astutely realized it was competing not against other airlines but against bus travel. It set out to satisfy commuters’ job-to-be-done by providing faster transportation at a nearly comparable price. This CVP put necessary constraints on Southwest’s profit formula. To deliver revolutionary low prices, it would have to keep margins low. To make money at these margins, it would need to keep direct costs and overhead low and resource velocity high. It would have to find ways to get more turns from its capital equipment.

As the company began to develop the key elements of its model, it made choices to support these requirements. For instance, Southwest adopted a direct sales model for tickets, eliminating travel agent fees, which also put payments in the company’s hands more quickly. Customer service could be high-touch (friendly behavior is cheap), but expensive extras like food and entertainment were trimmed or eliminated. On the resource front, the airline
chose to use a single type of plane to streamline repair and maintenance costs and relied heavily on electronic systems to run sales channels. Externally, Southwest chose to fly into secondary airports, whose lower gate fees reduced operating costs. It also negotiated industry-rule-breaking profit-sharing contracts with its pilots’ union, thus trimming another traditional source of high costs. Finally, it entered into long-term contracts for fuel.

These key resources all supported both the CVP and the profit formula. Secondary airports and standardized maintenance procedures—aided by a point-to-point routing system that decreased the waiting times associated with industry dominant hub-and-spoke routing—produced industry-leading turnaround times, maximizing asset velocity by keeping planes flying a greater percentage of the time. And Southwest’s decision to do away with reserved seating and institute a first-come, first-served approach got passengers on and off planes more quickly. Taken together, these choices formed a cohesive model that reinforced Southwest’s CVP and led to great success.

Years later, legacy carrier Delta attempted to enter the low-cost travel business. It launched Song, aimed at “discount divas,” female leisure flyers who wanted the convenience and affordability of a low-cost carrier coupled with a sense of style. In addition to serving a slightly refined customer segment, Song’s CVP differentiator was a “hip” approach to travel. It was a white-space-within play for Delta, but the company failed to recognize it as such. Like Southwest, Song’s profit formula relied on low margins, low cost drivers, and high resource velocity, a strategy that might have worked but for the incongruity of the other elements in its model.

Emulating Southwest, Delta chose a single type of aircraft flying point-to-point routes, which it hoped would result in faster turnaround times and higher resource velocity. But to serve its divas, it retained reserved boarding and lots of frills like organic
food, custom cocktails, personal entertainment systems, designer attendant uniforms, and an in-flight exercise program, all of which either added costs or slowed turnaround by increasing restocking and cleaning time. Fun, fashionable service is not fast, efficient service. These tensions in the model were difficult to reconcile. Flying to primary airports further increased costs and impeded resource velocity, as Song jets struggled to move quickly on crowded runways amid busy infrastructures.

The factor that was perhaps most destructive to the success of the model, however, was that Delta, in an effort to avoid alienating its unions, saddled Song with its existing pilots, crews, and machinists. All were protected by high-cost union contracts, and they were unaccustomed to the resource velocity required to make the Song model work. The core culture was hard to change and caused further tensions in the system. These inherent conflicts ultimately proved fatal.

Southwest’s and Song’s business models both had strong customer value propositions serving specific jobs-to-be-done, and both featured differentiators designed to serve those jobs (you might question the discount-divas concept, but at least it was clearly defined in Delta executives’ minds). But Southwest perfected its model in small foothold markets before gradually expanding to national service, whereas Delta bet the bank on a business model whose elements, it turned out, weren’t well integrated and therefore did not support Song’s CVP—and its initiative failed.

Profit Before Revenue Growth

Early in the incubation process, the business model framework helps to identify the new value propositions that have the greatest chance of success and weed out those that contain fatal flaws or inconsistencies. Just as important as testing assumptions is correctly defining what will constitute success and how you will
measure it. Some of the best-conceived initiatives have gone down in flames from such common errors as an overeager push for scale, overinvestment in imperfect suppositions, and a lack of patience with a process that needs time as its friend.

Transformational business models should demonstrate the success of their fundamentals fairly quickly by delivering value to the customer and profits to the company early on. Hindustan Unilever was able to predict the eventual success of the Shakti Initiative on the basis of early profit accrued from just a few dozen women. Xiameter started filling the production pipeline and clearing profit almost immediately after it refined the stringent
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Customer value proposition (CVP)
Provide stylish, affordable, and convenient service to female flyers at low fares through existing channels

Key resources
• Single type of plane (+)
• “Frills”: organic food, fashionable uniforms and cocktails; personal entertainment systems (−)
• Delta crews and machinists (−)
• Primary and secondary airports (−)

Key processes
• Standardized maintenance procedures (+)
• Medium turnaround (−)
• Point-to-point service (+)
• Reserved boarding (−)

Profit formula
• Lower prices (+)
• Insufficient lowering of direct costs and same amount of overhead (−)
• Lower unit margins (−)
• Medium amount of resource velocity (−)

Effect on overall model
(+): Positive effect
(−): Negative effect

Failure of Song Airlines

This is one of the great benefits of applying the business model framework to new business development. By articulating the basic framework and focusing early and explicitly on the initial key assumptions that define that framework, it becomes relatively straightforward to identify and evaluate proper metrics for business rules needed to serve its commodity market. The evidence of profitability demonstrated early on by Hilti’s initial eight customers gave Marco Meyrat and the other company executives confidence in the tool-leasing service. That granted them the patience to scale up in a measured way in their initial foothold market of Switzerland and beyond.
success. A clear definition, combined with the right approach to business model blueprinting and implementation, provides the structure you need to significantly reduce the investment and execution risk of ventures in your white space. Reduced risk means reduced fear, and as the fear of the unknown subsides, your white space becomes a more reasonable place to explore.

Successful incumbents may initially dislike revisiting the uncertainty they have worked so hard to banish. But you must learn to manage the paradox of embracing uncertainty while methodically working to stamp it out. You need to build tolerance for initial failure. In 1999, for example, Amazon wanted to expand the resources it offered customers. Seeing eBay’s popularity, it introduced an auction model to engage third-party sellers in the Amazon experience. The experiment was widely viewed as an abject failure at the time, but in fact, it was an important step in an emergent strategy that Amazon pursued to great eventual success. “The basic thought was: ‘Look, we have this Web site where we sell things, and we want to have vast selection,”’ says CEO Jeff Bezos, relating a story he often shares at company events:

One of the ways to get vast selection is to invite other sellers—third parties—onto our Web site to participate alongside us and make it into a win-win situation. So we did auctions, but we didn’t like the results. . . . Next we created zShops, which was fixed-price selling, but still parked those third parties in separate parts of the store. If a third-party seller had a used copy of *Harry Potter* to sell, it would have its own detail page, rather than having its availability listed right next to the new copy. We still didn’t like the results we got. It was when we went to the single-detail-page model that our third-party business really took off. Now, if we’re offering a certain digital camera and you’re a seller with the same camera to sell, you can go
right on our own detail page, right next to our product, and underbid us. And if you do, we will put you in the “buy” box, which is on that page.\textsuperscript{10}

As assumptions are tested, success or failure increases the knowledge in the system. As the enterprise gains traction and turns the corner toward viability, demonstrable knowledge takes over. At that point, clearly defining the metrics of success gives you a clear path toward achieving it, better enabling the nascent initiative to absorb the inevitable early failures along the way.

**ACCELERATION**

Once you’ve proven that a new model is viable through a well-staged incubation effort, it’s time to step on the accelerator. The knowledge side of the equation is substantially higher now, so here you focus less on experimentation and more on setting up repeatable processes to make your business profitable. Acceleration begins by refining and standardizing processes, establishing the business rules that govern them, and defining metrics that chart continuing success. Over time, these rules and metrics get internalized as norms; people think of them as “the way things get done.” Imposing such controls maintains quality and customer satisfaction as the business expands. These must be monitored and refined as the new business reaches each stage of growth to make sure the various business activities involved are still in harmony with one another.

Shifting from incubation to acceleration means moving from footholds to broad market adoption. Zara became one of the world’s fastest-growing and most successful clothing retailers in part because of the way it patiently accelerated its business model. In the first fifteen years of its life, Zara expanded only in Spain and established strong profitability in this home foothold market.
It did not open its first international store until 1988, and then only in nearby Oporto, Portugal. The following year, it crossed the pond to the United States but found little success there. The company realized that the challenges of internationally scaling up a model based on centralized manufacturing and control required significant adjustments to both its value chain and profit formula. Specifically, it needed to design a highly advanced integrated communications system that would allow its vertically integrated production model to extend successfully to remote locations. But because Zara’s investment in this overseas test was minimal, it was able to bring to bear the key resources and evolve the model to develop the needed capability.

In 1990, Zara entered the nearby French market and found greater success. It quickly began adding new stores in major city centers throughout the country. Each market provided further opportunity to experiment and adjust. “Trial and error is a key part of our model,” says a company spokesperson.

Zara’s patience for growth and willingness to explore different ownership paradigms—company-owned superstores on the Continent, franchises in Russia, partnerships elsewhere—helped it understand what its innovative model was ideally suited to do, and just as important, what it was not. Over time, it streamlined processes and concentrated acceleration efforts where they would be most likely to succeed.

Hindustan Unilever had a similar stop-and-go experience with its Shakti model. It successfully grew the business from twenty-eight hundred to forty-five thousand Shakti Ammas in just a couple of years, but as it contemplated the next stage of growth, it identified key processes that needed refinement if they were to support the much larger scale it envisioned. Hindustan Unilever kept the company at forty-five thousand representatives for some two years while it adjusted the model to correct the logistical challenges of higher volume and create new educational
tools suited to a more diverse group. In 2008, it accelerated toward its target of one hundred thousand Shakti Ammas by 2010.\textsuperscript{15}

Both companies grew intelligently while controlling risk. Throughout their acceleration processes, they vigilantly monitored how the elements of their models were holding up and working together, and they were able to change their rules and metrics, speed up, or slow down as necessary to protect and perfect the new businesses.

**TRANSITION**

The final stage of implementation applies only to incumbent enterprises. It addresses the question: Can the new business be reintegrated into the core or must it remain a separate unit in order to thrive?

I believe that the highest likelihood of success accrues to efforts that are kept fully separate from the core from the beginning of the strategy development process until well into the life of the new business. Most companies operate in a culture of advocacy: Units or silos protect their turf and push for what they want and need. Such infighting can crush attempts at business model innovation. “A large segment will always dominate a small one,” says Terry Kelly, president and CEO of outdoor apparel and plastics technology company W. L. Gore & Associates. “You must think carefully about dividing and segmenting so that emerging opportunities are not stifled. Leaders must determine how to divide in order to multiply.”\textsuperscript{16}

Determining the ultimate disposition of a newly developed business model should, of course, be guided by management’s judgment about the operating conditions that will give it the greatest chance of long-term success. But all too often a model’s unique characteristics are overlooked in a knee-jerk desire to consolidate operations. As a set of general guidelines, a new business
model should probably be separated out from an existing business unit when:

- It calls for a significantly different set of business rules and accompanying metrics, which will evolve into significantly different norms
- It requires a distinct brand with a very different promise than a core brand to fulfill its CVP
- It tends to be disruptive to the core business model (that is, it makes money with a much lower margin) and requires a much lower overhead structure and/or a much higher resource velocity

It may be possible to reintegrate a new business into the core if:

- It differentiates itself mainly in its resources and processes, but its profit formula is substantially similar or provides greater unit margins
- It enhances the core brand in some significant fashion
- It can transform and improve the core

As we saw in chapter 3, Xiameter discovered it needed autonomy from Dow Corning’s core operations very early in its incubation process when Don Sheets set up his experimental war game to gauge how existing staff and systems would react to the requirements of the new CVP. “The results were not positive,” says Sheets, “but it was the best thing that could have happened. If we had gotten caught up renegotiating and attempting to agree on everything with regard to the Xiameter brand, we’d still be waiting to launch it. Many efforts, when they lose a war game like that, are folded or significantly redirected. It just made it clear to me how we needed to be separate.”

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Hindustan Unilever paved the way for the possible integration of Shakti by accruing all early profits to the core and having Shakti employees work side by side with their HUL colleagues. Even so, the parent company still needed to evaluate how well the initiative would survive in the core. Once Shakti had grown to sufficient scale to prove its worth and not get smothered, Hindustan Unilever considered whether to reintegrate it into its rural distribution unit. Company leaders felt strongly that the Shakti model was the future of rural development for the company, believing the model would spur transformational growth in that market. They determined that to continue to grow the unit would benefit from the added resources of the core. Though there were clashes of organizational culture during the transition, the model has so far been successful because the ground had been well prepared ahead of time and the company culture valued entrepreneurial achievement.

Hilti devoted little serious consideration to whether the new business model could be nurtured and operated successfully within the core or would need to be a separate unit. But since the new model called for higher margins than the old, integration made sense. And it didn’t hurt that Hilti had a history of successful transformations: Its adaptable organizational culture was uniquely suited to embracing change.

For the purposes of explicating the business model innovation process, I’m calling transition the last stage, but integration issues must in fact be considered throughout the incubation and acceleration stages. Building a successful new model requires that incumbents constantly test and evaluate it against their existing business model to see what tensions arise. That’s why it’s critical for every incumbent to thoroughly analyze and articulate the key elements of its current business model before embarking on the process of business model innovation. Again, I cannot overstate this point. While it should be a given that successful companies understand
the model that is making them successful, many times this is not the case. We must first peel away the veneer of everyday operations and come to understand the business model at the core of our efforts—how it works, what it enables, and what it inhibits.

BUYING NEW BUSINESS MODELS

Organic new growth is far from a sure bet. New businesses can take years to mature. The skills needed to conceive and incubate them, as we have just seen, present a unique set of challenges that many companies find difficult to overcome. “A large enterprise has trouble making an investment in innovation,” says Brad Anderson, the recently retired CEO of electronics retailer Best Buy. “It’s in part because Wall Street has trouble imagining a new way to operate but, more important, because people inside the company can’t see the value of a new idea and so won’t allocate the resources and support the new initiative needs to succeed.”

Organic growth is not the only option available to companies seeking transformational growth. Though most of this book has been dedicated to developing new business models within incumbent organizations, that is not meant to imply that incumbents shouldn’t seek to achieve transformative growth and exploit opportunities in their white space through acquisition. When Anderson took over Best Buy, he led the company through a series of strategic acquisitions that helped it grow beyond a pure retail sales model.

Some companies are legendary for their acquisitive prowess. For a time, GE acquired dozens of companies a year. Cisco has made more than one hundred acquisitions in its twenty-six year history. Acquisitions can be a way to quickly spur sales and develop reputations. They can allow mature organizations to brand an emerging company as “most likely to succeed” or steadily pursue sound strategic growth. But most of the time, such
goals are achieved through sustaining acquisitions bought for their resources and integrated into the parent’s existing business model to help fill needed capabilities.

Study after study finds that acquisitions tend to disappoint, variously estimating that half to as many as 80 percent fail to create value. The high-profile struggle of AOL after its $180 billion acquisition of Time Warner is one obvious example of an acquisition gone bad. But there are others: Daimler/Chrysler, Sprint/Nextel, and Quaker Oats/Snapple, to name only a few. Quaker Oats paid $1.7 billion for the Snapple brand in 1994 but sold it to Triarc three years later for a mere $300 million.

By this time, you won’t be surprised to learn that I believe many M&A disappointments stem from a failure to understand the fundamentals of business model development. Companies often acquire other companies without fully understanding what they’re buying. New resources or products can be folded into the core, but new business models resist. The success of an acquired model frequently lies in its processes and profit formula and very often in the wholly interdependent, integrated nature of its model.

Johnson & Johnson has understood this, buying business models at an early stage and then keeping them separate. For example, its Medical Devices & Diagnostics division bought three business models that were fundamentally new to its respective markets: Visi-takon (disposable contact lenses), LifeScan (at-home diabetes monitoring), and Cordis (artery stents used in angioplasty procedures). J&J bought them young and incubated them into the larger enterprise, where they became the growth engine of the MD&D division for many years.

But all too often attempts to fold an acquired business into the core can kill what made it unique in the first place. Video game maker Electronic Arts (EA) learned this the hard way. Propelled by investor expectations, rising development costs, and an industry consolidation trend, EA aggressively bought up small companies
**FIGURE 35**

Growth of J&J’s MD&D and consumer divisions

Source: Johnson & Johnson 10-K.

**FIGURE 36**

Growth from new business models within J&J’s MD&D division

* Includes Cordis starting in 1995.
Source: Johnson & Johnson 10-K.
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led by creative teams that had found success in the market. To profit from anticipated economies of scale, it built up a standardized technical infrastructure and imposed streamlined production processes on its new acquisitions.

The results were abysmal. EA fell into a pattern of producing mediocre products based on movie licenses and sports franchises, which were updated each year. “EA is a strong brand, but a predictable one,” says Dan Hsu, longtime former editor-in-chief of *Electronic Gaming Monthly*. “Gamers know what they’re getting into: something with high production value and solid but not spectacular game play.”

Forcing creative teams to follow core processes was killing their innovative spirit. Luckily, CEO John Riccitiello saw the writing on the wall. “Where our industry has made mistake after mistake,” he says, “is forcing those technologies down the throats of development teams who know what works . . . It’s leading to creative failure . . . We’re getting less-creative, less-innovative products.”

Then he announced a sea change in EA’s operations: independent creative studios would operate as “city-states” within the EA corporate structure. “[Riccitiello] fell on his virtual sword and admitted that his company had squandered its leadership position in the market by trying to reduce the creative process to a cell on a spreadsheet,” reported the *New York Times*. “He said his company had lost its way by trying to homogenize and manage its creative process much like the consumer products companies (Häagen-Dazs, PepsiCo, Clorox) he used to work for . . . ‘Frankly, the core of our business, like in any creative business, are the guys and women who are actually making the product,’ Mr. Riccitiello said. ‘You can’t just buy people and attempt to apply some business-school synergy to them. It just doesn’t work. The companies that succeed are those that provide a stage for their best people and let them do what they do best, and it’s taken us some time to
understand that. In our business the accountant, the guy in the green eyeshade, is like the guy in the alien movie that eventually gets eaten. If you let him run your business, it is neither inspiring nor effective.”

Most of the same principles that govern the incubation, acceleration, and transition of homegrown new business models apply to acquired ones as well. Equally important is leadership’s ability to allow a newly acquired business model to pull what it needs from the core, rather than having elements of the core model pushed onto it. Best Buy’s Brad Anderson expressed this idea succinctly when asked about the company’s acquisition of Geek Squad, an in-home computer services and support company. “Geek Squad bought Best Buy,” he said, “not the other way around.” Anderson knew that the synergy would produce growth and transformation for the company, but he also knew that the low-margin, high-volume, retail mentality of Best Buy could easily suffocate the high-touch, high-margin service orientation of Geek Squad. He let Geek Squad pull from Best Buy what it needed to thrive. At the time of acquisition, Geek Squad had sixty employees and was booking $3 million in annual revenue. Today, working out of seven hundred Best Buy locations across North America, Geek Squad’s twelve thousand service agents clock nearly $1 billion in services and return some $280 million to the retailer’s bottom line.

As Vijay Govindarajan and Chris Trimble noted in Ten Rules for Strategic Innovators, a newly acquired business based on a model distinct from the core should decide what it can borrow from the parent, what it should forget (or forget about), and what it will do or learn that is completely new.
Chapter 7

1. From a lecture given by David Garvin on behalf of Intel’s NBI Group on February 18, 2008, at the Harvard Business School.


4. Scott Cook, comments given at “Meeting the Growth Imperative” forum, Boston, August 7, 2008.

5. Ibid.


7. Reed Hastings, comments given at “Meeting the Growth Imperative” forum, Boston, August 7, 2008.


12. Ibid.

Notes

16. Terry Kelly, comments given at “Meeting the Growth Imperative” forum, Boston, August 7, 2008.
17. Sheets, interview.
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